



CABINET REPORT

Report Title

Approval of a Council-owned Housing Development Company

AGENDA STATUS: PUBLIC

Cabinet Meeting Date:	17 October 2018
Key Decision:	No
Within Policy:	Yes
Policy Document:	No
Directorate:	Housing and Wellbeing
Accountable Cabinet Member:	Councillor Stephen Hibbert
Ward(s)	All

1. Purpose

- 1.1 On 18 July 2018, Cabinet approved the principle of establishing a Council-owned Housing Development Company (DevCo) that will build homes for sale and rent, cross-subsidise mixed housing developments and speed up housing development.
- 1.2 The purpose of this report is to provide Cabinet with additional information about how the DevCo will operate (including the types of scheme in which it could become involved) and to ask Cabinet to formally approve the establishment of the DevCo.

2. Recommendations

- 2.1 It is **recommended** that Cabinet:
 - (a) Confirms the establishment of a Council-owned, non-charitable Housing Development Company (DevCo), called Hamtune Homes Ltd, that will acquire, develop, manage and sell real estate to help the Council achieve its strategic objectives in relation to housing demand, place-shaping and income generation;

- (b) Confirms the appointment of the Head of Housing & Wellbeing and the Housing Options & Advice Manager as the two initial Directors of Hamtune Homes Ltd;
- (c) Delegates to the Borough Secretary & Monitoring Officer, in consultation with the Chief Finance Officer and the Cabinet Member for Finance, the authority to approve the Articles of Association and any appointment of a Company Secretary;
- (d) Agrees that a sum of up to £50,000 is made available from Reserves to fund the DevCo's initial start-up costs and support the production of the company's first business plan and development pipeline;
- (e) Agrees that each of the housing schemes / projects undertaken by the DevCo will require a fully-costed Business Case and formal approval by Cabinet; and
- (f) Receives a further report, prior to the commencement of trading, when Cabinet approval will be sought for the DevCo's business plan.

3. Issues and Choices

3.1 Report Background

- 3.1.1 On 18 July 2018, Cabinet approved the principle of establishing a Council-owned Housing Development Company (DevCo) that will build homes for sale and rent, cross-subsidise mixed housing developments and speed up housing development.
- 3.1.2 In September 2018, Northampton Partnership Homes (NPH) submitted a bid, on the Council's behalf, for Northampton's Housing Revenue Account (HRA) debt cap to be raised by £46.7m in order to enable an additional 523 council homes to be built.
- 3.1.3 Although a decision is currently awaited on the outcome of Northampton's bid for a share of the £500m HRA additional borrowing that has been set aside (over the next three years) for the councils outside London, how this will be impacted by the Prime Minister's announcement of 3 October 2018 – that the Government will be abolishing the HRA debt cap imposed in 2012 – will only be clear when the legislation is drafted.
- 3.1.4 The Prime Minister's announcement has coincided with a Government consultation on the options for changing the rules governing the money raised from Right to Buy sales to make it easier for councils to build more homes, and whether or not the commitment to replace sold homes on a one-for-one basis should be retained or reformed to focus on the wider supply of social and affordable housing.
- 3.1.5 It has always been envisaged that the DevCo will complement the work that the Council is already undertaking with NPH to maximise the supply of affordable homes through the Housing Revenue Account. The decision to abolish the HRA debt cap will help to further accelerate the delivery of new homes in the Borough.

3.2 Issues

The role of the DevCo

- 3.2.1 As explained in the Cabinet report of 18 July 2018, the delivery of new homes and associated development is fundamental to sustaining economic growth, supporting communities and meeting housing need in a sustainable way in Northampton.

3.2.2 Northampton's DevCo will enable the Council to intervene more effectively in the local housing market – and to act commercially for a social purpose – in order to accelerate housing delivery and play a more influential role in place-shaping, regeneration, meeting housing demand and maximising the supply of new homes.

