AFFORDABLE HOUSING COMPANY – UPDATE

Legal & Democratic Services Advisory Committee – 28 June 2018

Report of	Chief Officer Communities & Business
Status	For information
Key Decision	No

Executive Summary: This report updates Members on the setting up of an Affordable Housing Company.

This report supports the Key Aim of the Community Plan to deliver Caring Communities and a Sustainable Economy.

Portfolio Holder	Cllr. Anna Firth
Contact Officers	Lesley Bowles, Ext. 7430 Adrian Rowbotham, Ext. 7153 Martin Goodman, Ext. 7245

Recommendation to Legal & Democratic Services Advisory Committee:

To note the report.

Reason for recommendation: This is to update Members on the incorporation of an Affordable Housing Company as agreed by Council at its meeting on 21 November 2017.

Introduction and Background

1 A report to Council on 21 November 2017 agreed that subject to a sound case being established, the Head of Legal and Democratic Services was authorised to incorporate a stand alone Affordable Housing Company first taking detailed advice from specialist external lawyers on the delivery model and set up process.

2 Council noted the broad governance and funding arrangements set out in the report. It also noted that expert external advice to develop the business case had been commissioned.

3 Council gave delegated authority to the Portfolio Holders for Finance, Housing & Health and Legal & Democratic Services in consultation with the

Chief Executive, Chief Finance Officer and Head of Legal & Democratic Services to settle the detailed arrangements for the establishment of the company.

4 The decision was made by Council in order to enable Officers to pursue Members' ambition for the Council to develop its own affordable housing within the District through an Affordable Housing Company, which is wholly owned by this Council.

The Business Case

5 On 14 December 2017, a special meeting of the Legal & Democratic Services Advisory Committee was called to consider the commissioned business case, which was appended to the 14 December report. It included a short options appraisal, a viability analysis and advice about governance, funding, land and a risk appraisal. Mark Baigent, the consultant, was present at the meeting in order to present his business case and answer any questions.

6 The consultant had considered various investment options including varying levels of S106 grant and land subsidy. The business case showed that two options could be viable, Option A, which included a 66% S106 grant and receiving land at nil value, and Option G which included a 100% grant from S106 funds but paying full land value. The assumptions for all of the options included a land value of £1m and development costs of £2m to provide 10 x 2 bedroom homes.

7 The Chairman recommended Option G as the option to pursue as the least risky and most viable. The Portfolio Holder for Finance agreed that it was the safer option.

8 Option G showed that, based on the assumptions in paragraph 6 above, the cumulative surplus on the scheme would be £3.28m by the end of 40 years. Annual surpluses increased throughout the 40 year period. The income for Year 1 would be £71,725 with management and maintenance costs of £17,500, giving a Year 1 surplus of £54,225. When looking at the company running costs for Quercus 7, it seemed likely that these could amount to as much as £100k in the first year, which would mean that the company would not be viable based on these assumptions.

9 Members asked for clarification as to whether s106 monies could be used for the administrative costs and that the consultant remodel Option G based on a £5million investment, rather than a £3million investment.

Subsequent activity:

At a meeting of the Portfolio Holders and Officers with delegated powers to deal with the detailed arrangements of the setting up of the company held on 19 December 2017 additional actions were agreed as follows:

10 The consultant was asked:

a) To remodel Option G with expenditure of £5 million and £6 million on the basis that this would bring a higher surplus and potentially cover the company running costs;

b) How we might deal with end of life replacement costs;

c) Whether s106 monies might be used to assist the company running costs.

11 In response to questions a, b and c above, the consultant advised:

a) **Increasing the investment** - 'Option G5 assumes we can deliver 17 homes for £5m, at a slightly lower unit cost of £294,000 per home. This option gives a Year 1 surplus of £92k and a 40 year cumulative surplus of £5.6m.

'Option G6 is simply doubling the original numbers, i.e. 20 homes for £6m, the same unit cost of £300,000 per home. This option gives a Year 1 surplus of £108k and a 40 year cumulative surplus of £6.5m.'

