

MUNICIPAL YEAR 2019/2020 - REPORT NO. **238**

**AUDIT AND RISK MANAGEMENT
COMMITTEE**
5 March 2020

Agenda - Part:	Item: 9
Subject: Housing Development approach to identifying risk and management	
Wards: All Key Decision No: (not applicable)	
Cabinet Member consulted: Cllr Caliskan	

REPORT OF:
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1. EXECUTIVE SUMMARY

This report presents the approach to identifying and managing risk across the housing supply areas of Development and Regeneration, focusing on the controls in place to deliver the programme of 3500 homes over the next 10 years.

2. RECOMMENDATIONS

- 2.1 Note the governance and controls in place to identify and manage risk in the housing supply area.
- 2.2 Endorse the risk register provided within this report and the approach at project and programme level.

3. BACKGROUND

- 3.1 The Council's role, as a strategic housing authority, requires it to make adequate provisions and enable the effective planning to meet housing needs of all residents across tenures and prevent homelessness. One of the key aims of Enfield's Housing and Growth Strategy (2020 – 2030) is to increase the supply of quality accommodation for residents.
- 3.2 The Housing Service includes the development and regeneration operating areas, which deliver a range of capital projects across estates owned by the council and infill sites in the housing revenue account.

- 3.3 On 12 February 2020, Cabinet approved the *Maximising the Council's Direct Development Delivery strategy* which sets an ambition for "direct delivery" where the Council will prepare council owned land and commission contractors to build homes.
- 3.4 Development of sites within the Council's 10-year development strategy will meet significant housing need and provide a range of rented and shared ownership homes for local people and maximize underused or surplus assets to deliver new homes. It will also deliver homes for sale to support viability of the plan whilst creating mixed income communities.
- 3.5 By directly delivering homes, the Council retains control over the new dwellings which will strengthen the council's own housing portfolio and secure future revenue. All 3500 homes in the 10-year business plan are intended to remain as Council owned homes in the Housing Revenue Account.
- 3.6 Any large-scale construction programme, however, has inherent risks at corporate and project level and the Housing and Regeneration directorate has implemented controls and systems to mitigate the financial and delivery risks. A risk register is held at programme level to allow for the analysis of strategic risk and interdependencies across the direct delivery and estate regeneration projects. This will be informed by project (scheme) risk registers which record the operational risks and the actions necessary to mitigate site issues. The overall impact will be considered as part of the corporate risk management arrangements.
- 3.7 This report sets out the risk management process and procedures which provide oversight, challenge and analysis for effective risk mitigation and remedial action, focussing on the estate regeneration and housing supply areas.

3.8 Governance

- 3.9 The Housing Delivery Board has been established as the accountable group for the operation of the development programme. Similarly, a Regeneration board for all estate renewal schemes has been established to monitor the progress of developers with whom the Council is in contract with, such as Countryside UK and the Ladderswood LLP.
- 3.10 The Director for Housing and Regeneration is the chair for both boards and has oversight of the whole programme, approved capital and revenue budgets and grant funding streams, contracting and risk management.
- 3.11 Membership of the board includes representation from legal, finance, property and procurement. The role of the board is defined in the terms of reference provided in **Appendix 1**.
- 3.12 The Housing Delivery Board sets the direction and is ultimately accountable for the performance of the development strategy. The Board will meet on a regular basis with the purpose of ensuring that there is:
- Continuous delivery against the programme
 - Control at a Director Level
 - Resource optimisation across the programme