3.2.3 As well as generating extra income in New Homes Bonus, council tax and the Community Infrastructure Levy, the DevCo will offer the Council the opportunity to:

- Control, subject to planning and legislative requirements, all aspects of the development and construction process, including the scale of the development, the tenure mix, the amount borrowed, the rents charged and the number of homes that are sold or retained;
- Innovate and try different development models and tenure mixes;
- Achieve savings in the cost of providing homeless households with suitable temporary accommodation;
- Increase investment in regeneration and town centre development;
- Use income from rents and sales to cross-subsidise mixed housing developments, where financially viable;
- Provide affordable homes for specific groups, such as key workers, homeless families, students and older people;
- Benefit from any uplift in the land values associated with the development of council owned land (including land that has been acquired through land assembly) instead of just the capital receipt secured from a disposal on the open market
- Generate extra income for the Council by on-lending (borrowing from the Public Works Loan Board at below market rates and then lending it on to the DevCo at a market-rate premium) and by turning land assets into a rental / sales income.

Prioritising the work of the DevCo

3.2.4 Although exceptions may be made – to make the most of a compelling commercial or place-shaping opportunity – schemes will normally be prioritised as follows:

- **Priority 1: Homelessness** – Housing schemes that enable the Council to reduce the use and cost of temporary accommodation
- **Priority 2: Affordable Homes** – Housing schemes that enable the Council to increase the supply of affordable homes in the borough
- **Priority 3: Market Rent / Sale** – Mixed housing schemes that enable the Council to support the development of affordable homes by cross-subsidising them with the income generated by market rent or sale.
- **Priority 4: Income Generation** – Housing schemes that provide an extra income to the General Fund via loan interest, defrayed costs or net income.

Name of the DevCo

- 3.2.5 It is proposed that the DevCo is called Hamtune Homes Ltd. Hamtune was the name given to Northampton by the Saxons.

Abolition of the HRA debt cap

- 3.2.6 Although the Government has yet to announce the precise details of how and when it will abolish the HRA debt cap, it is understood that Ministers will seek to pass legislation to lift the cap, with HRA borrowing being subject to the prudential code.
- 3.2.7 Councils are required to borrow “prudentially” – only taking on what they can afford to repay – with loans being repaid from the rental income received from the properties.
- 3.2.8 The housing consultancy firm Savills has estimated that abolishing the HRA debt cap could “release extra borrowing capacity, capable of delivering a total of around 100,000 new homes”.
- 3.2.9 In Northampton, the abolition of the HRA debt cap will enable the Council and NPH to make full use of the preparatory work that has already been undertaken to deliver a development pipeline of hundreds of new council homes that can be built at various locations in the borough if funding is made available through the lifting of the cap.

Use of NPH as the DevCo’s development agent

- 3.2.10 It is envisaged that, subject to it having the necessary capacity and expertise, NPH will normally act for the DevCo as its development agent.

Examples of the types of scheme in which the DevCo may become involved

- 3.2.11 Although each housing scheme / project undertaken by the DevCo will require a fully-costed Business Case and formal approval by Cabinet before it can be delivered, Appendices A, B & C (attached to this Cabinet Report) provide an illustration of the type of scheme in which the DevCo may become involved:
- **Illustration 1 (Appendix A)** provides details of a scheme in which up to 90 family-sized homes are purchased (using funding provided by the Public Works Loan Board) for use as lower cost temporary accommodation for homeless families.
 - **Illustration 2 (Appendix B)** provides details of a mixed tenure housing scheme of 12 homes that is developed (using funding provided by the Public Works Loan Board) and which the market sale of some homes cross-subsidises the provision of affordable rented homes.
 - **Illustration 3 (Appendix C)** provides details of a town centre apartment scheme (120 homes converted from an empty office block) that is funded by institutional investment and results in the Council leasing and managing the homes for between 30 years and 40 years before they are transferred to the DevCo for £1.

3.3 Choices (Options)

- 3.3.1 Cabinet can choose to use the DevCo to support housing delivery and make available a sum of up to £50,000 to fund the DevCo’s initial start-up costs and the production of the company’s first business plan and development pipeline;
- 3.3.2 Cabinet can choose not to use the DevCo.

4. Implications (including financial implications)

4.1 Policy

- 4.1.1 The development of new affordable housing remains a key priority for the Council.
- 4.1.2 Although the HRA new build programme continues to meet its targets – and is expected to gather further when the HRA debt cap is removed – the Council only has powers to let rented property on a secure tenancy or fixed term basis and it has no power to deliver assured shorthold tenancies through its HRA.
- 4.1.3 A company structure is required to meet the Council’s aspiration to provide sub-market private rented accommodation that is able to meet the housing needs of, for example, families that are threatened with homelessness.
- 4.1.4 Although the Council has identified the need for a range of affordable housing tenures, addressing the demand for affordable rented housing remains the priority. Even when the DevCo is established, the Council will continue to fund most of its housing development programme through the HRA.

