CABINET	Agenda Item 55 Brighton & Hove City Council

Subject:		**Proposed Leases for Brighton & Hove Seaside Community Homes Limited (Seaside)**	
Date of Meeting:		**16th September 2011**	
Report of:		**Strategic Director, Place**	
Contact Officer:	**Name:**	**Judi Wilson**	**Tel: 293143**
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Key Decision:	**Yes**		
Wards Affected:	**All**		

Note: The special circumstances for non-compliance with Council Procedure Rule 19, Access to Information Rule 5 and Section 100B(4) of the 1972 Local Government Act as amended (items not to be considered unless the agenda is open to inspection at least five days in advance of the meeting) are that there have been ongoing negotiations between the parties and the need to conclude as much of the detail as possible in order to provide clear recommendations.

1. SUMMARY AND POLICY CONTEXT:

1.1 In 2008 the Council was faced with a projected funding gap (after identified savings) of around £45 million to achieve the improvements required to its stock of over 12,000 Council homes. In response to this situation Cabinet in consultation with the Housing Management Consultative Committee (HMCC) agreed to the development of a Local Delivery Vehicle (LDV) which would generate a significant capital receipt contributing towards meeting the Council’s decent home standards.

1.2 In January 2011 Cabinet delegated authority to the Chief Executive, 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 to take all necessary steps to conclude the LDV project and bring about financial, legal and commercial close including the completion of all documents as necessary.

1.3 This report details the proposed final contractual and financial arrangements necessary for the Council to lease the 499 properties to the LDV. It provides details of the changes made since the January 2011 report including their impact on the risk profile. These changes are outside the scope of the existing delegations to officers. Confidential aspects of this complex project are dealt with in the Part II report. The deadline to complete the deal is midnight 23rd September 2011 in order to take advantage of the current funding terms. This report ensures that officers have sufficient delegation to conclude the project.

2. RECOMMENDATIONS:

This report recommends that Cabinet:

(1) Note the risk matrix and the impact on the General Fund of those risks held by the Council (detailed in appendix 1)

(2) Note the best consideration valuations and the methodology used in leasing the 499 properties over a 5 year leasing period.

(3) Approve the use of receipts from the leasing of HRA assets to Brighton & Hove Seaside Community Homes for affordable housing and in particular for the carrying out of improvements to the Council's retained HRA stock under the Council's decent homes programme during the period from October 2011 to October 2018

(4) Agree that the HRA capital programme over the five year leasing period be increased as required to refurbish properties before leasing to Brighton & Hove Seaside Community Homes where appropriate in order to efficiently manage empty properties identified for leasing and maximise the benefits to the HRA

(5) Agree additional funding of up to £150,000 to complete the project as set out in para 10.17

(6) Agree the overall principles of the proposed deal as set out in this and the part II report and, subject to paragraph 2 (8) below, agree to enter into agreement with Brighton & Hove Seaside Community Homes Ltd and the funders.

(7) Without prejudice to any authorisation previously granted to Officers authorise the Strategic Director of Place, the Chief Executive and the Director of Finance, after consulting the Deputy Leader (Executive) and Cabinet Members for Housing and Finance to:

- settle any outstanding or new issues that may arise during negotiations:
- settle the terms of the required suite of documents with Brighton & Hove Seaside Community Homes Limited and the Funders;
- decide on the properties to be leased to the company; and
- take all steps necessary or incidental to completion and/or implementation of the overall transaction.

(8) Authorise the Head of Law to draft, finalise and execute all documents necessary to completion and/or implementation of the overall transaction.

3. PROJECT GOVERNANCE

3.1 The project received its mandate from Cabinet and Full Council in 2008 and delegated responsibility to the then Director of Housing to take all actions necessary to complete the project in consultation with the Cabinet Member for Housing. The Director of Housing set up a project team and a budget of £500,000 to deliver the project. In 2010 as a result of time spent and increased advisor costs Cabinet approved additional budget sums of £200,000 (January 2010 - Decision No: CAB159) and £600,000 (November 2010 – Decision No: CAB 22 - 111110) respectively to ensure project close.

3.2 In November 2010 Cabinet further confirmed delegated responsibility to senior Council officers together with the Cabinet Member for Housing and the Cabinet Member for Finance to conclude the project.

3.3 The project is tightly managed by an internal governance structure and team which provides the platform to develop processes ready for 'project go live'. It also enables a review of the project risks and issues and supports executive decision-making. External advisors are used where specialist knowledge is required (e.g. taxation) and where this adds value for money. The Executive Board signs off all key project delivery decisions. Prior to May 2011 that Board was chaired by the Leader and since the change in administration strategic decision making of the Executive Board has been led by the Deputy Leader of the Council. This is to prevent any conflict of interest issues arising from the fact that the current Leader of the Council is a member of Seaside's Board.

3.4 The governance process provides opportunity for representatives, such as the Chair of the LDV Board, to participate at Executive Board meetings so that a 360-degree view of all elements can be accounted for and effectively responded to.

4. RELEVANT BACKGROUND INFORMATION/CHRONOLOGY OF KEY EVENTS:

4.1 The LDV, now known as Brighton & Hove Seaside Community Homes Ltd (Seaside), is an independent company, limited by guarantee managed by a Board of 12, four of whom are council nominees, four are independent and four are council tenants appointed by their Area Housing Management Panel. In January 2010 Seaside was awarded charitable status to reflect the company's charitable objects including the provision of housing accommodation to vulnerable households in housing need. Seaside is a not-for-profit company which as a charity can benefit from tax breaks by being exempt from Corporation Tax and Stamp Duty Land Tax. Seaside is seeking to benefit from a VAT Shelter by approval from her Majesty's Revenue & Customs for works that would attract a non-taxable supply status and in doing so use its financial resources at maximum efficiency.

4.2 139 properties are modelled to be leased by 31 March 2012 to Seaside under the Housing Act 1985, Disposal of Part II Dwelling Houses 2005, paragraph A5.4.1.which enables the disposal of land under general consent powers. The remainder of the 499 properties will be disposed of under the amendments to section 32 of the Housing Act 1985, and the amendments to the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 which are discussed in more detail in the part II report.