Mark Baigent advised that we would 'need to deduct company running costs which he estimates could be kept to £50k per year, provided there is not much abortive work on design and planning applications for sites that do not progress into development.' He advised that the AHC could 'comfortably run the company on the basis of both these scaled up options'. He also advised that 'further investment of s106 funds in future should generate further surpluses without increasing the company running costs substantially.'

b) **End of life replacement** - 'In terms of replacement of homes after their design life expires, the industry standard is a minimum 60 year lifespan. At that stage, the company would already hold the freehold of the land so need to fund only the redevelopment costs (demolition and rebuilding). Assuming no grant would be available, these costs would need to be met by a mix of accumulated surpluses and debt finance.

'In Option G6 (paragraph 4a above), if the model is extended over 60 years, then the cumulative surplus reaches £12.8m in Year 60. If the replacement cost is also inflated by 2% pa, then by Year 60 the cost of building 20 homes increases from £4m now to almost £13m in Year 60.'

Mark Baigent continued 'So in principle the cumulative surplus would virtually cover the replacement costs in Year 60 without much need for debt funding. However, if half the surplus each year goes into running the company, the cumulative surplus in Year 60 will meet less than half the replacement costs and so debt funding will be needed, paid for from rent income over Year 60 to Year 100.

‘In relation to asset value, if the homes are valued at cost (i.e. land value plus build cost) and then asset value is also inflated by 2% pa, then by Year 60 the 20 homes have increased in value from £6m now to over £19m in Year 60. However, if the s106 agreement constitutes a commitment to provide affordable homes in perpetuity, then there is no real prospect of the company (or the Council) liquidating this asset. It could be sold to another affordable housing provider, but that sale would most likely be at EUSH (Existing Use - Social Housing) valuation rather than open market value.’

c **Use of S106 to fund company costs -** ‘If the s106 agreement does not specify use for capital costs of new homes then using s106 cash in lieu to finance company revenue costs and overheads is fine.’ An action was also agreed to **model a potential affordable and market housing project using land in Sevenoaks**, which it was thought may become available in the future. Advice was sought from RPC Land.

- RPC Land advised that in order to achieve the land value of £2million, the tenure mix would need to be revised to include 4 x shared ownership flats, 6 x affordable rent flats and 14 x market rent flats. They also set out suggested build costs, contingency, demolition, profit etc. and that the total GDV would be £7.175million.

- This information was passed to Mark Baigent to ask him to use it to model the development and he has produced an addendum to his original business plan which is set out at Appendix A.

- This model (Option Gm) looks at the development as a whole but focuses on the affordable element for the purposes of forecasting AHC income and expenditure. It includes AHC running costs (£50k in the first year) in addition to Management and Maintenance costs. The model shows that in Year 1 there would be a surplus of £19,710 and a surplus over 40 years of £1.2million. Mark Baigent suggests that there are benefits to a mixed tenure development with the AHC buying ‘off plan’ from the developer, who could be Quercus 7.

12 A further action was agreed to investigate if there is likely to be a **demand for Right to Buy** if Government changes the legislation so that it affects the AHC.

- West Kent housing association advised that they sold 4 homes in 2017. However, currently they can only sell properties that were in place at the time of the transfer and only to tenants who had those rights at the time of the stock transfer. This is therefore not a good indicator of future demand for newly-built properties. The Council’s Housing Policy Manager’s view was that it is impossible to predict the levels of interest at this stage. Members felt that the high cost of housing in Sevenoaks District would minimise the number of properties being bought under Right to Buy.

13 A further action was agreed to **check void percentage rates locally**

- West Kent housing association void rates are between 1% and 2% but they advise that for a smaller company you would normally plan for 5% (which is the percentage that Mark Baigent used in his model). The Council's Housing Policy Manager's view is that 5% may be higher than needed for an AHC in our district because demand for housing is high.

14 A further action was agreed to **check company running costs** – with variations, e.g. with one 1 large purchase in Year 1 and minimal activity thereafter and with some activity every 3 years.

Please see calculations at Appendix B

Sound business case

15 The responses to the additional questions and actions were considered at a meeting on 6 April of those Portfolio Holders and Officers with delegated authority to act and it was decided at there was a sound business case and that the company should therefore be incorporated according to the Council decision.

Incorporation

16 The Council's affordable housing company (Quercus Housing Limited) was incorporated on 13 April 2018. In all material matters the intention is for the Company to follow the governance structure of the Council's trading company Quercus 7 Limited. In particular, on 6 April 2017 the relevant Portfolio Holders agreed that the Directors of both Companies should be the same (subject to an agreement to act being forthcoming from the non-executive Directors). However, it should be noted that there is one material difference between the two companies in that the new Company is limited by guarantee rather than by shares.

