

MUNICIPAL YEAR 2014/2015 – REPORT NO. 21

MEETING TITLE AND DATE
CABINET – 23rd July 2014

JOINT REPORT OF

Director of Health, Housing and Adult
Social Care and Director of Finance,
Resources and Customer Services

Agenda – Part 1	Item: 11
Subject: Special Purpose Vehicle for New Build Council Homes	
Wards: All	
Key Decision No: KD3890	
Cabinet Members consulted: Cllrs Oykenor and Stafford	

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1. EXECUTIVE SUMMARY

- 1.1 The challenges facing Enfield are not dissimilar to the national picture, which set against a background of tough austerity measures and a depressed housing market has seen an increase in the demand for both affordable housing and private rented homes.
- 1.2 As part of a wider redevelopment strategy to increase the supply of value for money quality accommodation for Enfield residents it is proposed that the Council establishes a local authority company to develop, own and manage a portfolio of properties to be made available for private rent.
- 1.3 This would be the second wholly Council owned company to be established to manage housing assets following the recently established Housing Gateway Limited which has been created to purchase homes for temporary accommodation.
- 1.4 The New Build company affords the Council the opportunity to intervene in the market and increase the supply of new housing in the Borough. It is proposed that the initial portfolio will be made up of the 57 private homes to be built as part of the Small Housing Sites (Phase 1) project which was approved in items Addendum KD3780 & Cabinet Addendum 206A. However the company will be established with the ability to accommodate additional homes if this is decided by the Company Directors.
- 1.5 The company needs to be established at this stage to allow the Small Housing Sites project to proceed to a start on site. In September a second report will be taken to Cabinet which explains how the Council proposes to structure the companies and how the new homes could be managed.

2. RECOMMENDATIONS

It is recommended that Cabinet:

- 2.1 Use its powers to set up a limited liability company (SPV) for the purposes of developing, owning and managing property.
- 2.2 To delegate to the Company Management Board approval via a Portfolio Decision to finalise the Terms of Reference and Company Memorandum and Articles of Association of the local authority company proposed and other such matters necessary to (i) incorporate and register the company and (ii) facilitate the objectives identified in this report.
- 2.3 Note that the investment model proposed was approved by Cabinet and Full Council March/April 2014 respectively and that there are no additional costs to the Council from the approval to reallocate money from the Investment in Private Rented Sector Homes to the Small Housing Sites project. This borrowing has already been factored into the Council borrowing requirement.
- 2.4 Note that the Council has sought independent expert legal advice/support on forming a wholly owned SPV subsidiary and on drafting an arms-length development finance facility agreement. To include memorandum and articles of association, shareholder issues and overview tax advice, and due diligence on development and construction arrangements, full suite of development covenants and formation and administration of conditions precedent respectively.
- 2.5 Note that the Council is proposing to add the redevelopment of the Ordnance Road site to the Small Housing Sites (Phase 1) project and to bring forward a Small Housing Sites Phase 2 (project), along the same principals as Small Sites (Phase 1). Both proposals will be the subject of a separate report, to be submitted for consideration at the September meeting of Cabinet.
- 2.6 Note that the company structure being proposed could be used to hold other property assets, such as the housing to be developed as part of the proposed Bury Street project and the Small Housing Sites Phase 2 project, or simply be amended as required.
- 2.7 Delegates the final decision on the management of the private rented units held by the SPV to the Cabinet Member for Housing and Estate Regeneration and the Director of Health Housing & Adult Social Care.
- 2.8 To note that the final decision on the name of the New Build company will be taken by the Cabinet Member for Housing and Estate Regeneration.