4.3 Under existing legislation consent and funding options are linked and the chosen consent route either restricts or enables particular funding approaches. Express consent from the Secretary of State (SoS) offers up both commercial and prudential borrowing routes, the latter being unavailable under general powers of consent. In view of the time constraints permission was given by Cabinet and unanimously supported by HMCC to pursue an alternative route in the event of Express SoS consent being refused or unreasonably delayed. The Department for Communities for Local Government ("DCLG") has not been amenable to requests for express consent and therefore the council has to use general consent powers.

4.4 Further details of the project's history and chronology are detailed in appendix 3 & 4.

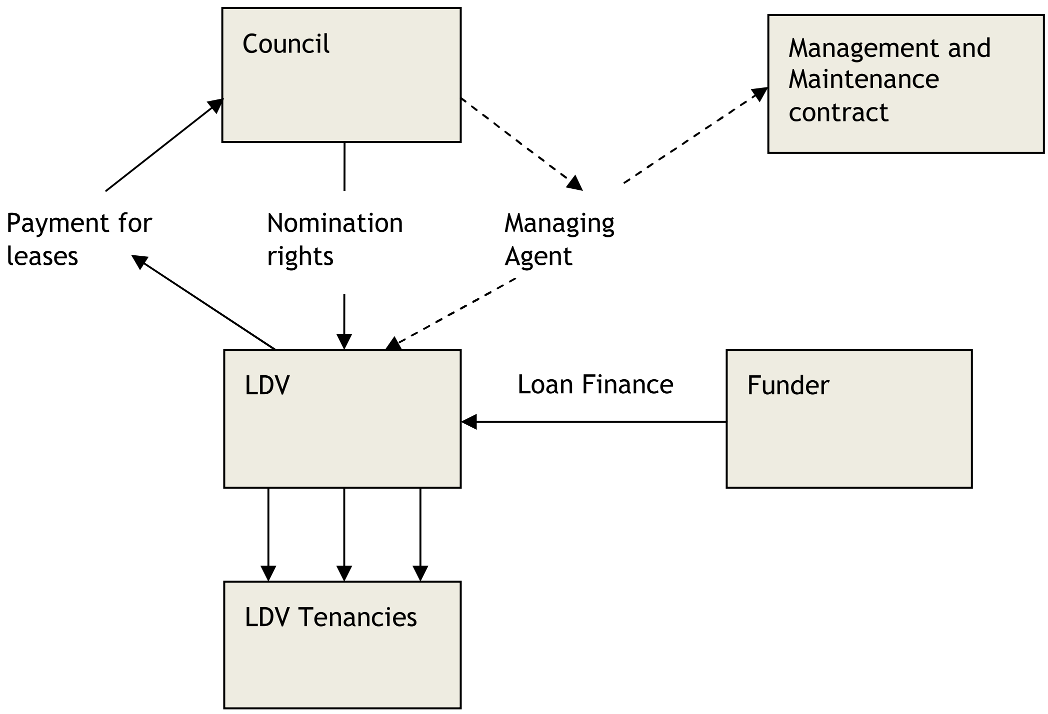
5. KEY DECISION DATES AND APPROVALS OF COUNCIL RESOURCES

5.1 Key decisions have been made and approval given by Members with written reports presented to HMCC, Cabinet and Full Council. An outline of the approvals is listed below with full details of the approvals provided in appendix 2.

23.09.08	HMCC support setting up the project
24.09.08	Cabinet approve setting up of Seaside
09.10.08	Full Council approve the project
18.12.08	Cabinet – Determination of funding options
17.09.09	Cabinet – Determination of funding options
12.10.09	HMCC – Use of General Consents
14.01.10	BHSCH – Funding Options & Consents
12.02.10	Financial & Commercial Offer from Council to Seaside
08.11.10	Response to Financial & Commercial offer from the Council
11.11.10	Cabinet – Response to Financial & Commercial Offer from the Council

6. BUSINESS MODEL

6.1 The business model is framed around a three-way relationship between the Council, Seaside and a funder. In simple terms Seaside secures sufficient funds from a funder to pay for leases purchased from the Council and to bring the leased properties up to an agreed standard. The Council uses the receipt from the sale of the leases to meet its objectives towards meeting decent homes standard. Seaside's main income stream will be from rents. The Council nominates tenants to Seaside, providing the company with a reliable income stream (see diagram below). Seaside enters into a management agreement with the Council to provide tenancy management services including repairs and maintenance. The initial refurbishment of properties after leasing will be undertaken under a development agreement and refurbishment works contract.



6.2 The business case will support a loan of £33 million. Loan repayments will commence at the end of year 5 when all of the 499 properties have been leased to Seaside and improved to the agreed property standard. The funder secures security for the loan in two ways – through a debt service cover ratio whereby the company's annual income after costs exceeds the amount due to the funder and an asset cover ratio whereby the value of the properties equals or exceeds the value of the loan outstanding at any one time.

6.3 Seaside's income, in addition to repaying the loan, will be used to pay the company's operational costs (including the managing agent's fee, reactive maintenance, planned and structural works costs) and its own internal costs. The company has made provision for a limited number of staff, including the appointment of a full time Chief Executive.

6.4 The responsibility for rent collection, void and tenancy management and reactive maintenance is held by Seaside but will initially be delegated to the Council's temporary accommodation team in Housing Commissioning through a Management Agreement. Responsibility for maintaining the structure of the leased properties and the cyclical maintenance of communal equipment and services will be held by the Council as freeholder. The management fee payable by Seaside includes structural and cyclical maintenance capital costs and renewals which are collected and held by the Council for this purpose. The funds are used in line with the Council's planned, cyclical maintenance and capital programmes.

6.5 The Council will have 100% nomination rights on the properties leased to Seaside. Nominated tenants will be those client groups whom the Council has a legal duty to house and who meet the definition of vulnerable as required under the General Consent. The Nominations Agreement between the Council and Seaside is an integral part that underpins the rental income in the business case.

6.6 Under the terms of the Nominations Agreement Seaside can secure its own tenants if the Council fails to nominate tenants within one month, although the company is required to set rents no higher than LHA levels.

6.7 Seaside's tenants who secure employment face an affordability risk as housing costs are likely to exceed income. To prevent such households from falling into the poverty trap tenants in accordance with current practice for temporary accommodation will be re-prioritised into band A where suitable alternative, less expensive accommodation will be found.