- Focus on strategic priorities
- Links to key decisions

3.13 Once a Project Plan / Gateway has been approved, the Programme Board is kept informed by Highlight Reports during the phases. The Programme Manager informs the Board immediately if any exception situation is forecast. The major controls for the Board are:

a) *Justifying and Initiating the Project – should the project proceed?*

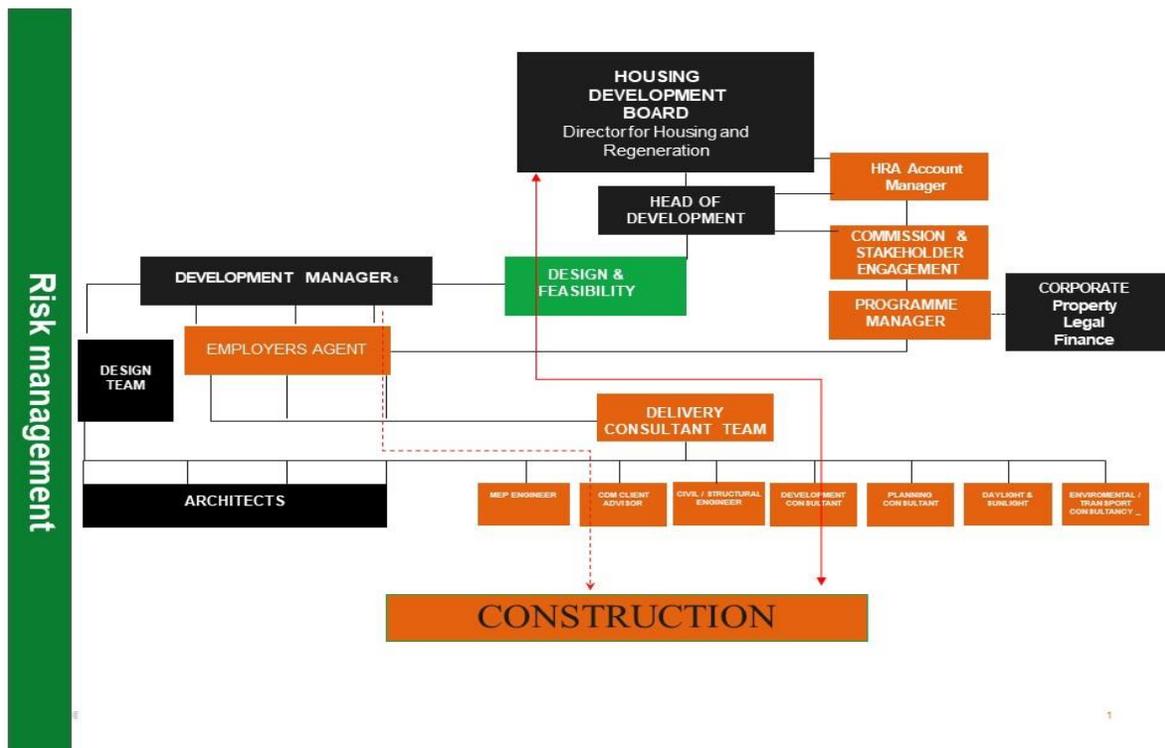
b) *Managing and Delivering the Programme through;*

i) **Highlight Reports** - Regular progress reports are submitted during each stage of the project: has the stage been successful, is the project still on course, is the Business Case still viable, is the project resourced, are the risks still under control? Highlight Reports will cover any exceptions, for example performance issues, not delivering to time, within budget or to standard.

ii) **Closing and Evaluating the Project** – has the project delivered what was expected; are any follow-on actions required; what lessons have been learned?

3.14 The Board receives information from the Development team and has control over whether the project continues, stops or changes direction or scope, striking a balance between the level of risk and the potential benefits the project may achieve.

3.15 The structure below represents the governance process and illustrates the controls embedded to monitor performance and risk from feasibility stage to completion.



3.16 Programme Management

3.17 A Programme Management Office (PMO) function has been established to monitor the delivery of the 10 year development strategy. The PMO reviews and assesses the service, risk, control and governance arrangements, supplemented by discussions with senior officers throughout the Council. This approach allows for providing assurance for known risks and mitigation of new risks and issues. By embedding a governance process at programme level the Council is able to identify interdependencies earlier and take action. Visually this can be represented as :



3.18 Gateway process

The sites within the Council’s 10-year housing development programme are at different stages of design and build, ranging from schemes already under construction to newly identified sites. To ensure the deliverability of the programme the gateway process, that is governed by the Housing Development Board, has been developed and agreed by Cabinet on 12 February.