4.2 Resources and Risk

Financial implications

- 4.2.1 Funding for any development could be provided through borrowing from the Public Works Loan Board (PWLB) or from other financial institutions. The margin on these loans could generate additional surpluses for the General Fund whilst offering the DevCo competitive loans secured against its housing stock.
- 4.2.2 If the DevCo undertakes market activities, it will need to ensure that any loans are lent at a market rate and therefore a margin is added on to the PWLB rates. However, if the DevCo focuses on affordable housing (including intermediate rent or keyworker accommodation) then the loan would not need to be provided on commercial terms. If the company carries out both types of activities, it will require separate loan agreements.
- 4.2.3 The DevCo would be subject to Corporation Tax on any surplus of its activities. The financial modelling for the Business Plan would contain a detailed tax analysis.
- 4.2.4 The overriding principle of establishing a Council-owned DevCo is that there would be no overall cost, over the life of the business plan, to the Council and that, depending upon the delivery model chosen and subsequent performance, the Council could benefit from the following:
- Any dividends (surplus after tax) from the company
 - Any capital growth in the value of the property portfolio
 - A premium on the loan repayments
 - Council Tax and New Homes Bonus payments as new units become occupied

- 4.2.5 The operating costs of running the company would need to be determined as part of the business plan and these will include any specialist advice or support that is required from support services such as Legal, HR and Finance. It will also be necessary to take into account the costs relating to the new homes, including marketing, sales, lettings, housing management. Income and debt recovery, repairs, maintenance and cyclical serving, etc.
- 4.2.6 The investment in the delivery of housing will form part of the wider Council investment strategy that is being developed.

Risk management

- 4.2.7 Property development carries inherent risk in terms of the potential for cost escalation (due to site conditions, design issues, material and wage inflation) as well as uncertainties around market demand and movement in property values.
- 4.2.8 All of these factors and more will need to be reflected in a thorough approach to risk management and mitigation. A full risk analysis will be developed as part of the business model that is developed and presented to Cabinet in the next report.

4.3 Legal

- 4.3.1 The Council may exercise its general power of competence under Section 1 of the Localism Act 2011 to establish a DevCo as a wholly owned housing delivery company of the Council. The detail contained in the business case will determine the exact structure and operation of the company. Due to the number of statutory controls and requirements that apply to the operation of a local authority DevCo (including the Local Government and Housing Act 1989) these will need to be addressed in terms of the DevCo's own governance and how this links to the Council's existing governance arrangements.
- 4.3.2 The DevCo will be governed as a wholly owned company of the Council constituted as a company limited by shares in accordance with the Companies Act 2006. The Council will own the entire share capital and will have ultimate control of the DevCo.
- 4.3.3 The DevCo will initially adopt the Companies House model Articles of Association prior to their amendment to fit the delivery of the business.
- 4.3.4 The initial appointment of the two Directors pursuant to Paragraph 2.1(b) of this report to enable the registration of the DevCo will require further examination as the direction of business is determined and when the formulation of the managing structure can then be addressed to ensure there is strategic control over the management of the business undertaken.
- 4.3.5 There are certain statutory requirements to be addressed in operating a company, including the obligation to file annual returns and accounts. The appointed directors will require advice on their duties, risks and liabilities as directors, together with the acquisition of appropriate liability insurance.
- 4.3.6 As part of the process, detailed consideration will be given to the development of clear documented policies, business plans, financial appraisals (including detailed tax and VAT consideration), the procurement rules if deemed to be a contracting authority (this will depend on the final structure of DevCo, its structure and governance), state aid compliance and processes by which sites are identified for development and/or acquisition as well as a policy and procedure which will determine when an identified site is not pursued, or alternatively identified as a "windfall" and to the governance policy which will regulate the company.

4.4 Equality and Health

- 4.4.1 The action that is proposed in this report will help to improve the housing conditions and life chances of people with protected characteristics, including homeless people, people with disabilities and families with children. It will therefore have a positive impact on Equality and Diversity.
- 4.4.2 Maximising the supply of new homes is part of the Council's commitment to improving communities and our town as a place to live. In its operation of the DevCo, the Council will have due regard to its Public Sector Duty and will continue to work to tackle discrimination and inequality and help to create a fairer society.