Small Housing Sites (Phase 1) project

- 3.1 July 2012 (KD 3517) Cabinet approved a report to redevelop seven small sites located across the Borough and delegated authority to the Cabinet members for Housing & Estate Regeneration and Finance to appoint a developer to build the new homes across the sites.
- 3.2 In July 2013 the Council successfully bid for £690,000 funding from the GLA to support the scheme. The grant is subject to the developer starting on site in June 2014.
- 3.3 In November 2013 Planning Committee approved all associated applications subject to conditions and the developer signing the Section 106 Agreement. The planning consent provides 94 new homes including 57 private properties and 37 affordable (20 social rent / 17 shared equity) Council owned homes.
- 3.4 The Councils innovative approach, where all seven sites have been packaged together under one Section 106 Agreement, will deliver 37 (39.4%) affordable homes. This is seven more affordable homes than would otherwise have been the case.
- 3.5 In October 2013 bids were received from three developers. Two of the bids submitted were based on a traditional cross subsidy model whilst the third was an alternative bid based on a lease and lease back model. The bids were clarified, evaluated and a preferred bidder identified in December 2013. Following identification of the preferred bidder the Council commissioned a firm of accountants to undertake a thorough due diligence and benchmarking exercise on the private funding proposed by the preferred bidder.
- 3.6 The benchmarking exercise has demonstrated that replacing the private funder with Public Works Loan Board (PWLB) and European Investment Bank (EIB) funding would, through LBE intervention in the market, result in a significantly stronger return to the Council, a shorter repayment period, and greater flexibility over use of 94 homes.
- 3.7 On 27th February 2014 a meeting was held with EIB officials to discuss funding the Small Housing Sites project as part of a larger programme of investment in Enfield capital projects. The positive outcome of the meeting means that the Small Housing Sites project has been provisionally included in the portfolio of projects which the EIB are prepared to fund.
- 3.8 In accordance with the original Cabinet decision in July 2012, to make the appointment of a developer a portfolio decision, the Cabinet Members for Housing & Estate Regeneration and Finance approved a recommendation to appoint, the preferred development partner, utilising PWLB/EIB funding, for the Small Housing Sites project.
- 3.9 2nd April 2014 full Council approved a recommendation by Cabinet (12th March 2014) to update the General Fund Capital Programme for 2014-16 and allocate funding from the Investment in Private Rented Sector Homes to the Small Housing Sites project.

- 3.10 Note there are no additional costs to the Council from the recommendation to reallocate money from the Investment in Private Rented Sector Homes to the Small Housing Sites project. This borrowing has already been factored into the Council borrowing requirement.

Ordnance Road

- 3.11 In September 2014, a report will go to Cabinet (KD3920) recommending that it be agreed to add a site at Ordnance Road to the Small Housing Sites project (Phase 1). Working in partnership with our appointed developer partner, consultation, design, planning and financial modelling works will be undertaken to develop a detailed proposal for the residential development of the site that could include community space.

It is recommended that Cabinet delegate authority to the Cabinet members for Housing & Estate Regeneration and Finance to approve the specific details of any future development proposal for the site at Ordnance Road. That Cabinet delegate authority to the Directors of HH&ASC and Finance, Resources & Customer Services to approve the budgetary resources to finance the cost of specialist consultants to provide financial cost analysis and design team services to deliver a financially viable scheme with detailed planning consent. In keeping with the original seven sites the SPV will own and have responsibility for management of any privately rented residential units built on this site.

Small Housing Sites (Phase 2) project

- 3.12 In September 2014, a report will go to Cabinet (KD3920) recommending an approach for the planning, design and consultation on the possible development of a number of small council-owned sites across the borough for new housing as part of the Small Housing Sites (Phase 2) project. The report will update Cabinet on the progress made to date on feasibility work for a number of sites, and request a budget to appoint a firm of architects and any other specialist consultants. The report will ask Cabinet to note (or to delegate authority accordingly), that subject to the outcome of consultation, subsequent detailed design work and costings, another report will follow in 2015 setting out an options appraisal for funding and procurement, with a recommendation for the project.

Special Purpose Vehicle

- 3.13 March/April 2014 Cabinet and Full Council respectively delegated authority to the Director of Finance, Resources & Customer Services to make the final decision on funding the loan to the SPV.
- 3.14 The above reports also sought authority in principle to establish a separate wholly owned subsidiary (SPV) that would take a lease of the 57 private rented properties. This report sets out the details of the SPV.
- 3.15 Any delay in setting up the SPV will have Stamp Duty Land Tax (SDLT) and contractual implications. The SDLT is calculated on the value of the sites; the

further the construction works have progressed the more value the sites will have.

- 3.16 The Council has given an undertaking to seek Cabinet consent for the formation of the SPV as soon as possible. Contractually the point is a major one for the developer as they see holding the leases longer than necessary as being a risk issue.
- 3.17 The company structure being proposed could be used to hold other property assets, such as the housing to be developed as part of the proposed Bury Street project and the Small Housing Sites Phase 2 project, or simply be amended.

4. PROPOSAL

PWLB/EIB Finance

- 4.1 Under the PWLB/EIB structure, the Council will be responsible for borrowing the construction cost. Once the SPV has been established the long leases will be assigned to the SPV and the income generated from the rent on the homes held under the long leases will be used as the mechanism for the SPV to repay the loan to the Council.
- 4.2 An SPV is required for this option because legal advice recommends against holding housing assets in the General Fund unless they are held in an SPV to mitigate the risk of the Council being caught by State Aid legislation. Holding homes in an SPV also removes the risk of tenants seeking the Right to Buy.
- 4.3 To mitigate the risk of the SPV being caught by State Aid legislation The Council will arrange the borrowing from PWLB/EIB and lend on to the SPV at a rate which is the greater of either the Council's cost of borrowing or the EU reference rate (– the EU reference rate is currently 4.88%). The SPV will be expected to repay both principal and interest on a 6 monthly basis which equates to an effective cost of finance of 5.9%.