6.8 The selection criteria for properties leased to Seaside were agreed by Cabinet on 24th September 2008 CAB 32-240908. At that time Cabinet agreed 106 HRA units already used for temporary accommodation should be leased to Seaside, with the remainder to be properties with a negative net present value to the Housing Revenue Account, and a requirement for investment in units which are untenanted and are not an adapted dwelling. Nine of the temporary accommodation units have since been deemed more suited for redevelopment than refurbishment and leasing.

6.9 An average figure of £21,000 per property (plus 5% per annum) will be spent on refurbishing the leased properties. An average four to six month void period has been built into the financial model for each of the properties leased un-refurbished, depending on whether they need major works, to allow improvement works to be completed. Based on our knowledge of the housing stock the refurbishment works period is judged to be sufficient for the level of works identified however the link between the works completion and expected income dates are critical to the loan repayment covenants. The risks associated with works completion and offer and acceptance have been detailed in the risk matrix (appendix 1).

6.10 Due to the loss of units from works to make former temporary accommodation properties with shared facilities self-contained, the council has been carrying out refurbishment works to these properties before leasing. In addition, the Council has refurbished some empty properties which meet the criteria for leasing because they need major works and are at risk of further deterioration from reserves. In those cases where properties have been refurbished prior to leasing, Seaside will pay for the refurbishment works at the same time as the lease premium.

6.11 Risks identified in the project have been assessed and are held by the party best able to manage and mitigate the risk. Further details have been provided in section 9 which reviews the risk management and the risk matrix. The risks detailed are those reviewed and identified by the Council's internal audit team (appendix 1).

7. BEST CONSIDERATION

7.1 The Council has a legal duty to achieve best consideration when disposing of its assets. This is also a requirement under the General Consent route. Best consideration is determined as that reasonably attainable but without taking into account any factor that artificially depresses the market value. Self-imposed restrictions such as limiting rental value to that of the LHA can not be used as a reason to reduce the market value.

7.2 Savills were engaged in 2009 to develop a valuation method to demonstrate how the best consideration requirements could be tested and validated.

7.3 The method has since been refined and further research has been carried out to test property values with shorter lease periods. Savills looked at the short lease property market in London, Brighton & Hove and the South East of England to ensure that the values being applied to the sampled properties were robust. They found there were fewer short-term leases in Brighton and the surrounding areas due to lender reticence and found typical unexpired leases of between 50 – 60 years. The London housing market is more diverse and provided a matrix of values based on known transactions of short-term leases over several years. Savills applied an appropriate discount to these figures based on their latest research of property values to reflect the south coast market.

7.4 In their later research Savills recognised an additional factor that could be taken into account when assessing best consideration. Based on discussions and advice from Savills' Residential Investment Dept. in London, who have experience of market rented transactions involving the sale of residential portfolios of varying sizes in the current market, Savills are of the view that a realistic discount to the vacant possession value of the portfolio is 25%. Savills have therefore discounted the market value of properties when purchased in a portfolio sale.

7.5 In February and March 2011 Savills were invited to carry out further valuations to 504 properties. The valuations provide a realistic and robust sample of actual and typical properties identified for lease to Seaside. Savills' best consideration valuations based on vacant possession and with the benefit of repair and improvements totals £28.5m, equivalent to approximately £57,000 per unit based on an average 40 year lease or a 99 year lease with a 40 year break clause.

7.6 The best consideration test was to have been assessed as each batch was leased to Seaside. However this approach introduces uncertainty and potential default. The agreed approach now allows for best consideration to be tested at the outset then at the mid point 2½ years into the 5 year leasing process to allow for re-valuation of typical properties suitable for leasing. Where the mid-term review shows property values to have increased, Seaside will be required to pay the difference between the original and revised value for the remaining units to be leased. If at this point Seaside has insufficient funds to pay for increased property values, the Council will need either to accept payment at a later date (a deferred consideration) or to make a grant of the increase in value. Payment of the deferred consideration or repayment of the grant would be met by Seaside from available monies generated by the business case.

8. IDENTIFICATION OF PROPERTIES

8.1 In October 2008 Full Council and Cabinet agreed that 499 Housing Revenue Account dwellings would be leased over five years. The identified properties were 106 units already used for temporary accommodation, with the remainder satisfying three specific criteria as detailed in appendix 5 and paragraph 6.8 above. Cabinet and Council noted that these would include properties currently empty due to the need for funding for major repairs. In October 2009 the LDV Project Board noted that properties which would meet the leasing criteria if and when they become vacant are distributed across the City and primarily comprise high and medium rise flats. The LDV Project Board agreed that the pool of stock identified as meeting the leasing criteria should exclude bedsits and one bedroom units from the two highest areas of multiple deprivation in order to avoid over concentration of vulnerable households in these areas and flats in fully let sheltered schemes.

8.2 The financial model assumes properties meeting the criteria will be batched in unit groups of around 50 as there will be overheads such as legal fees associated with leasing each batch. As set out in paragraph 6.10 above, some properties leased in the first 13 months of the project will already have been refurbished by the Council. Projections of the rate at which properties that meet the criteria for leasing will become available, based on historic turnover in that stock, indicate it could take up to 16 months for a batch of around 50 properties meeting the leasing criteria to become available in years two to five of the project. In order to efficiently manage empty properties identified for leasing and maximise the benefits to the HRA and Seaside, it may be beneficial to lease smaller batches of properties in years two to five and refurbish more properties before they are leased to Seaside. The HRA capital programme would need to be increased accordingly over the five year leasing period.

8.3 Non-acceptance of a batch is restricted to the offer notice being incomplete and or confirmation that funds have not been made available by the funder. Outside of these constraints Seaside is able to refer any disagreement regarding an offer of a batch via the dispute resolution process, the decision of the adjudicator being final.

9. CONSULTATION

9.1 As the properties to be leased to the LDV will be vacant, we were advised that the Council is not under a statutory duty to consult with secure Council tenants about the proposed lease arrangements. However, the Council committed to openness and transparency with tenants on proposals for the future of the housing stock, and undertook widespread consultation with tenant representatives and all Council tenants and leaseholders before Cabinet agreed to establish the LDV in 2008.