4.5 Consultees (Internal and External)

- 4.5.1 NPH, Housing and Planning and Regeneration Officers at Northampton Borough Council, Borough Councillors and a wide range of stakeholders, have been supportive of the proposal to maximise the supply of new homes and accelerate the delivery of housing.

4.6 How the Proposals deliver Priority Outcomes

- 4.6.1 The action proposed in this report will help meet the following priority in the Council's Corporate Plan 2018-2020:
- **More homes, better homes:** By helping to maximise the supply of new homes, the establishment of the DevCo will improve housing choice and help people to meet their housing needs in decent housing.

Appendices

- Appendix A: Illustration 1 – A temporary accommodation scheme funded with money borrowed from the Public Works Loan Board
- Appendix B: Illustration 2 – A family housing scheme funded with money borrowed from the Public Works Loan Board
- Appendix C: Illustration 3 – A town centre apartment scheme funded by institutional investment

Background Papers

- Cabinet Report - Maximising the supply of new homes – 21 February 2018
- Cabinet Report - Establishment of a Council-owned Housing Development Company (DevCo) – 18 July 2018

Phil Harris
Head of Housing and Wellbeing
01604 837871

APPENDIX A

ILLUSTRATION 1 – A temporary accommodation scheme funded with money borrowed from the Public Works Loan Board

Background

Local authorities have the power to purchase and acquire housing – including temporary accommodation for homeless households – through their General Fund.

Although the Council is not compelled to use a DevCo to establish a portfolio of temporary accommodation, substantial savings can be achieved by the Council purchasing, acquiring, refurbishing and/or converting properties for use as lower cost temporary accommodation.

It is envisaged that, by reducing the net cost of temporary accommodation, the acquisition of a sizeable stock of council-owned temporary accommodation in Northampton will have a significant positive impact on the Council's General Fund and Medium Term Financial Plan.

Temporary accommodation

During the last couple of years, the number of households applying to the Council for assistance under the homelessness legislation has doubled and, between March 2016 and March 2018, the number of households living in temporary accommodation more than quadrupled from 66 to 267.

Since the introduction of the Homelessness Reduction Act 2017 – which has extended local authorities' duties to prevent and relieve homelessness – in April 2018, the number of households in temporary accommodation has continued to rise and, by 30 September 2018, exceeded 300.

Although the Council uses some of its permanent housing stock as temporary accommodation, approximately 80% of the temporary accommodation it uses is procured from private sector housing suppliers in the form of nightly-purchased accommodation and Bed & Breakfast.

Net cost of temporary accommodation

Unfortunately, the Council is only able to recover a relatively small proportion of what it pays housing suppliers for the temporary accommodation it uses.

After taking into account the maximum income the Council receives from homeless households and Housing Benefit – and assuming a 100% rent collection rate – the net cost (to the Council) of the self-contained accommodation it procures from suppliers is at least:

Size of accommodation	Net cost of each household to the Council
One bedroom	£111.43 per week (£482.86 per month)
Two bedrooms	£119.85 per week (£519.35 per month)
Three bedrooms	£154.24 per week (£668.37 per month)
Four bedrooms	£132.27 per week (£573.17 per month)
Five bedrooms	£181.27 per week (£785.50 per month)

Council-owned temporary accommodation

At present, 65 of the council homes in Northampton's Housing Revenue Account (HRA) have been set aside for use as temporary accommodation. All of the other temporary accommodation that the Council uses is procured from private sector housing suppliers.

Although consideration will need to be given to the size, type and number of homes purchased, acquired and converted for use as temporary accommodation – and whether or not it is necessary and appropriate for the DevCo to play a pivotal role in the development of such a portfolio – it is clear that the Council will achieve substantial revenue savings from the creation of a sizeable stock of council-owned, non-HRA temporary accommodation.

Assumptions

For the purpose of this illustration, it is assumed that the Council will obtain a loan from the Public Works Loan Board (PWLB) and then use these funds to 'on-lend' to the DevCo.