This is provided in **Appendix 2** and summarised below:

Gateway	Activity	Controls	Authority level
Gateway 1	Site identification	Planning likelihood assessed against Local Plan Assessment of Market and rental values to inform viability, capacity and mix.	HDB
Gateway 2	Feasibility assessment	Budget monitoring Appraisals	HDB
Gateway 3	Scheme Development	Appraisals benchmarked against Proval hurdle rates act as guiding principles for investment outcomes and cost control	HDB

Gateway 4	Scheme delivery	Robust procurement procedure Contract administration and management Cost planning and assessment at each stage of RIBA plan of work	HDB* escalation to ED or Cabinet if required
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3.19 The Gateway criteria will also be applied to how retained RTB receipts are spent with an additional preference for schemes that are stalled or would be optimised by using the Council's investment.

3.20 To ensure that the assumptions that underpin the scheme appraisals are evidence based and reflect the scheme specifics, the Council will seek to align with the GLA's Benchmarks for Development Viability Reviews and conduct a quarterly review of market conditions for sales, shared ownership and private rented tenures, undertake a review and establish maintenance, repair and replacement costs for new build based on build type and M&E systems used.

3.21 Strategic risks

The following areas have been identified as strategic risks.

3.22 *Budget and Financial risk management*

3.23 The Development Strategy is underpinned by the assumptions within the HRA Business Plan, approved by Cabinet on 26 January 2020. These assumptions have been translated into hurdle rates including an average build cost at £250,000, the internal rate of return (3.5%) for the borrowing and the net present value of the investment at greater than -£50K per unit. This is assessed at site specific level and aggregated on a programme basis, to ensure any budget commitments are within the approved HRA business plan by financial year.

3.24 If schemes are not viable then, depending on at which point of the Gateway process it is being assessed at, remedial action will be undertaken to improve the affordability within the HRA budget, including value engineering the design.

3.25 The highlight risks for the development strategy is provided in **Appendix 3**. A risk register will be created for each project to capture the key risks and the measures to mitigate the impact will be considered as part of the project management arrangements

3.26 The following financial controls are in place to mitigate risks and impact to the HRA budget:

i) Annual review (September 2020)

The 10 year development plan will be reviewed in line with the HRA Business Plan on a annual basis. This will allow for continuous performance management of the programme

and wider deliverables and the identification of steps to remedy any delays or cost increases.

ii) Monitoring Income

The development strategy assumes a significant income from rents, sale of land and overage receipts to offset the borrowing cashflow. The programme management controls will ensure that risks are identified early and escalated to the Board. This includes movement (re-profile) of schemes and slippage where HRA capacity is impacted.

iii) Maximising GLA funding

The development programme is predicated on external funding from the GLA at £100k a unit. To mitigate risk, monthly programme meetings will be held to monitor progress and any changes or slippage will be reported to the Housing Delivery Board. If substitutions are required, then this will be for the Board to agree and in accordance with the HRA business plan only.

The Council meets with the GLA at quarterly review points, where any changes to the grant funded schemes are discussed and agreed and subsequently ratified at the Housing Development Board. There is an ongoing dialogue with the GLA for the Council to establish a collaborative partnership status which would attract higher grant rates.

iv) Controlling Build costs and Hurdle rates

Within the development team, there are budget controls in place at project and programme level to monitor risks against the HRA Business Plan. This provides a financial framework and tolerance level for the appraisal of schemes. Any variations are agreed on an exception basis and in line with the budget forecasts for the overall programme, within the relevant financial year. Where costs vary at actual tender stage from pre-tender or budget allocation, the development team will be required to re-appraise the scheme and seek approval from the Board in order to proceed. A contingency of 10% has been built into the development appraisals for sites to manage unknown risks at construction stage and to control any cost increases due to change in the labour market or material supply chain.

v) Change log and decision record – escalation (strategic risk/project risk)

As schemes are at different stages, a risk register will be produced at project and programme level. Integrated in this is a Change Log which will aim to monitor any variances and decisions made against outputs, phasing and budgets. This will identify issues for escalation at strategic level or project management issues at any stage of the programme.

