

TELFORD & WREKIN COUNCIL

CABINET - 8th JANUARY 2015

HOUSING INVESTMENT PROGRAMME – BUSINESS CASE

REPORT OF DIRECTOR: DEVELOPMENT, BUSINESS & CUSTOMER SERVICES

LEAD CABINET MEMBERS – CLLR SHAUN DAVIES / CLLR BILL McCLEMENTS

PART A) – SUMMARY REPORT

1. SUMMARY OF MAIN PROPOSALS

- 1.1. This follows the Cabinet report for the Housing & Property Investment Programme approved on the 24th July 2014 for the delivery of a number of housing and commercial opportunities.
- 1.2. This report presents the Business Case (“BC”) to deliver approximately 425 private and affordable rented properties. The BC comprehensively identifies the governance and structure arrangements between the Council and the proposed Wholly Owned Company (“WOC”), building on information in the report approved by Cabinet on the 24th July 2014 and Full Council on the 11th September 2014. If this report is approved, the WOC will implement its Business Plan operating in accordance with this BC framework for the delivery.

2. RECOMMENDATIONS

- 2.1 That Cabinet approve the Business Case as attached at Appendix A
- 2.2 That Cabinet approve the revised terms of reference and governance arrangements for the Project Board Contained within Appendix A (A2)
- 2.3 That Cabinet delegate authority to the Managing Director in consultation with the Cabinet Members for Co-operative Council and Partnership and Finance and Enterprise to approve any minor amendments to the Business Cases providing the borrowing is in accordance with the Cabinet report of 24th July 2014 and full Council of 11th September 2014
- 2.3 That Cabinet delegate authority to the Managing Director to establish the Wholly Owned Company (“WOC”) as detailed within the Business Case.
- 2.4 That Cabinet delegate authority to the Managing Director in consultation with the Cabinet Members for Co-operative Council and Partnership and Finance and Enterprise to approve the Company’s Business Plan providing that it is in line with the Business Case and the borrowing is in line with the Cabinet report of 24th July 2014 and full Council report of 11th September 2014. Cabinet to note that the business plan will include the Company’s lettings and allocations policy, rent setting policy, tenancy terms and enforcement policy. Governance and monitoring of the Business Plan and Company’s performance will be in accordance with the Business Case and the Project Board’s terms of reference and governance arrangements
- 2.5 That Cabinet delegate authority to the Managing Director to appoint and replace the directors of the Company on the Council’s behalf.

SUMMARY IMPACT ASSESSMENT

COMMUNITY IMPACT	Do these proposals contribute to specific Co-Operative Council priority objective(s)?	
	Yes	Regenerate those neighbourhoods in need and work to ensure that local people have access to suitable housing and amenities.
	Will the proposals impact on specific groups of people?	
	No	
TARGET COMPLETION/DELIVERY DATE	Creation of Wholly Owned Company - January 2015 Appointment of Contractor – January/February 2015 Commencement on Site - Spring 2015 Expected delivery of first houses - Autumn 2015	
FINANCIAL/VALUE FOR MONEY IMPACT	Yes	Full financial details are included in the finance comment and as part of the Business Case (Appendix A)
LEGAL ISSUES	Yes	Full legal details are contained within the legal section of the report and as part of the Business Case (Appendix A)
OTHER IMPACTS, RISKS & OPPORTUNITIES	Yes	Full details of the risks and opportunities are contained within Business Case as included in Appendix A (at A4)
IMPACT ON SPECIFIC WARDS	Yes	Southwater (Malinslee Ward) – Cllr K Sahota & Cllr S Davies Hollinswood and Randlay Lorry Park (The Nedge Ward) – Cllr N England, Cllr B McClements & Cllr C Turley Woodlands (Woodside Ward) – Cllr K Guy & Cllr R Evans Springfields Newport (Newport South) – Cllr A Meredith Madeley Court (Madeley) - Cllr Paul Watling & Cllr G Green

PART B) – ADDITIONAL INFORMATION

3. INFORMATION

- 3.1. The Housing & Property Investment Programme will deliver a number of objectives by providing a significant number of quality private rent and affordable rent homes, responding to the housing needs in the Borough. It will also deliver Commercial development opportunities that will provide an enhanced investment as part of the regeneration.
- 3.2. The programme will develop sites which are owned by the Council, bringing forward development and creating regeneration opportunities. The project will create a number of jobs during the construction and operational phase stimulating economic growth. During the operational stage, the programme will deliver income and capital growth for the Council for re-investment in, and protection of, frontline services.
- 3.3. The approved cabinet report of the 24th July 2014 is to deliver approximately 425 houses and a number of commercial opportunities, this BC relates to the houses which will be managed through the WOC. All commercial opportunities will be managed via the Council's existing Property Investment Portfolio ("PIP"). This report seeks approval for the BC which provides the framework, monitoring procedures and Governance for the Council along with the establishment of the WOC and provision to the WOC of the funding as approved by Cabinet to enable commencement of activities.

4. FINANCE

- 4.1. The previous Cabinet report presented the consolidated financial position for both the commercial and the housing development elements of the programme. There are financial, regeneration and economic benefits of physically delivering these elements together, however the Cabinet report concluded that a different delivery vehicle was required for these, being:

- Housing – The Council will establish a wholly owned General Fund Special Purpose Housing Company (“Wholly Owned Company” WOC) to develop new homes on Council owned land. The Council will invest in the housing company by transferring land from its General Fund in return for shares in the WOC and by providing cash equity and debt to the WOC. The Council will also lease a number of apartments above the retail units (Southwater) for the WOC to manage as part of its portfolio.
- Commercial – The Council will deliver all commercial units through the PIP.