9.2 A presentation and consultation meeting open to all tenants and leaseholders and advertised in Homing In was held on 19 September 2008 with the Leader and Cabinet Member for Housing, to which all Area Housing Management Panel resident representatives were also personally invited. Notes of that meeting and the presentation were circulated to all tenant and resident associations. Tenant and leaseholder HMCC representatives had an additional informal meeting to give them full opportunity to understand the proposals, ask questions and make comments before the formal HMCC meeting on 24 September 2008 commended the proposal for approval with their unanimous support. HMCC's representations to Cabinet were accepted at the following Cabinet meeting which approved the establishment of the LDV.

9.3 Since then, HMCC have had frequent updates on the project and been consulted prior to all proposals put to Cabinet for further decision. There have also been numerous updates to tenants and leaseholders through Homing In magazine, presentations to Area Panels in October 2008 and February 2009, an information sheet to resident representatives in February 2010 and the four LDV Tenant Board Members – who are Council tenants appointed by the four Area Panels – have provided written and oral updates to each Area Panel meeting since 2009. The project has continued to have the support of resident HMCC representatives.

9.4 A briefing meeting for HMCC members and tenant representatives is to be held on 16th September 2011. A presentation to Area Panel meetings at the end of September and early October is planned to update residents and representatives on the project and answer their questions on the properties to be leased and how they will be allocated and managed.

10. FINANCIAL & OTHER IMPLICATIONS:

Financial Implications:

10.1 The business case that underpins the borrowing requirements of Seaside makes assumptions about a number of key variables and changes to these assumptions will have financial consequences depending upon which party holds the risk. These variables are rental income, cost of refurbishment, the management and maintenance of the leased properties and the cost of funding.

10.2 The latest business case supports borrowing by Seaside of nearly £33 million. Of this sum £17.3 million will be paid to the council for the leases (and therefore available to meet decent homes commitments) and £11.2 million will be spent on refurbishing the properties, with the balance available to fund set-up costs (including bank fees) and to fund interest payments not met from operating cash flows.

10.3 Abbey National Treasury Services (ANTS), part of the Santander (UK) plc group, has been selected by Seaside following a market testing exercise and a full assessment of the offers to provide private sector funding to Seaside. The offer from ANTS contains a number of key requirements, including:

- certainty around rental income,
- certainty around the cost of refurbishment and Seaside's operating costs, and
- a series of loan covenants to be met
- a form of guarantee and indemnity from the council.

10.4 The loan covenants requested by ANTS are consistent with standard bank requirements for this type of funding. The covenants provide a buffer for the bank to ensure Seaside can repay the debt along with interest from its operational cash flows. The covenants are important as failure to achieve the minimum requirements could lead to a default of the loan agreement. The covenants include:

- Seaside must set aside an amount of money sufficient to satisfy the minimum requirements set out in the following two bullet points by the end of year 5,
- Seaside's net income (i.e. rental income less operational costs) must be equal to or greater than 112% of the amount to be paid to ANTS each year;
- Seaside's projected future net income, after discounting for the future value of money, must be equal to or greater than 115% of the total debt outstanding to ANTS at any one time each year.

10.5 It is the Council's understanding, based on advice from Seaside's financial advisors Baker Tilly, that unless agreement is reached on the deal by 23rd September then it will be subject to further review by the funder's credit committee. That brings risks of changes to the terms that may impact on the viability of the project.

10.6 Until recently the Council could only facilitate cost certainty around the refurbishment works and Seaside's operating costs through a direct works agreement and management agreement. The *General Consent under Section 25 of the Local Government Act 1988 for financial assistance to any person 2010,* which came into force on 9 December 2010, now provides wider powers that allow the Council to underwrite Seaside's rental income in the business case. As there are no proposals from the government to change the terms of this particular consent, it is reasonable for the council to rely on this consent as necessary.

10.7 A number of iterations around indexation allowances for rental income, management costs, maintenance costs and repair costs included in the business case have been carried out by Seaside's financial advisors in order to achieve a capital receipt that matches the best consideration test. The latest business case, which supports a capital receipt in the region of £28.5m, includes the following key indexation allowances:

- Rental income – annual increases at 3.2% previously 2%
- Seaside's management costs – annual increases at 2%
- Repairs and maintenance costs – annual increases at 4% previously 2.5%
- Refurbishment costs – annual increases at 5% previously 6%

10.8 A key risk for the Council is guaranteeing annual increases in LHA rates and hence rental income. The guarantee is based on 91% of total rents due – that is after allowing a combined provision for bad debts and voids of 9%. With effect from April 2013 LHA rates will be linked to movements in CPI (consumer prices index). With modelled rents indexed at 3.2% each year this represents an uplift of 1.2% on the key target of 2% set for CPI under current UK economic policy. In addition to differences between the modelled increase and increases in CPI the Council will also guarantee any reductions in income caused by other changes to the way LHA rates are calculated in future such as changes in methodology which could be significant. Without this guarantee ANTS will not provide the funds to Seaside and the project will not proceed.

10.9 The following table summarises the financial implications in each of the first 10 years at various levels of CPI below that guaranteed by the Council. For example if CPI has average 2.5% in the first five years the Council will be required to pay an additional £123,000 in year 5 under the guarantee to support Seaside.

		Average annual CPI at		
Year	Modelled rents	2% (current UK target for CPI)	2.5% (former UK target for RPIX)	3% (current upper limit of UK target for CPI)
	£000	£000	£000	£000
1	164	1	1	-
2	1,571	27	16	5
3	3,002	87	51	15
4	3,566	143	84	24
5	4,093	210	**123**	36
6	4,904	306	180	52
7	5,161	378	223	65
8	5,326	447	265	77
9	5,496	520	308	90
10	5,672	596	355	104
20	7,772	1,585	966	289
30	10,649	3,107	1,937	592

10.10 To put all the LHA income risk into perspective the Council is legally required to house this client group and therefore would need to find alternative accommodation through private sector contracts if this scheme does not proceed. It would therefore already be exposed to future reductions in LHA rates in any case if private sector landlords were unwilling to reduce their contracted rents and be subject to the risk that private sector rents increases at a rate over and above the increases in LHA where new contracts are negotiated.

10.11 In addition the Council has agreed to underwrite the cost incurred in refurbishing the properties where the total value exceeds the £11.2 million included in the business case. This risk will be managed through the selection of properties for leasing and a refurbishment contract whereby Seaside will sub-contract the Council to undertake all the initial refurbishment works.