3.27 *Acquisitions*

3.28 As capacity within the HRA business plan is limited, all acquisitions of land and property will need to follow the same gateway process, supported with an independent RICS valuation. The level of deliverability and viability risk will be considered in line with hurdle rates and where a site does not deliver additional social value to the Council, then the Board will not agree to the use of borrowing.

3.29 *Procurement and construction*

3.30 One of the key risks to the delivery of council-led sites is the procuring of professional services, contractors and the cost of construction. Lengthy procurement processes and poor performing contractors are risks to achieving the 10 year development plan. This is being minimised by:

- a) commissioning STACE to design a procurement strategy for engaging professional services and managing construction for the delivery of 3500 homes,
- b) embedding financial modelling, legal requirements and procurement processes at the project initiation and planning stages, including developing design specification and Employer requirements in line with affordability within the HRA business plan.

3.31 *Properties into management (handover, defects and maintenance)*

3.32 To mitigate the cost of maintenance, and taking the learning from previous projects, there will be a handover process built in, starting 12 weeks before the practical completion of the development. This will be a collaborative process with Council housing and the development team to ensure there are defined responsibilities and an agreed defects strategy from occupation onwards.

4. ALTERNATIVE OPTIONS CONSIDERED

4.1 The delivery of site by site was considered but given the changes to the labour market and build costs reflecting increased pricing for risk, it was considered that a strategic programme approach would be more attractive to SME contractors. Additionally, by taking a programme approach to assessing value and cost, the investment is able to be targeted with larger more expensive estate regeneration schemes offset with packages of low yield infill sites.

5. REASONS FOR RECOMMENDATIONS

To support the delivery of the 10-year development plan.

6. COMMENTS OF OTHER DEPARTMENTS

6.1 Financial Implications

This is a report for update purposes only. The financial implications will be considered and provided at each decision report level.

6.2 Legal Implications

This is a report for update purposes only. The financial implications will be considered and provided at project decision report level.

6.3 Property Implications

This is a report for update purposes only. The financial implications will be considered and provided at project decision report level.

7. KEY RISKS

A summary of the highlighted risks and remedial actions is provided at **Appendix 3**.

8. IMPACT ON COUNCIL PRIORITIES – CREATING A LIFETIME OF OPPORTUNITIES IN ENFIELD

8.1 Good homes in well-connected neighbourhoods

This programme will increase the supply of a range of housing tenures including affordable housing and create thriving neighbourhoods and places

8.2 Sustain strong and healthy communities

Developing and sustaining good quality housing in areas where people desire to live will help to create and maintain strong sustainable communities and increase the portfolio of stock it has to discharge its statutory housing responsibility to households that live in the borough.

8.3 Build our local economy to create a thriving place

Support residents to take more responsibility to increase the local economy and improve their communities by more active engagement in project delivery.

9. EQUALITIES IMPACT IMPLICATIONS

Any implications will be considered and integrated at each project level decision report

10. PERFORMANCE AND DATA IMPLICATIONS

Any implications will be considered and integrated at each project level decision report.

11. HEALTH AND SAFETY IMPLICATIONS

Any implications will be considered and integrated at each project level decision report.

12. HUMAN RESOURCES IMPLICATIONS

Any implications will be considered and integrated at each project level decision report.

