

Appendices

None

**NORTHAMPTON**
BOROUGH COUNCIL**CABINET REPORT**

Report Title	Opportunity to redevelop Belgrave House as affordable rented housing for key workers
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AGENDA STATUS: PUBLIC

Cabinet Meeting Date:	16 January 2019
Key Decision:	NO
Within Policy:	YES
Policy Document:	NO
Directorate:	Finance
Accountable Cabinet Member:	Councillor Brandon Eldred
Ward(s)	Castle

1. Purpose

- 1.1 The purpose of this report is to provide Cabinet with an update on the preliminary work that has been undertaken to develop a scheme to convert Belgrave House (an empty office block) into 120 affordable rented homes.
- 1.2 As well as seeking Cabinet's 'in principle' agreement to the redevelopment of Belgrave House as an affordable housing scheme, this report seeks Cabinet approval of the approach that the Council and Northampton Partnership Homes (NPH) are taking to develop the scheme, including the necessary expenditure that is being incurred in relation to the assessment, design and 'due diligence' work that is being carried out on Belgrave House.

2. Recommendations

2.1 It is **recommended** that Cabinet:

- (a) Approves the principle of Belgrave House being converted into 120 affordable rented apartments which will be leased to the Council by Legal & General (the owner of the building), retained within the Housing Revenue Account and managed and maintained by Northampton Partnership Homes;
- (b) Approves the action that the Council and Northampton Partnership Homes are taking to progress the development of Belgrave House, including the expenditure that is being incurred in relation to the assessment, design and 'due diligence' work carried out on Belgrave House; and
- (c) Receives a further report in May 2019 when Cabinet approval will be sought for the Council to enter into an investment arrangement with Legal & General, using a financial lease, in order to facilitate the conversion and regeneration of the Belgrave House office building into a residential scheme of 120 apartments.

3. Issues and Choices

3.1 Report background

- 3.1.1 Belgrave House is a large office block, built in the 1970s and situated in Northampton's town centre. It is owned by Legal & General (L&G) and, despite the owner's best efforts to attract tenants, Belgrave House has been unoccupied for a number of years.



- 3.1.2 Although L&G has already secured planning permission to convert Belgrave House into student housing, it approached the Council and Northampton Partnership Homes (NPH) in 2017 to establish whether or not they would be interested in entering into a partnership to convert the building into homes.

- 3.1.3 The Council and NPH responded positively to L&G's approach because the redevelopment of Belgrave House would offer the following strategic benefits:
- Regeneration of a large town centre building and an adjacent alleyway;
 - An increase in the number of homes situated in the town centre, resulting in a boost for the town centre businesses and economy; and
 - A significant increase (120 homes) in the supply of affordable rented housing for key workers, meeting employers' needs to attract and retain key workers and meeting the housing needs of key workers who are working in the public sector and town centre retail and leisure but are currently unable to buy or rent a home in the area in which they work.
- 3.1.4 Consideration is currently being given to the merits and feasibility of the three parties (L&G, NPH and the Council) entering into a 30 - 35 year finance lease that entitles the investor (L&G) to receive rent and own the new housing scheme until the end of the finance lease term, at which point it will grant the Council a longer lease in relation to the whole scheme of 120 homes for £1.
- 3.1.5 Such an arrangement will offer the following benefits:
- The opportunity for the Council to acquire an asset which it will own at the end of the finance lease period; and
 - The opportunity for Northampton to attract inward private sector investment and to use additional subsidy in the form of Right to Buy receipts and/or Homes England funding.

The role played by NPH

- 3.1.6 As the Council's Development Agent for the Belgrave House scheme, NPH has led on the feasibility work, instructed all necessary surveys, appointed the design team and will submit the planning application.
- 3.1.7 If the Belgrave House scheme progresses to completion, NPH will appoint the main contractor and oversee the development using its in-house Project Managers, Building Surveyors and Quantity Surveyors.
- 3.1.8 On completion of the scheme, NPH will act as the Council's managing agent for the 120 homes, undertaking the letting, management, maintenance and rent collection functions on the Council's behalf.