10.12 A VAT shelter will be implemented to enable Seaside to reclaim VAT on the refurbishment works completed by the company (albeit under the works contract in 10.11 above). VAT shelters are common practice in stock transfer programmes and the Council has received an “in principle” agreement from HM Revenues & Customs (HMRC) to implement a similar agreement in this project. The Council has consulted external VAT advisors to ensure the legal documents are consistent with the in principle agreement received from HMRC. Full approval from HMRC will not be given until all the legal documents are signed but in the unlikely event that approval is not given then the council will have to undertake the refurbishment works prior to leasing the properties to Seaside, thereby ensuring VAT can still be reclaimed and costs kept within the £11.2 million funding limit. There will be a cash flow cost to the HRA of prefunding the works but with interest rates currently at low levels this cost is considered to be marginal.

10.13 Seaside has appointed the Council to manage the property portfolio. The period of the appointment has yet to be finalised but will initially be for 5 years, the period over which the properties will be leased to Seaside and refurbished.. Seaside will pay the council a management fee of around £2,600 per property per year with annual increases as set out in 10.6 above. Increases in the maintenance and repair element of the management fee are linked to caps on the price increase in the partnership agreement with Mears thereby reducing the financial risk to the Council in managing the properties. Under the management agreement the Council has committed to collect 91% of the gross rent due (after allowing for bad debts and void periods), consequently in the event that collection rates fall below this percentage the council will make up the shortfall.

10.14 A summary of the business case is attached. Based on the indexation levels described above the business case generates significant available monies after year 10 as rental income increases and debt servicing costs reduce. The Council has been negotiating with Seaside and the lender over the potential calls on and use of the available monies. This is set out in more detail in the Part 2 report elsewhere on this agenda.

10.15 The business plan currently includes an annual budget of £350,000 towards the operational costs of Seaside which will need to be agreed by the Council. It is essential that Seaside introduce measures to ensure the company's spending plans are contained within the budget. Failure to keep within the budget will have implications on the business plan and will reduce the potential to generate available monies or reduce the available monies available.

10.16 Section 7 of this report highlights the need for the properties to be re-valued after 2½ years in order that the best consideration test can be demonstrated. Should this revaluation result in a higher figure Seaside will be required to increase the amount paid to the Council to the higher amount. The business case does not support any increase in the sum payable by Seaside and therefore agreement has been reached whereby payment of the increased sum can be deferred until such time as Seaside generates sufficient available monies to pay the Council. Interest will be payable by Seaside on the sum deferred until payment is received.

10.17 In terms of the set-up costs the council has spent some £1.3m on the project to date and a further £150,000 is needed to take the project to close. Of this sum a total of £600,000 will be reimbursed when the documentation is signed and financial close is achieved. The balance of £900,000 will be funded by the Council through General Reserves until such time as Seaside generates sufficient available monies to reimburse the Council.

10.18 Seaside's business plan is predicated on the company borrowing the full £33 million on fixed interest rate terms – that is the interest rate will remain the same throughout the 30 year period irrespective of movements in the level of interest rates generally. This strategy provides certainty over funding costs and ensures the business plan remains affordable irrespective of any fluctuations within the financial markets. This issues is explored in more detail in the Part 2 report.

10.19 The financial implications have been prepared without full access to the financial model which has restricted the ability of Council officers to carry out a detailed sensitivity analysis of all the financial risks within the project. However, officers have been given the following assurances:

- the integrity of the model has been audited by ANTS as part of the due diligence exercise;
- officers have had demonstrations of the model from Baker Tilly, supervised access at their offices and hard copies of the individual spreadsheets have been provided.

Finance Officer Consulted: Peter Sargent Date: 13 September 2011

Legal Implications:

10.20 This is a complicated project involving a wide range of documents including (a) an Overarching Agreement, (b) the Nominations Agreement, (c) Development Agreements and (d) the Management Agreement, all between the council and Seaside, (e) a Facility Agreement between Seaside and its funders and (f) a Guarantee & Indemnity Agreement between the council and the funders.

10.21 Document (a) as its title implies regulates the project relationship between the council and Seaside. It currently has 39 clauses, 15 schedules and 4 annexures dealing with such issues as to how the purchase prices for batches are calculated, the offer and acceptance process the forms of tenancy Seaside tenants will have and the form of the Leases the council will grant to Seaside. As explained elsewhere in this report document (b) regulates the nomination process for Seaside's tenants. Document (c) deals with the VAT shelter referred to in the financial implications part of this report and ensures that the units within the lease batches will be refurbished. Document (d) sets out the terms of how the leased properties will continue to be managed.

10.22 The funding arrangements are set out in document (e) and are consistent with the financial model and business case. Those arrangements are cross referred to in the terms of document (f). this is the most contentious area of negotiation and discussions between the parties are ongoing.

10.23 For ease of reference the general legal implications are otherwise set out in the body of this report and in the Part II report.

Lawyer Consulted:Bob Bruce Date: 15 September 2011

Equalities Implications:

10.24 An equalities impact assessment has been undertaken which has identified that the project will offer greater access to higher quality accommodation to vulnerable households who hitherto have found decent standard accommodation difficult to access. The project will provide settled accommodation to vulnerable households that was previously in short supply.

Sustainability Implications:

10.25 The establishment of Seaside enables access to funding to refurbish properties and in so doing meet housing needs, contributing to 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:

10.26 Providing stable accommodation to some of the City's most vulnerable households reduces the downward spiral of poverty. It also limits and helps prevent dysfunctional behaviour which unchallenged can lead to crime and disorder. The delivery of Seaside into a viable provider of good standard accommodation is expected to have a positive impact on crime and disorder within the City.

Risk and Opportunity Management Implications:

10.27 A risk management strategy has been in place for the project from its inception with project management risks having been identified, defined and effectively managed. The project costs have been efficiently managed and arrangements are in place to ensure that the project progress is managed reviewed and reported to key individuals identified within the project's governance structure.

10.28 The risk share as detailed in the November 2010 report was approved by Cabinet with responsibility to conclude the outstanding risks delegated to the individuals detailed in para 1.2. The outcome of these risks has been detailed in the risk matrix together with risks identified by the Council's internal audit and risk team. The Executive is being recommended to accept these risks having considered the impact of these for the Council. (see appendix 1)

Corporate / Citywide Implications:

10.29 Providing access to funding to refurbish up to 499 properties in need of investment will support the Council's existing strategies and policies and the City's Sustainable Communities Strategy.

