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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.

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%

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