Work undertaken to date

- 3.1.9 On behalf of the Council, NPH has assessed the scheme feasibility of the Belgrave House redevelopment.
- 3.1.10 As well as undertaking a property condition survey, NPH has carried out a desktop review of all available reports relating to Belgrave House. It has also engaged its supply chain to help build up an estimate of what it will cost to refurbish, reconfigure and extend the building to create a new housing development of 120 apartments (75 one-bedroom and 45 two-bedroom).

- 3.1.11 This work has included designing floor layouts, commissioning intrusive structural and asbestos surveys, and pre-planning consultation with the planning and highways authorities. It has also involved discussions with Council Officers on how the Belgrave House residents' parking requirements can be met by using the top floor of the Grosvenor Centre car park.
- 3.1.12 Considerable thought has been given to the merits and feasibility of combining the institutional lease model (frequently used by local authorities and other public sector bodies) with other forms of funding – including Right to Buy receipts and Homes England funding – which could be utilised if the scheme is delivered through the Housing Revenue Account (HRA).
- 3.1.13 The work that NPH has already undertaken on feasibility has informed the proposed model for design, ownership, funding, management and lettings.
- 3.1.14 NPH, the Council and L&G have agreed to proceed with a full planning application for Belgrave House and, within a spirit of partnership working, L&G has given an undertaking to share the financial risk on this.

3.2 Issues

Design, management and lettings

- 3.2.1 Good progress has already been made in relation to the proposed design of the building and how it will be managed and let.
- 3.2.2 As Belgrave House is situated in a very prominent position and its existing external elevations are unattractive, considerable thought is being given to how the elevations of the building can be significantly improved.
- 3.2.3 NPH is researching other conversion schemes to identify a solution for Belgrave House that enhances the appearance of the building and is also financially viable. Fire safety will, of course, be the priority and any changes that are made to the building will heed the Government guidelines from the review that followed the Grenfell tragedy in 2017.

In terms of the design of the building, it is proposed that:

- The height of Belgrave House is increased to include an additional two floors (taking it to nine), using a lightweight steel frame construction;
- The internal layout of Belgrave House is reconfigured to accommodate a mix of 120 one and two-bedroom apartments;
- A roof garden is created to provide outside amenity space for residents;
- An additional lift shaft and entrance are created on the West side of Belgrave House, and extensive works are carried out to modernise and improve the external appearance of the building; and
- Access and parking will be a major design consideration.

3.2.4 In terms of the management of the building, it is proposed that:

- NPH will act as the Council's managing agent for the 120 homes, undertaking the letting, management, maintenance and rent collection functions on the Council's behalf.
- A concierge model of housing management (possibly combining repairs and housing management functions through an on-site facilities manager) is likely to best suited to Belgrave House, given the density and location of the apartments and the requirements of the tenants.

3.2.5 In terms of the letting of the 120 apartments, it is proposed that:

- The apartments are let to 'key workers' (including public sector workers who are working in the borough and residents employed in town centre retail and leisure) who are finding it difficult to buy or rent a home in the area where they work and do not have sufficient priority to be offered an affordable rented home through Northampton's Housing Register.
- In the interests of transparency, all of the Belgrave House lettings will be made to 'key workers' who are on Northampton's Housing Register and are nominated by their employers (strictly in accordance with a Local Lettings Policy that is written specifically for Belgrave House).
- The views of local employers are sought on the nature and volume of demand that is likely to come from their workforce, in order to ensure that Belgrave House benefits the local economy and helps employers to attract and retain 'key workers', and the nominations and letting arrangements are appropriate and easily understood.

Rent levels at Belgrave House

3.2.6 It is proposed that the rents charged at Belgrave House will be equivalent to 80% of the open market rent. Such rents will offer the following benefits:

- As they will be more affordable, they will offer better housing and more choice for local people who are living on a low income and might otherwise have only limited housing options;
- As they will be within the Local Housing Allowance rates, the rent will be affordable for any key workers who need to apply for Housing Benefit to help them meet their rent;
- As they will be competitive, it is most unlikely that Belgrave House will suffer from a lack of demand and the associated lettings risk.