Public Health Implications

10.30 The investment generated by this initiative will be invested into improving the quality of affordable housing and thus improve the health and well being of residents.

11. EVALUATION OF ANY ALTERNATIVE OPTION(S):

11.1 Previous reports to Cabinet have set out the options that have been explored and rejected for funding investment in the Council housing stock.

12. REASONS FOR REPORT RECOMMENDATIONS

12.1 To confirm that the council wishes to proceed to complete the LDV transaction, receive a substantial sum for re-investment in affordable housing and to ensure that officers have the necessary delegated authority to complete the project by the required deadlines.

SUPPORTING DOCUMENTATION

Appendices:

1. Risk Matrix
2. Cabinet and HMCC Approvals
3. Project Objectives
4. Chronology
5. Identification of Properties

Appendix 1: Risk Matrix

	Risk	Risk Mitigation	Council' s Original Risk Allocation	Brighton & Hove Seaside Community Homes Risk Allocation	Change/Revision
1.	Rent levels				
1.1	Rent collection – risk that rent is not received		Council – if appointed under management agreement, otherwise BHSCH	Council – if appointed under management agreement, otherwise BHSCH	No change
1.2	Rent collection where properties let direct by BHSCH at market levels	Risk mitigated by rent payment direct to BHSCH where special circumstances exist – direct payments are assessed individually	BHSCH	BHSCH	No change
1.3	LHA rate – risk that LHA rises by less than inflation	An analysis of LHA rates since 2004 indicates that LHA rates have increased in line with RPIX + ½% (as per the financial model).	BHSCH	Council	Change Agree via negotiation
2.	Demand – Risk that demand falls	Where cheaper accommodation was	Council	Council	No change

	Risk	Risk Mitigation	Council' s Original Risk Allocation	Brighton & Hove Seaside Community Homes Risk Allocation	Change/Revision
		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 BHSCH. There may be an opportunity to have a value for money provision in the agreement			
3.	Property allocation – Risk that less than 499 properties transfer to BHSCH:	Council has identified some 2,000 properties that would currently satisfy the criteria for lease to BHSCH where they become vacant. It is unlikely that 499 properties suitable for lease to BHSCH can not be identified.	Council	Council	No change

	Risk	Risk Mitigation	Council' s Original Risk Allocation	Brighton & Hove Seaside Community Homes Risk Allocation	Change/Revision
3.1	Where council fails to identify 499 properties		Council	Council	No change
3.2	Council identifies 499 properties but BHSCH rejects		Council if BHSCH can demonstrate properties are not "financially viable"; otherwise BHSCH	Council	No change
4.	Property mix – Risk that property mix varies from model and reduces income	Nomination agreement provides for Council to place clients in BHSCH accommodation Linked to Demand risk	Council	Council	No change
	Where Council requirement does not match property mix		Council	Council	No change
5.	Voids – Risk that void levels are higher than anticipated	Council to manage nominations process efficiently	Council – at 6% and above (i.e. up to 94% of gross rent) Council / BHSCH to	Council – at 6% and above (i.e. up to 94% of gross rent) Council / BHSCH to	No change

	Risk	Risk Mitigation	Council' s Original Risk Allocation	Brighton & Hove Seaside Community Homes Risk Allocation	Change/Revision
			share equally financial gain where void levels fall below 6%	share equally financial gain where void levels fall below 6%	
6.	Bad debt – BHSCH own tenants – Risk that bad debts are higher than anticipated	Council has robust procedures in place to minimise bad debts	Council – at 3% and above Council / BHSCH will share equally financial gain where bad debt levels fall below 3%. Council will only accept risk if appointed under management agreement. If not, the risk of bad debs fall on BHSCH	Council – at 3% and above Council / BHSCH will share equally financial gain where bad debt levels fall below 3%. Council – Council will only accept risk if appointed under management agreement. If not, the risk of bad debts fall on BHSCH	No change
7.	Housing management – Risk of under-pricing and inflation higher than anticipated	Pricing based on management specification	Pricing – Council RPI – BHSCH	Pricing – Council RPI – Council	Change Pricing – Council CPI inflation indicator BHSCH –

	Risk	Risk Mitigation	Council' s Original Risk Allocation	Brighton & Hove Seaside Community Homes Risk Allocation	Change/Revision
8.	Reactive maintenance – Risk of under-pricing and inflation higher than anticipated		Council if appointed under management agreement; otherwise BHSCH	Council	No change
9	Planned/Cyclical maintenance – Flats – Risk that works are understated and increase by more than inflation	Sufficiency of fund to be reviewed every 5 years. Annual sum from BHSCH to be adjusted if insufficient funds available.	Structural – Council (BHSCH paying an annual sum) Non-structural – council (BHSCH paying an annual sum) RPI – BHSCH	Structural – Council (BHSCH paying an annual sum) Non-structural – Council (BHSCH paying an annual sum) RPI – Council	No change RPI – BHSCH
10.	Planned/cyclical maintenance – Houses – Risk that works are understated and increase by more than inflation	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	Structural – BHSCH Non-structural – BHSCH RPI – BHSCH	Structural – Council Non-structural – Council RPI – Council	No change

	Risk	Risk Mitigation	Council' s Original Risk Allocation	Brighton & Hove Seaside Community Homes Risk Allocation	Change/Revision
		practical) only for the internal works.			
11.	BHSCH overheads – Risk that these are higher than anticipated	BHSCH board to put robust systems in place to regularly review operating costs	BHSCH	BHSCH	No change
12.	Interest on cash balances – Risk that investment returns are lower than anticipated	BHSCH to ensure cash balances are managed to minimise capital risk.	BHSCH	BHSCH	No change
13.	Tax – Risk that tax payments are higher than anticipated	Tax is minimised by operating as a charity with a VAT shelter put in place.	BHSCH	BHSCH	No change
14.	Insurance – Risk that insurance costs are higher than anticipated		BHSCH	Council	Revision BHSCH
15.	Surpluses – Risk that surpluses are not used effectively or become taxable	Funder may expect BHSCH to set aside surpluses to cover debt servicing costs in the	BHSCH	BHSCH	No change