13. PUBLIC HEALTH IMPLICATIONS

Any implications will be considered and integrated at each project level decision report

Background Papers

Key Decision 4998 : Maximising the Council's Direct Development Delivery

Appendices

Appendix 1 : Terms of Reference Housing Development Board

The Housing Development Board (“Board”) comprises of Council Officers from procurement, legal, finance and development and is chaired by the Director for Housing and Regeneration.

The Board is responsible for monitoring and overseeing the progress of the Council new supply and development programme. The purpose of the Group is to ensure the successful delivery of 3500 council homes by 2030.

To this end the following critical success factors will need to be achieved:

- The new homes are delivered within the agreed timeframe
- Quality expectations are met
- Budgetary control is exercised
- Risks are identified and appropriate mitigation strategies are implemented

The Board will approve the acquisition and allocation of sites for the new build programme, monitor and approve budgets for individual developments if within the agreed 10 year development strategy and approve the terms of the delegated authority reports to award contracts (for subsequent decision to be taken by the agreed operational/portfolio/cabinet lead)

The remit of the Board is to:

- Meet monthly to monitor progress and operational requirements, including the procurement strategy and needs for the delivery of the programme.
- Agree a scheme of delegation and for overall decision-making to be taken in line with that
- Review and approve the evaluation of tenders for design consultant services and contractors
- Exercise authority to approve budgetary allocations to schemes – providing these do not exceed the original scheme budget approved by Cabinet
- Approve all design submissions and changes for new Council homes (subject to Development Control Committee approval where required). This will be done in consultation with the Leader, Cabinet and other officers where necessary.
- Exercise authority to commit expenditure (as approved by Cabinet/Council) related to feasibility studies and investigatory works for the purpose converting development opportunities into potential new sites/schemes.

Appendix 2 – Governance Framework and Gateway process

The sites within the Council’s 10-year housing development programme are at different stages of development – ranging from schemes already under construction to newly identified sites.

To ensure the deliverability of the programme the following gateway process, that is governed by the Housing Development Board, has been developed:

Gateway 1: Site Identification

New sites and acquisition opportunities are considered at Housing Development Board and recommendations are made to the Director of Housing and Regeneration, who then authorise officers to proceed with feasibility appraisals.

Gateway 2: Feasibility Assessment

Sites that pass the first gateway undergo a feasibility assessment (including capacity studies, risk assessments and scheme appraisals) which are considered at Housing Development Board and recommendations made to the Director of Housing and Regeneration on whether to authorise officers to proceed with scheme development.

Gateway 3: Scheme Development

At this stage, a design team is commissioned to develop the initial capacity studies, in consultation with local residents and internal stakeholders, to fully designed schemes. They are then reappraised and presented at Housing Development Board, which recommends to the Director of Housing and Regeneration whether to authorise the scheme to be developed further for planning submission.

Gateway 4: Scheme Delivery

Prior to submission, the finalised schemes and their updated scheme appraisals are reviewed Housing Development Board and the Director of Housing and Regeneration gives authority to submit.

Once planning consent achieved, contractor procurement will commence through existing corporate and departmental governance frameworks. As part of the contract award approval process the Delegated Authority Reports and updated scheme appraisals will be presented to the Housing Development Board for consideration.

Scheme Appraisal

We will appraise development proposals and viability against the following criteria and seek to secure additional GLA grant funding for their delivery:

<p>Cost</p>	<p>The cost of each proposed development will be examined. It will be assessed with the cost of comparable schemes to ensure value for money. Investment decisions will be based on the following benchmarks:</p> <p>Build Cost per Unit (CPU) of £250,000 or less</p>
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	<p>Cost to Value Ratio of equal to or less than 100%</p> <p>Net Present Value (NPV) of -£50,000 per unit or greater</p> <p>Internal Rate of Return (IRR) of 3.5% or higher</p> <p>Subsidy to Costs Ratio (Grant/ RTB) of 30% or higher</p> <p>Loan to Value Ratio of 50% or less</p> <p>Loan repayment within 30 years</p> <p>Residual Land Value of £1 or higher</p> <p>The overall development programme will need to meet the key assumptions in the HRA business plan.</p>
<p>Timescale</p>	<p>All schemes will be expected to progress efficiently within realistic timescales. Where applicable, schemes that can be delivered within funding deadlines will be progressed ahead of others that have longer timescales.</p>
<p>Housing Need</p>	<p>New homes will be designed to meet housing demand. The decisions on housing type, bed size and tenure mix will be subject to planning policy, viability, location and local housing need. Schemes that can meet specific priority housing need, such as accommodation for vulnerable adults, large family or key worker homes, will be progressed ahead of others.</p>
<p>Complexity</p>	<p>Some sites are more difficult to develop than others. For example, converting garages into flats on constricted sites will be more complex than building new homes on large Greenfield sites. Complex schemes can cost more and take longer to develop, although they may have a positive impact in terms of regeneration. Schemes that are more deliverable will be progressed ahead of other more complex schemes. Unviable sites can be unlocked by carrying out option appraisals with different tenure split including more open market dwellings to cross subsidise affordable units.</p>
<p>Social value</p>	<p>All schemes will be expected to deliver real gains for the residents that will live in the new homes and, more generally, for all Enfield residents – whether its use of local labour and supply chain, offering training and apprenticeships opportunities, making public realm improvements, raising capital receipts to fund future regeneration schemes, helping reduce carbon emissions by offer bike or car sharing schemes or providing needed community infrastructure. Schemes that can deliver greater social value will be progressed ahead of those with limited gains. In some cases, such schemes may not meet all of the viability benchmarks and this will be acceptable as long as the overall programme is within the hurdle rates.</p>

Appendix 3 : Headline risks

No	Item	Stages in development process	Associated risk	Risk Level	Impact on Business Plan and Cashflow	Mitigation
1	Land risk	Purchase of site/Title and or/Third Party Interests	Site may have unforeseen problems (land assembly, title, leaseholders, third party interests, contamination, archaeological remains etc). The cost of acquiring land – which can often be inflated when there is competition from several developers or purchasers/owners of interest.	High	15-20% of additional cost	Contingency to cover unexpected costs, use of Council Land Appropriation and Compulsory Purchase Powers.
2	Low level of Funding/Grant risk	Feasibility	Reduction of grant rate and no grant agreed/secured	Medium	impact on debt financing	Schemes are likely to be unviable if grant can't be secured - explore different funding streams i.e. RTB receipts
3	Purchase and negotiation of section 106 sites	Feasibility/Procurement	over valuation and purchase of section 106 obligated units	Medium	impact on debt financing	We would pay the OMV - if this value wasn't within our hurdle rates, we wouldn't go ahead with purchase
4	Differential inflation rates	Feasibility/PC	The differential between cost and revenue inflation will vary over time and cannot be wholly predictable.	Medium	impact on debt financing	Model increase in interest rates - this will affect the delivery of 3,500 units and if rates were to increase this number would have to reduce
5	Planning risk	Prior to discussion with local authority; Secure planning permission; meeting detailed planning conditions	Planning permission may not be granted for requested scheme. Time taken to secure permission may be longer than expected and conditions may be problematic which may require additional cost.	High	15-20% of additional cost	If planning problems cause delays, then other schemes may need to be substituted in. Feasibility cost risk
6	Construction and delivery risk/Development risk	Build	Construction costs may be higher than expected. Delays also add costs.	Medium/High	additional 5% for construction risk.	High risk - have to be very clear with the financial appraisals and costs of the projects that are taken forward, higher build cost will reduce the number of units we will be able to deliver
7	Sales risk	Marketing	income volatility and housing market may turn down. Units may not sell for expected price or take longer to sell than expected.	Medium/High	2-10% income reduction and additional holding cost	Brexit is high risk and could impact many parts of development including, interest rates, build costs sale prices. properties could be held and let until market conditions improve.