Proposed ownership model

3.2.7 Belgrave House is owned by L&G and held in its Northampton Shopping Centre Limited Partnership Fund, an annuity fund that also includes the Grosvenor Shopping Centre.

- 3.2.8 L&G is proposing to transfer (within the L&G group) the ownership of Belgrave House from the Northampton Shopping Centre Fund via a long (185 year) lease to L&G's Limited Price Inflation Property Fund (managed by L&G's investment management arm) which will, in turn, enter into a full repairing finance lease with the Council for between 30 – 35 years.
- 3.2.9 The lease will commence shortly before NPH enters into contract with the contractor and will provide for the first two years' lease payments to be deferred until later in the lease in order to help with cash flow during the construction period when no rent is being collected.
- 3.2.10 At the end of the finance lease period, the long lease (with an unexpired term of at least 150 years) will transfer to the Council for £1.

Proposed finance model

- 3.2.11 Index-linked finance leases (based on the Consumer Price Index) are used widely in the housing sector as a way of funding development.
- 3.2.12 The finance lease model involves an investor funding development and securing this investment through a lease arrangement.
- 3.2.13 The model is attractive for investors for three main reasons
- The length of the term (it is typically 30 - 40 years)
 - The stability it provides (it is linked to a fairly low risk rental stream)
 - The strong covenants it provides (it is typically linked to local authorities, universities and health authorities)
- 3.2.14 The model is attractive for local authorities for four main reasons:
- It is becoming 'tried and tested' and is now a more commonly used funding model
 - The interest rates can be competitive (if negotiated well)
 - The development risk can be shared with the investor
 - The investor may bring additional development expertise into the partnership
- 3.2.15 In the case of Belgrave House, it is anticipated that the finance lease that the Council enters into with L&G will fund between 70% and 100% of the scheme's capital costs – with the remainder being funded through Right to Buy receipts and/or other forms of subsidy (if available), such as Homes England funding – and that the lease funding will be repayable over a period of between 30 and 35 years.

- 3.2.16 The length of the lease will be determined by a number of factors including, but not limited to, the following:
- The scheme capital costs (acquisition, design and construction);
 - The forecast income stream;
 - the forecast management and maintenance costs;
 - The starting interest rate agreed with the lessor and the agreed interest cap and floor; and
 - The investment that the lessee may wish to put into the scheme, through its own reserves or, in this case, through right to buy receipts and/or (if available) Homes England grant funding.
- 3.2.17 As the Belgrave House scheme will be owned in the Housing Revenue Account (HRA), the finance lease will be treated as a loan and accounted for within HRA borrowing. The Government's recent decision to lift the HRA debt cap has meant that such finance leases can now be considered on their individual merits, rather than on whether or not they are within the debt cap.
- 3.2.18 As there will be nothing to pay at the end of the lease term – when the Belgrave House scheme will transfer to the Council for £1 – the Council will not need to have a minimum revenue provision (MRP).
- 3.2.19 One of the important advantages of the scheme being owned in the HRA is that it enables the Council to subsidise the scheme by up to 30% by using Right to Buy receipts or, potentially, by applying for Homes England funding through its status as a Registered Provider.
- 3.2.20 The biggest risk of the index-linked finance lease model is 'convergence'; when the lease costs are equal to, or more than, the rental stream, leaving insufficient income to cover the lease commitment.
- 3.2.21 For the Belgrave House scheme, it is proposed to de-risk this by:
- Ensuring the starting interest rate is competitive and viable
 - Applying an upper and lower limit to the annual inflationary rise
 - Ensuring there is sufficient headroom (at least 25%) between the forecast rental income and lease. The Belgrave House lease will be structured so that no more than 75% of the rental income will be needed to pay the lease, leaving a buffer of at least 25% to pay for maintenance, void loss, bad debt, management and a sinking fund for major works.
 - Ensuring capital works have long warranties to minimise major works during the lease period
 - Undertaking sensitivity analysis to look at the impact of inflationary changes to mitigate any risk of convergence

3.3 Choices (Options)

- 3.3.1 Cabinet can decide to support and approve the principle of redeveloping Belgrave House as affordable rented housing for key workers, endorse the approach that the Council and NPH have taken to progress the development of the scheme and await a further report in May 2019 (following planning approval, lease negotiations and contractor tender submissions, and when all of the legal and financial details are available) when Cabinet approval will be sought for the Council to enter into an investment arrangement with L&G.
- 3.3.2 Cabinet can decide to suspend or stop the action that the Council and NPH are currently taking to progress the development of the Belgrave House scheme.