	Risk	Risk Mitigation	Council' s Original Risk Allocation	Brighton & Hove Seaside Community Homes Risk Allocation	Change/Revision
		event BHSCH fails to achieve income levels. Surpluses above this requirement to be shared with the council.			
16.	Inflation Risk – Risk that inflation is higher than anticipated	Risk of inflation is with BHSCH. Inflation allowance included within financial model.	BHSCH	Council	Change BHSCH to be negotiated
17.	Refurbishment Cost		BHSCH	Council	Revision BHSCH

Appendix 2 Cabinet & HMCC Approvals

Date	Decision Group	Approvals
23.9.08	HMCC support setting up the LDV project	
24.9.08	Cabinet approve setting up the LDV project to deliver key strategic housing and corporate priorities and generate funding	Responsibility for project completion delegated to the Director of Housing in consultation with the Cabinet Member for Housing LDV becomes an incorporated company limited by guarantee and seeks charitable status LDV is established with a management board of 12 comprising of 3 constituent parts Private funding solution required concurrently assessing prudential borrowing Any necessary consents are sought from the Secretary of State Once all due diligence has been completed, completion of a report back to a committee of the Cabinet comprising the Cabinet Members for Housing & Finance Permission to enter into a VAT shelter Approval to use up to £45m from the leasing of HRA assets to the LDV for affordable housing and in particular to improve HRA stock under the Council's decent homes programme Recommendation to Full Council to authorise the leasing of 106 identified HRA dwellings Recommendation to Full Council to authorise the making of an application to lease other HRA dwellings to the LDV for a period of up to 125 years up to a maximum of 499 properties.
9.10.08	Full Council approve	Cross party support to establish the LDV

Date	Decision Group	Approvals
	LDV project	project. Approved the general recommendations approved by Cabinet and the specific recommendations put to Full Council.
18.12.08	Cabinet – Determination of funding options	
17.09.09	Cabinet - use of General Consents	Agreed to retain approvals granted on the 24.9.08 by Cabinet and on the 9.10.08 by the Full Council. Agreed to consult with Housing Management Consultative Committee (HMCC) on the use of general consents A5.4.1 of the General Consents 2005
14.01.10	BHSCH – Finding Options & Consents	Agreed risk sharing matrix as the basis for a financial offer Approved additional resources of £0.2m temporarily funded from the General Fund reserves 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 Approves the adoption of the general consents route Notes the following: The outcome of recent discussions with CLG The latest capital receipt projections and the reasons for the reductions since the September 2008 reports. The methods for determining best consideration for the property leases
12.2.10	Financial & Commercial Offer from BHCC to BHSCH	Leader of the Council & Cabinet Member for Housing approve the offer which includes the business case model inputs, the risk matrix, the overarching legal agreements and the property schedule.

Date	Decision Group	Approvals
11.11.10	Cabinet – Response to Financial & Commercial Offer from the Council	Approved to: Accept the revised financial and commercial approach subject to Council and funder due diligence Accept the revised risk table subject to a final review of the risks relating to income streams and additional funder requirements. Delegates' conclusion of the deal as detailed in paragraph 1.2 of this report. Approves further funding of £600k Notes the revised timetable

Appendix 3 Project Objectives

1.1 In 2008 Brighton & Hove City Council (BHCC) was faced with a projected funding gap (after identified savings) of around £45 million to bring all its stock of over 12,000 Council homes up to the Government's decent homes standard. At this time around half of these homes fell below the decent homes standard, since then the percentage of stock falling below the standard has reduced to 26%.at March 2011.

1.2 The level of housing need is significant and results in the Council being a high user of temporary accommodation, some of which require substantial improvements. Based on these facts BHCC needed to establish a long-term, sustainable supply of temporary accommodation at predictable cost for vulnerable households whom the Council has a housing supply duty. The demand for this form of accommodation is over 700 clients each year.

1.3 In developing a response to this need the Council identified five key objectives :

- To obtain best value from its assets:
- Bring in additional investment
- Meet housing need
- Promote regeneration; and
- Assist with meeting decent homes

1.4 Within the context of the objectives the Council considered a range of different types of local delivery vehicles as part of the initial feasibility. These options were subjected to a high level assessment against a set of agreed criteria which led to a small number of suitable vehicles being progressed further. Having considered all of the issues and options, a possible workable option which had the desired characteristics was that of the Local Housing Company.

1.5 A financial analysis was carried out on the Local Housing Company with iterations being made against the base case which tested a number of sensitivities around the assumptions. The results ranged in degree but all produced a positive outcome producing a capital receipt between £54m and £36m. The resulting capital receipt to be achieved was set between the range detailed above.

1.6 In identifying a suitable vehicle with a positive financial outcome, Cabinet in consultation with the HMCC set a number of parameters in which the Company could be developed, these being:

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

1.7 The establishment of an LDV was designed to produce a number of benefits for the Council and its residents which have been detailed below:

- A capital receipt of up to £45m to support delivery of the decent homes programme
- Empty properties and undesirable housing stock brought back into use, increasing housing supply
- Refurbished and improved standards of accommodation
- Increased access and opportunity to high standard accommodation for vulnerable households improving opportunity and life chances
- Improve HRA stock viability by directing resources to stock with a positive NPV

Appendix 4 Chronology

1.1 In 2008 Cabinet agreed to set up an independent, not for profit, charitable housing company (LDV) to deliver key strategic housing 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. The decision was endorsed by Full Council on 9 October 2008.

1.2 The intention has been to create an independent housing company limited by guarantee which would seek charitable status demonstrating its not for profit intentions. As a charity it would benefit from relief from stamp duty land tax and corporation tax on income received from its charitable activities. It would also seek to create a VAT shelter with the approval of Her Majesty's Revenue & Customs (HMRC) for works that would attract a non-taxable supply status and in doing so use its financial resources at maximum efficiency.

1.3 Express consent to the leasehold sale would be sought from the Secretary of Sate under section 32 of the Housing Act 1985. Delays in obtaining consent from the Secretary of State led to the alternative route of proceeding within the general consent under s32 Housing Act 1985, Disposal of Part II Dwelling Houses 2005, paragraph A5.4.1. Given the critical nature of this proposal to meeting city-wide, corporate and strategic housing priorities and tenant aspirations for investment in their homes this alternative route commonly referred to as Plan B was endorsed by HMCC on the 12th October 2009 and later confirmed by Cabinet. Both parties having agreed to use this secondary route in the event of the following:

- That Secretary of State consent for the Council to lease HRA properties to the LDV is refused or;
- Secretary of State consent for the Council to lease HRA properties to the LDV is delayed to such an extent as to be impractical in terms of project timetable and achieving project priorities.