Company Structure

- 4.4 It is proposed that a company is registered at Companies House under a name to be approved by the Cabinet member for Housing and Estate Regeneration. The Company Management Board could easily change the name if they chose to when agreeing a permanent name and brand for the company.
- 4.5 It is recognised that the company may change and develop over time according to decisions made by the Company Management Board, or by the Council, in line with the Scheme of Delegation. The primary focus of the company will be on the management of its assets, initially the 57 new homes, in order to generate an income that will be used to pay back the loan in accordance with the requirements set out in a PWLB/EIB Finance Agreement. Initially it is proposed that the company is formed of Members, officers and two non-executive appointments. The Company Management Board will be guided by the company's Terms of Reference and Articles of

Association. With the possible exception of the non-executive director positions the Board positions will not be remunerated

- 4.6 The Company Management Board will be responsible for the overall management of all aspects of the company. This will include making sure that the company upholds all legal requirements, such as submitting annual returns and accounts and sending notifications of changes in personnel to Companies House. In addition the Company Management Board will oversee the management of the property portfolio ensuring that properties are delivered in accordance with the agreed criteria, that the loan is paid back in accordance with the requirements set out in the finance agreement, any profits paid in the form of dividends, and that regular reviews of the financial model are undertaken.
- 4.7 The company will have a Company Secretary whose duties would include maintaining the statutory registers including:
- Register of Members
 - Register of Directors and Secretary
 - Register of Director's Interests
 - Register of Charges
- 4.8 Initially it is proposed that the board membership will follow the member of Housing Gateway Limited as set out below. Moving forward the membership of the board is expected to evolve to achieve a more commercial focus.
- 3 x Cabinet Members - one of whom will be the Chair.
 - Director Finance, Resources and Customer Services - who will also be Company Managing Director
 - Assistant Director of Community Housing
 - Assistant Director Corporate Governance – who will also be the Company Secretary
 - 2 Non-Executive Directors (possibly to be remunerated).
- 4.9 The sole member (or shareholder) of the company will be the Council. In order for the Council, as sole shareholder, to take decisions in its capacity as shareholder, it needs to have a person acting as its representative who can attend general meetings and/or make sole member resolutions. An example of when the Council as sole shareholder would need to take such decisions is whenever the company constitution needs to change. The Assistant Director Corporate Governance will be the Council shareholder's representative.
- 4.10 This limited company (SPV) once set up could also be used to hold other property assets, such as the housing to be developed as part of the proposed Bury Street project and the Small Housing Sites Phase 2 project.

Property Management

- 4.11 A number of options for the management of the properties should be considered. It is proposed that once established the SPV will assess the options and make a recommendation to the Cabinet Member for Housing and

Estate Regeneration and Director of HH&ASC who under delegated powers will make the final decision on management of the private rented units.

- 4.12 To achieve the market rental income sought the SPV must have a commercial focus if it is to deliver the high levels of service demanded by private rented sector tenants paying a premium.

5 ALTERNATIVE OPTIONS CONSIDERED

- 5.1 The Council could decide not to set up an SPV and hold the 57 units for private market rent in the General Fund. This is not considered a viable option as it would see the Council fall foul of legislation Counsel's advice against holding housing directly in the General Fund and open the possibility of private tenants acquiring a secure tenancy including any associated rights such as Right to Buy.

6 REASONS FOR RECOMMENDATIONS

- 6.1 Establishing an SPV, a wholly owned subsidiary of the Council, to borrow the money from the Council and then pay the developer to build the properties benefits the Council in various ways. The SPV serves as a mechanism that enables the Council to intervene in the market to deliver new homes, it returns significant net cash flows to the General Fund and it reduces risk to the Council in two ways. Firstly it allows the Council to obtain lower rates of public funding and make a profit on on-lending at a higher commercial rate to the SPV so avoid any State Aid issues. Secondly it avoids the risk of any private tenants acquiring a secure tenancy or the right to buy the property.

7. COMMENTS OF THE DIRECTOR OF FINANCE, RESOURCES & CUSTOMER SERVICES AND OTHER DEPARTMENTS

7.1 Financial Implications

- 7.1.1 The funding of £17.3m for the development of the Small Housing Sites was approved by Cabinet in July 2014 (Cabinet Addendum 206A).
- 7.1.2 The cost of setting up a wholly owned SPV subsidiary and drafting an arms-length development finance facility agreement will initially be funded by the General Fund. However, this cost will be recouped from future rental income from the private rented properties.
- 7.1.3 The assessment of the financial viability for the redevelopment of the Ordnance Road site has not been completed.