4. Implications (including financial implications)

4.1 Policy

- 4.1.1 The redevelopment of Belgrave House as affordable rented housing for key workers will help the Council meet its policy objectives in relation to the regeneration of the town centre, tackling homelessness, meeting housing need and maximising the supply of new homes.

4.2 Resources and Risk

- 4.2.1 A comprehensive risk register will be developed and evolved throughout the life of this scheme. At this stage in the scheme's development, the key risks and mitigations can be summarised as follows:

Risk	Mitigation
Rejection of planning application	<ul style="list-style-type: none">• Early (pre-application) engagement with planning and highways and all statutory consultees (Environment Agency, Police, etc.)• Good design• Transparent public consultation• Robust and credible supporting documentation including (but not limited to) noise, air quality, transport and ecology
Unforeseen building conditions	<ul style="list-style-type: none">• Early surveys• Robust design team with structural engineering specialists• Additional contingency built into agreement.
L&G withdraw (risk of abortive costs)	<ul style="list-style-type: none">• L&G agreement to fund 50% of costs pre-lease• Draft heads of terms negotiation underway

Adverse media coverage	<ul style="list-style-type: none"> • Good design and visuals • Communications plan • Early engagement of local media
Lack of funding	<ul style="list-style-type: none"> • Inclusion in the 2019/20, 2020/21 and 2021/22 HRA capital programme • Early engagement with L&G • Promotion of scheme to potential funders such as Homes England • Use of Right to Buy receipts
High construction costs/higher than envisaged tender submissions	<ul style="list-style-type: none"> • Good design • Robust and well-advertised procurement exercise • Early (soft marketing) engagement with potential supply chain

4.2.2 The feasibility work undertaken to date has been funded from the existing General Fund budget and made possible by using NPH Officer time. The work that is underway to progress the design and planning of Belgrave House is being funded from the existing Housing Revenue Account budget.

4.2.3 Before the Council commits itself to entering into a financial agreement with L&G and the capital investment in Belgrave House, Cabinet will receive a very detailed report, setting out the financial risks and opportunities in detail, in order that Members are able to make an informed decision.

4.2.4 When the Cabinet considers the scheme in May 2019, it will be provided with a very detailed breakdown of the estimated costs of the development.

4.2.5 It should be noted that the HRA capital programme for 2019/20 contains sufficient funding (earmarked for new home building) to enable the Belgrave House scheme to proceed in 2019/20 if it is approved by Cabinet in May 2019.

4.2.6 If the Cabinet approves the scheme, the Housing Delivery Group (comprising Officers of the Council and NPH) will act as its Project Board.

4.3 Legal

4.3.1 It is noted at paragraph 3.1.1 that Belgrave House is owned by L&G. For the purposes of clarification a review of HM Land Registry confirms that the land on which the Belgrave House is situated is in the freehold ownership of the Council under title Number NN8052 and pursuant to the provisions of a ground rent lease granted by the Council to Postal Properties Limited on 30th March 1992 for a term of 999 years the ground rent lease is now registered in

the proprietorship of Northampton (General Partner) Limited under title number NN150883.