1.4 The option of obtaining express consent at a future date has been retained although CLG remain concerned at the LDV's reliance on housing benefit as a single source of income.

1.5 Funding was to be sought by the Cabinet's preferred route of private sector funding. This became the sole funding option because the prudential borrowing funding route which Cabinet requested officers to assess required consent by the Secretary of State. Funding routes have been an important consideration as each funding route is based around different funding assumptions which have an impact on the level of the capital receipt. In particular, Queen's Counsel advised use of the leaseback option, which would have accessed higher rents for the smaller units, was doubtful under prudential borrowing. The decision to proceed with the project using the alternative general consent route for the reasons discussed above in 1.3 resulted in having one viable funding option of private financing.

1.6 The general consent route requires properties to be leased at best consideration. Savills, who are an independent firm of valuers, have provided advice about the best way to manage best consideration valuations. They have also carried out valuations to a sample of properties which are representative of the property size and archetype profile of the 499 units projected to be leased in accordance with the criteria agreed by Cabinet and Full Council in 2008. (see section 7)

1.7 Following agreement regarding the consent and funding routes to deliver the project, the Council was able to develop its business offer for the LDV. In February 2010 the Cabinet Member for Housing and the Leader of the Council approved the business offer and it was issued to the LDV's board.

1.8 The Council's business offer detailed the financial and legal information and set out the business model that needed to be adopted by the LDV. The business offer is based on a set of assumptions (such as expenditure levels and risk factors) which provides the LDV with a cash flow model that can secure a significant capital receipt. The business offer is underpinned by a commercial contract which captures the key terms of the deal, it also includes specific legal documents i.e. management and lease agreements.

1.9 The LDV responded to the Council's offer in September 2010 having received funding of £100k from the Council to seek independent financial advice and deliver a business case in order to obtain bank funding.

1.10 The business case and information memorandum issued to funders was based on the Council's response to the LDV's submission in September 2010. The Council's response,. which was included in the Cabinet report of November 2010, took account of the projected reduction in income following Government's announcements of reductions in the housing benefit receivable. The Council's review of costs, including management, and all categories of repair and improvements led to a reduction in overall costs of 68% and an overall unit figure of £2,613 per annum and an average initial refurbishment cost of £21,000 per unit.

1.11 Seven funders initially responded to the LDV's information memorandum and by December 2010 following further discussion the seven funders were pared down to a short list of three, Nationwide, Santander, and RBS.

1.12 In February 2011 following an assessment of the details of the indicative offers of all three funders and a review of the impact to the funding costs, bank margins, interest rates, inflation rates and arrangement fees and other inputs which formed the funding offers, the LDV supported by the Leader of the Council and the Cabinet Member for Housing agreed to mandate Santander as their preferred funder. Santander's indicative offer was more favourable and offered a 30 year term, a loan facility of up to £30m and a cheaper arrangement fee which provided a capital receipt of £1.5m more than the other two funders. On the basis of the comparison of offers provided by the LDV's financial advisors Santander were mandated by the Vice Chair of the LDV on the 23rd February 2011 to agree the remaining elements of the project and conclude the deal.

1.13 On the 24th March Santander's credit committee approved to fund the LDV with a loan of up to £30m on terms detailed in the indicative offer. The credit committee's approval has led to the funders' lawyers and their counterparts acting for the LDV and the Council to complete the loan agreements and other legal documents which will lead to contract and project completion.

Appendix 5 Identification of Properties

1.1 In October 2008, Full Council and Cabinet agreed the 499 Housing Revenue Account dwellings to be leased over five years should comprise:

- 106 units already used for temporary accommodation (TA); and
- other HRA properties that satisfy the following criteria:
  - That the property is not tenanted
  - That the property has a negative Net Present Value to the HRA and a requirement for investment
  - That the property is not an adapted dwelling.

Full Council delegated the power to make decisions on the inclusion of individual properties to the Director of Adult Social Care and Housing after consulting with the Cabinet Member for Housing.

1.2 The TA units are scattered street properties, many having shared facilities and high maintenance and repair requirements. The number of units will reduce due to self-containment as part of the refurbishment works and some have since been deemed more suited for redevelopment than refurbishment. Up to 76 units are now expected to be leased from this TA stock. These units generally have higher market value and works costs than the average for the 499 units and all are expected to be leased in the first year or so of the project going live.

1.3 Cabinet and Council were informed that other HRA properties which may be identified as suitable for leasing to the LDV would include properties currently empty due to the need for funding for major repairs. The cost of the exceptional works they require puts them into negative NPV so that they meet the leasing criteria. 90 properties are currently identified in this category and in total 120 of the 499 units to be leased over the five year period were modelled to be properties which meet the leasing criteria because of the need for funding for major works. These properties are expected to be the main source of houses for the LDV. They have higher than average works costs and some have higher than average market value for the 499 units as a whole.

1.4 The third source for the 499 units to be leased is HRA properties which have already been identified as meeting the above leasing criteria should they become vacant through normal turnover of stock. Some 2,000 tenanted units which meet the leasing criteria have been flagged in our database to be offered for leasing if and when they become vacant, once the project has gone live. These comprise 16% of the HRA's stock. A process has been developed to ensure those vacant properties would not be re-let when the Council tenant gives notice to terminate their tenancy, but instead would be referred to be batched and offered to the LDV.

1.5 As agreed by the LDV Project Board in 2009, this pool of flagged properties excludes sheltered units and bedsits and one bedroom units in the two highest areas of multiple deprivation in the City, so as to avoid concentration of the most vulnerable tenants in what are already the City's two most deprived neighbourhoods. The flagged stock is predominantly high and medium rise flats and a large proportion is of non-traditional construction. All of the 64 houses in this pool are non-traditional construction. The anticipated 300 or so properties to be leased from routine vacancies in flagged stock will have lower than average works costs and market value enabling the £21,000 average refurbishment cost and best consideration to be achieved for the whole 499-unit portfolio.