17 The Council is Guarantor of the Company in the sum of £1 and has entered into a Guarantor's Agreement. This agreement reflects the provisions of the Quercus 7 Limited Shareholder Agreement but has been refreshed to omit any inapplicable terms or clauses.

18 The Company will report to the Cabinet, sitting not as part of the Council but as a Guarantor Board, on a quarterly basis. All Members of the Council will be entitled to attend the Company AGM, where they may question the Board of Directors and pass resolutions. By matching the procedures and processes of Quercus 7 Limited it is very much hoped that the Company will be able to act in the most efficient and cost-effective manner possible.

19 The Guarantor's Agreement is separate to the Articles of Association and does not have to be registered at Companies House. The Guarantor's Agreement regulates the relationship between the Council and the Company and gives rights and obligations that would not normally be put into the

Articles. All relevant documents to the incorporation of the Company, along with a copy of the Guarantor's Agreement, are appended to this report.

Key Implications

Financial

The cost of specialist external advice and the costs of setting up the company have been met from existing budgets.

It will be necessary for Quercus Housing Limited to pay the Council for the use of its resources (including officers) and to pay the non-executive directors. These costs will need to be met through the trading activities of the Company.

The activities of Quercus Housing Limited will be funded from S106 funds.

Legal Implications and Risk Assessment Statement.

Legal implications are considered throughout the report. Members are referred to the Risk Assessment Statement accompanying the report to Council of 21 November 2017, replicated below for ease of reference. It should be noted that those risks associated with not setting up the Company are of course now inapplicable. Other risks have been assessed as remaining the same.

Risks are scored from 1 (a low impact / likelihood) to 5 (a high impact / likelihood)

Risk	**Likeli-hood**	**Impact**	**Total**	**Comments and controls**
Failure to set up a company in strict compliance with legislation	1	4	4 Low	Extensive consultation with other authorities and appropriate external advice on governance arrangements
Acting ultra vires	1	2	2 Low	Every new activity via the company to consider statutory obligations
Failure to comply with taxation laws – corporation tax & VAT	2	3	6 Medium	External advice sought in relation to taxation
Possibility of challenge to state aid	1	2	2 Low	Obtain full cost recovery and any loan given to the Company to be set at commercial lending rates, subject to expert advice

Inability to find sites in the parts of the District where there is an identified need	2	1	2 Low	Proactively search for property where there is an identified need, either geographically or by type of property, or where this frees up property where there is a proven need.
Available funding to incorporate an affordable housing company	2	3	6 Medium	Report to Members requests approval of a budget to enable the company to be incorporated
Available expertise to incorporate an affordable housing company	3	4	12 Medium	Plans in place to procure the expert advice required to incorporate the company
Availability of land to enable the construction of affordable housing	4	4	16 High	The Council has limited land in its ownership for the delivery of affordable housing. Business case proposed to evaluate maximising potential of existing sites.
Availability of finance to invest in the construction of affordable housing	4	4	16 High	Current assumptions are limited to the use of S106 contributions to enable affordable housing development. Business case proposed to assess financial sources and implications.
Inability to meet revenue costs of managing affordable housing from trading activity	4	4	16 High	Providing affordable housing is not a profit making activity and the Council does not have in-house expertise to manage housing stock. Business case proposed to assess and evaluate costs and models of management.
Failure to deliver community benefit from the trading activities	2	2	4 Low	The provision of affordable housing in the District will address a proven need and benefit low income families seeking to live in the District.

Adverse impact on the local housing market	2	2	4 Low	Current projections of housing delivery not expected to have a detrimental impact on the local housing market

Equality Assessment

The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act. There is no perceived impact on end users.]

Conclusions

20 The incorporation of the company is based on a sound business case and will enable the Council to respond to Members' ambition for the Council to develop its own affordable housing within the District through an Affordable Housing Company, which is wholly owned by this Council.

Appendices	Appendix A – Business case
	Appendix B – Estimated Company Running Costs
	Appendix C – Certificate of Incorporation
	Appendix D – Articles of Association
	Appendix E – Memorandum of Association
	Appendix F – Guarantor's Agreement
Background Papers	None

Lesley Bowles

Chief Officer, Communities & Business