7.2 Legal Implications

- 7.2.1 Section 1 of the Localism Act 2011 gives local authorities a "general power of competence", meaning that they have the legal capacity to do anything which an individual may do unless prohibited by law. This power may be exercised for the benefit of the local authority, its area or for persons resident or present there. The setting up of a company as an SPV falls within that power.

- 7.2.2 The SPV must adhere to the general principles and requirements of company law as set out in the Companies Act 2006 and associated legislation.
- 7.2.3 Legal documentation connected with the formation and running of the company should be in a form approved by the Assistant Director (Legal Services).

7.3 Property Implications

- 7.3 There are no property implications arising from the proposal for the Council to form a limited liability company (SPV). There will be property implications to consider when Kier seek to assign the leases, of the properties on which the private rented properties are being constructed, to the SPV. The assignments will be dealt with by the Council under the Property Procedure and by the board of the SPV under rules to be agreed after the establishment of the SPV.

8 KEY RISKS

- 8.1 Housing needs change and the demand for private rented properties and subsequently level of market rents achievable declines. Independent research by Strettons into the dynamics of the private rented sector in Enfield evidences that private rental income streams have and are likely to continue to be above the retail price of inflation.
- 8.2 The project does not break even over the life of the lease term due to rent arrears, voids and also depreciation in capital value. A robust financial model has been produced that makes prudent assumptions on income and expenditure. This will be reviewed and updated over the life of the project to ensure the assumptions continue to be accurate. Exit strategies have been considered and the company will have the ability to sell assets if required.
- 8.3 Reputational risk for the Council if the company is not financially sustainable. This is mitigated as far as possible by a robust financial model that will be monitored closely throughout the life of the lease term. Plus the company/Council has the option to exit the scheme by selling the assets at any time.
- 8.4 The Council receives a legal challenge due as the project is considered to be in breach of State Aid. Expert legal opinion has been sought and concludes that provided the terms and interest rate offered on any loan by the Council to the company meet the Market Economy Lender Principles that loan would not be State Aid or alternatively the arrangements between the Council and the company could be structured to meet one of the exemptions.

9 IMPACT ON COUNCIL PRIORITIES

9.1 Fairness for All

- 9.1.1 Increasing the supply of quality accommodation within the Council's control, will enable the Council to increase access to both secure

affordable accommodation, for some of the most vulnerable residents in the borough, and high end quality accommodation for private rent.

9.2 Growth and Sustainability

9.2.1 Access to good quality, stable housing is a key aspect of a person's health and wellbeing. By using long term finance the Council will remove concerns over refinancing or the need to sell properties after a few years. Furthermore by ensuring properties are maintained to a good standard, the scheme will be able to increase the supply of quality accommodation and in turn improve health and wellbeing and prospects of securing employment.

9.3 Strong Communities

9.3.1 By increasing the supply of quality homes that the Council can access within the borough and the surrounding area, this will increase opportunities for local residents to access employment and training and thus reduce the likelihood of them requiring additional services from the Council.

10. EQUALITIES IMPACT IMPLICATIONS

10.1 A full equalities impact assessment has been prepared for the project. Allocations to individual properties will be made in line with existing Council policies, which have also been equality impact assessed.

11. PERFORMANCE MANAGEMENT IMPLICATIONS

11.1 Through this project the Council has the opportunity to address a shortfall between supply and demand of quality public and private accommodation available for rent in Enfield. This in turn, provides the opportunity for the Council to make a positive impact for wider objectives, such as reducing employment and improving health and wellbeing.

12. HEALTH AND SAFETY IMPLICATIONS

12.1 All properties constructed will be built to the highest standards and subject to health and safety certification prior to habitation.

13. HR IMPLICATIONS

13.1 The local authority company will appoint relevant personnel in accordance with HR processes and procedures. The terms of existing members of staff will not be affected as a result of this project.

14. PUBLIC HEALTH IMPLICATIONS

14.1 Issues arising during the demolition and construction phases will be closely monitored and contractors will be required to work in accordance with the Considerate Constructors Scheme.

- 14.2 By increasing the supply of good quality housing in the borough across tenures, health and wellbeing of individuals will be improved.
- 14.3 Through employment and training opportunities people will be actively encouraged and enabled to return to work, with all the positive outcomes associated with being economically active i.e. improved general well-being, self-esteem and longer term employability.

Background Papers

None.