- 4.3.2 The freehold title of Belgrave House will it is understood be retained by L&G. For the Council as lessee this means that for the period of the finance lease and thereafter the subsequent grant of a long lease (referred in paragraph 3.2.10) the Council bears most of the risks and rewards associated with ownership of a property, whilst only retaining the right to possess the Belgrave House for the duration of the respective lease periods.
- 4.3.3 Assuming Belgrave House is leased to L&G Limited Price Inflation Property Fund as proposed pursuant to paragraph 3.2.8 under the lease financing structure proposed between the parties the Council would be required to repay over the term of the finance lease the capital expenditure paid by L&G Limited Price Inflation Property Fund to develop Belgrave House
- 4.3.4 In addition, to the above costs it will be the Council's responsibility to both maintain and to possibly insure (note confirmation of the insurance position is still pending at the time of writing) Belgrave House under the finance lease and long lease. As a consequence the Council will be liable for any loss or damage caused to Belgrave House during these lease periods, so these additional costs should be allowed for and depending on the underlying terms of the finance lease, the risk of any defects in Belgrave House may be passed to the Council (without any right of set off) if it has previously accepted Belgrave House.
- 4.3.5 It is noted that at paragraph 4.2.1 that draft Heads of Terms are in the process of negotiation and at paragraph 3.1.9. that some preparatory works have been undertaken, on behalf of the Council by NPH in relation to an initial investigation of Belgrave House. However given the potential complexities that may exist in respect of Belgrave House in relation to potential defects in the building it is important that consideration be given to the following in relation to the both the heads of terms and level of due diligence required.
- 4.3.6 For the protection of the Council the heads of terms should include a specific condition that the Council will only proceed subject to the completion of due diligence to the satisfaction of the Council.
- 4.3.7 In relation to due diligence the Council must ensure that a proper valuation has been conducted and that it has a full picture of any material assets and liabilities of Belgrave House and that the key parties engaged in assessing the viability of Belgrave House have sufficient expertise and experience required to conduct a detailed assessment, this will include for example an assessment of such matters as whether ancillary documentation will be required to deal with such matters as consent from L&G for any future repairs or modifications to Belgrave House, and consideration as to how the relationship between the Council and L&G is to be documented during the development period.

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 people with disabilities and families with children. They 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.
- 4.4.3 In implementing the changes, 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 The Senior Management Teams of the Council and NPH have worked collaboratively on the proposed redevelopment of Belgrave House.
- 4.5.2 Consultation with local employers of key workers (to inform the Council's understanding of the scale and nature of demand) has commenced.
- 4.5.3 Consultation with local businesses and property owners of buildings adjacent to, and in close proximity to, Belgrave House will commence in January 2019 following Cabinet and before a formal planning application is submitted.

4.6 How the Proposals deliver Priority Outcomes

- 4.6.1 The action proposed in this report will help meet 5 of the priorities in the Council's Corporate Plan:
- More homes, better homes
 - Shaping place and driving growth
 - Creating a thriving and vibrant town
 - Spending your money wisely
 - Putting the customer first

4.7 The next steps

- 4.7.1 On behalf of the Council, NPH has commissioned the Watermans Group to develop the concept design for Belgrave House, including the following:
- Internal layouts incorporating design of fire safety measures, heating, lighting, acoustics, refuse management and ventilation
 - Access arrangements including regeneration works to the alley way to the Western side of Belgrave House
 - The two-storey vertical elevation
 - Improvement works to the elevation of the building

- 4.7.2 Once the designs have been developed sufficiently, NPH will submit a planning application on the Council's behalf.
- 4.7.3 NPH will continue to work with L&G (on the Council's behalf) to conclude the Heads of Terms, and it will work collaboratively with the Council's Legal Team to finalise the content of the lease.
- 4.7.4 When planning consent has been secured, NPH will undertake a procurement exercise (on the Council's behalf) to appoint a main contractor.
- 4.7.5 A further report will be presented to Cabinet, in May 2019, on completion of all three critical path milestones:
- Planning approval
 - Lease terms agreed with L&G
 - A contract sum agreed with the main contractor
- 4.7.6 The Cabinet report will seek approval for the Council to enter into a finance lease with L&G and to proceed with the proposed model for design, delivery, funding, ownership, management and lettings.
- 4.7.7 The following table provides an indicative summary of the next steps:

<u>Date</u>	<u>Activity</u>
February 2019	Planning submission
May – August 2019	<ul style="list-style-type: none"> • Planning approved and completion of the technical design • Procurement exercise for main contractor • Conclusion of lease negotiations with L&G • Cabinet approval to proceed
September – November 2019	<ul style="list-style-type: none"> • Site clearance and strip out works • Appointment and mobilisation of main contractor
January 2020	Main construction commences
January 2021	Construction completes
February - March 2021	Occupation of new scheme

Appendices

None

Background Papers

None

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