It is assumed also that:

- The Council will purchase or acquire a total of 30, 60 or 90 two and three-bedroom homes (with a ratio of 2:1 in favour of the two-bedroom homes);
- The average cost of a two-bedroom property will be approximately £150,000;
- The average cost of a three-bedroom property will be approximately £180,000;
- The costs of purchasing, acquiring, refurbishing and/or converting the homes will be funded by a loan from the Public Works Loan Board;
- The PWLB loan will be repayable over a period of 25 years;
- The rental income received from the households in temporary accommodation will be used to fund the loan repayments and the cost of housing management, repairs and maintenance. This is based on Local Authority Housing Allowance Rates for Northampton;
- No assumptions have been built into the modelling for any benefit the Council may receive through reduced Housing Benefit subsidy loss;
- Stamp Duty Land Tax (SDLT) would be payable on completion of any purchases but has not been factored into the high level modelling (approximately £5k - £7k per dwelling);
- Major repairs to dwellings over their life has not been factored into the modelling and will need to be considered as part of the final business case for purchase;
- Allowances for marginal increase to Management costs and Repairs and Maintenance costs has been included.

Outcome of the modelling

It is estimated that the Council would need to borrow between £5m and £15m to build a portfolio of between 30 - 90 units of family-sized, council-owned, non-HRA temporary accommodation. Lower purchase prices may be negotiated for bulk purchases and new homes that are bought 'off plan'.

Based on the current PWLB loan rate of 3% (over 25 years), the appraisal model currently used by the Council and NPH and taking into account the assumptions listed above, the Council could reduce its net expenditure as detailed in the table below if it sets up such a scheme:

Description of temporary accommodation	Annual net cost (council-owned)	Annual net cost (private suppliers)	Potential annual savings
<ul style="list-style-type: none"> • 20 x two-bedroom homes • 10 x three-bedroom homes 	£106k per annum	£205k per annum	£99k per annum
<ul style="list-style-type: none"> • 40 x two-bedroom homes • 20 x three-bedroom homes 	£212k per annum	£410k per annum	£198k per annum
<ul style="list-style-type: none"> • 60 x two-bedroom homes • 30 x three-bedroom homes 	£318k per annum	£615k per annum	£297k per annum

As well as reducing the net cost of temporary accommodation (TA), this TA scheme will afford the Council the flexibility to either sell the properties or let them out at market rents or sub-market rents to generate extra income for the General Fund or prevent homelessness – if the demand for temporary accommodation reduces in the future.

APPENDIX B

ILLUSTRATION 2 – A family housing scheme that is funded with money borrowed from the Public Works Loan Board

Background

It is envisaged that, in helping to maximise the supply of new homes in the borough, the DevCo could play a role in delivering new build homes for sale and rent.

On the Council's behalf, Northampton Partnership Homes (NPH) is bringing forward and developing brownfield sites for housing development, funded through the Housing Revenue Account (HRA) for affordable rent. NPH has recently secured planning permission for a housing scheme of 12 x 3-bedroom (five person) council homes.

This illustration shows how such a housing scheme could be delivered through a Council-owned Development Company (DevCo), using on-lending from the Public Works Loan Board and open market sales for cross-subsidy.

This housing scheme provides a useful illustration of what the DevCo can deliver because:

- It uses standard house types to drive efficiencies in both the construction of the homes and future maintenance;
- It is in a neighbourhood with a mixture of tenures and a number of homes that have been sold over the past year and, as a consequence, it is much easier to benchmark sales and rental values;
- It has planning permission; and
- It is a cleared site and ground surveys have revealed no abnormal conditions.

Assumptions

For the purpose of this illustration, it is assumed that the cost of the site acquisition and construction will be funded through a loan from the Council to the DevCo, funded by the Public Works Loan Board (PWLB).

It is also assumed that:

- As ownership of the land will transfer from the HRA to the DevCo, an assumed land value has been included in the illustration.
- The scheme will comprise 12 three-bedroom (5 person) family homes.
- The length of the loan from the Council to the DevCo will be informed by the payback for the scheme costs (acquisition and construction) and the income that is anticipated from the completed scheme.
- The loan will start at land acquisition and construction but loan repayments will start a year later to allow for construction and lettings.

- For the duration of the loan, the Council will have First Charge on the scheme as security. This will be removed when the loan is fully repaid.

It should be noted that:

- As the DevCo is wholly owned and controlled by the Council, Right to Buy receipts cannot be used to support the development.
- As the DevCo will not be a registered provider, Homes England funding will not be available to support the development.

Outcome of the modelling

Based on the appraisal model currently used by the Council and NPH, a positive Net Present Value (NPV) would be achieved by the DevCo selling nine of the 12 three-bedroom homes and retaining three of them as affordable rented homes let at the Local Housing Allowance (LHA) rate.

With payback over a period of 12 years, the scheme would achieve an estimated NPV of £17,399 and an Internal Rate of Return (IRR) of 5.53%.

APPENDIX C

ILLUSTRATION 3 – A town centre apartment scheme funded by institutional investment

Background

It is envisaged that, in helping to maximise the supply of new homes, the DevCo will play an important role in facilitating the conversion of empty office or retail space into homes.

The Council has experience of working with private landlords and investors to convert empty offices into flats and apartments. At the Council's request, NPH has started to explore ways in which it can help the DevCo increase housing supply with the aid of institutional investors.

Institutional investment is now a 'tried and tested' method used by local authorities, across the country, to increase housing supply and support economic development and regeneration.

A scheme of this type could be delivered as an affordable housing scheme, through the Housing Revenue Account, using Right to Buy receipts or Homes England grant funding. However, if the Council wants to deliver sub-market rented housing and/or open market rented housing, it can develop such a scheme through a Council-owned DevCo, using institutional investment.

This example – conversion of an empty office building into 120 homes – is provided because:

- The owner of the building is willing to work with the Council to bring the empty building back into use;
- The conversion of the office block into apartments is feasible; and
- Institutional investment is likely and viable because the scheme offers the opportunity for a long term, low risk investment with a public sector covenant.

Assumptions

For the purpose of this illustration, it is assumed that the cost of the site acquisition and construction will be funded by the institutional investor and that this cost will be recovered through a finance lease that is signed by the investor and the DevCo, with the Council acting as guarantor.

It is also assumed that:

- The length of the lease (between 30 years and 40 years) will be informed by the payback period required for the scheme costs (acquisition and construction) and the income that is anticipated from the completed scheme;
- The scheme will comprise 75 one-bedroom (2-person) homes and 45 two-bedroom (4-person) homes;
- The lease will start at construction, but will include a rent-free period of up to two years for construction and the phased letting of the apartments;
- For the duration of the lease, the institutional investor will own the homes and, at the end of the lease term, ownership of the homes will transfer to the DevCo for £1 and the lease payments will cease;

- As the institutional investor owns the homes until the end of the lease, the homes will not be subject to the Right to Buy during the term of the lease.
- The lease will be index linked (rising, typically by CPI+1% per annum) and the lease term, the starting point for the interest rate, the cap (the rate at which it will not go above) and floor (the rate at which it will not go below) will be negotiated between the DevCo and institutional investor. To ensure that the lease terms are at the appropriate market value, an independent valuation will be carried out in advance of the lease being signed.
- As the DevCo's Development Agent, NPH will appoint the design team, secure planning permission, design the development and project manage the construction.
- The rent from the completed homes will be received by the DevCo which will pay the institutional investor the agreed annual lease cost and retain a minimum of 25% for management and maintenance costs.

It should be noted that:

- As the DevCo is wholly owned and controlled by the Council, Right to Buy receipts cannot be used to support the development.
- As the DevCo will not be a registered provider, Homes England funding will not be available to support the development.

Indicative scheme costs and income

As explained above, the land acquisition costs and construction costs are indicative. Working on the assumption that there will be no public subsidy, the scheme will not be financially viable if all of the homes were let at affordable rents. However, on a scheme of this size, it is possible to provide a mixture of affordable rents (within the local housing allowance rates) and intermediate rents (at 80% of open market value) by extending the finance lease over a longer period.

Based on a scheme of 120 homes – 75 one-bedroom (2 person) apartments and 45 two-bedroom (4 person) apartments – the indicative costs and income would be as follows:

Number of new homes created	120
Indicative costs (land and construction)	£15m
Homes sold for cross-subsidy	None
Homes retained by DevCo for affordable rent	120
Annual gross rent received by DevCo	£0.78m per annum
Pay-back period for finance lease	35 years