4.2. The BC at Appendix A sets out the proposals for the Council to set up a WOC limited by shares to develop new homes. Finance have worked extensively with professional advisors to inform this BC, confirming the commercial, accounting, and taxation positions of the proposals. The results of this work confirms that the net returns detailed in the Cabinet report of 24th July 2014 remain achievable, and will generate a surplus to the Council over the period of the project. Wider economic benefits of increased New Homes Bonus and Council Tax on housing stock will also be achieved which will enable these additional sums to be invested in Council Services.

The capital cost estimate and source of funding for each element of the programme can be summarised as:

Projected Cost (£'000s)	Housing Investment	Commercial	Combined
Construction cost estimate	48,493	6,680	55,173
Land Value and retention of Council owned land for commercial developments	4,125	2,650 (2,650)	6,775 (2,650)
Total Cost	52,618	6,680	59,298
Source of Funds			
PWLB Borrowing	45,743	6,180	51,923
Capital receipt	4,125	500	4,625
Developer contribution	2,750	-	2,750
Total Funding	52,618	6,680	59,298

4.3. A review of the key modelling assumptions has been performed by the Project Team in conjunction with external specialists. As part of this review, the rate at which the Council will borrow from the PWLB has been revised to reflect current rates which have reduced since the original modelling was performed. This reduction in the borrowing rate has enabled an annual allowance to be made to accommodate client management costs associated with appropriate central support services to manage the WOC. All remaining assumptions contained in the Cabinet Report of 24th July 2014 remain valid. Further financial modelling details are contained in the BC attached to this report. Advice has been received on the following key commercial considerations:

- The Council is likely to prudentially borrow from the Public Works Loan Board (“PWLB”), unless an alternative which is more financially viable to the Council is identified, in order to finance the WOC’s construction activities. The financing of the WOC’s activities will be structured as a mixture of loan finance and cash equity in order to optimise the equity returns generated by the WOC and to match the capital structure of a private sector developer.
- In order to ensure the commercial structure is state aid compliant, the General Fund will be required to include a margin over the PWLB interest rate when pricing the loan to the WOC.
- In practice the Council will manage its borrowing requirement through its Treasury management function.

The key commercial metrics for the assumptions within the BC may be summarised as:

Metric	Output
PWLB loan rate	Interest only, 30 year maturity, 3.96%
WOC loan rate	Interest only, 30 year maturity, 5.69%
Equity Internal Rate of Return (IRR%)	5.61%

4.4. The Council's external auditors (KPMG) have been consulted and have confirmed that they are satisfied that the project will deliver an appreciating asset and that the following accounting treatments are acceptable:

- An interest only loan is an appropriate method of finance for the Housing model
- Interest earned during construction may be rolled up into the cost of such construction
- Where the Council has undertaken additional borrowing to fund capital expenditure, it will ordinarily be expected to set aside an annual Minimum Revenue Provision (MRP) for the repayment of such borrowing. However, KPMG have confirmed that for the Housing model, no Minimum Revenue Provision is required to be set aside, on the basis that the housing stock is an appreciating asset and any proceeds on sale will be used to repay the PWLB loan.

4.5. An external review of House Price inflation statistics has confirmed that a more realistic figure of 2.5% in line with RPI inflation could be incorporated in the modelling (2% is included in the previous modelling). This would improve the return on equity investment to the Authority to 6.5% from the 5.61% in the business case.

4.6. The General Fund impact of the housing element of the project over the 30 year term can be confirmed as:

£'000s	Years 1-10	Years 11-20	Years 21-30	Cumulative
Benefit to General Fund Income and Expenditure Account	2,668	7,661	55,864	66,194
Council Tax	3,030	3,836	3,836	10,702
New Homes Bonus	2,922	-	-	2,922
Net income retained by the Council	8,620	11,497	59,700	79,818

The finance model includes revenue benefit from New Homes Bonus (NHB), which has been assumed to be received in financial years up to and including 2022/23. Should the allocation of NHB be extended or curtailed, the model will be refined accordingly. The finance model allows for the growth in income to the Council from Council Tax on the developments throughout the modelling period (30 years). There is a risk that future changes to the Local Government Finance System (LGFS) will reset the base for Council Tax and that this will have the effect of reducing the additional income from this tax. Currently there are indications that the LGFS may be reset in 2019/20 taking effect in 2020/21. However there is no information currently available to allow the implications of any reset to be reflected in the model.

A one-off investment income on the sale of the houses of £41m gross, (£38m net of applicable taxes) is included in the returns above. These returns are in line with those contained within the 24th July 2014 Cabinet report, full financial support will be provided as the project continues. Full details are contained within the BC attached at Appendix A.

Appendix A1 provides details of the annual benefit to the Council's General Fund Income and Expenditure Account for the years 1-10 and 5 yearly thereafter for the life of the project (30 years), analysed between the Housing and Commercial elements of the programme, which are in line with the returns contained within the 24th July 2014 Cabinet Report.

5. LEGAL

5.1. The Council has powers to form, fund and sponsor the WOC under sections 1 and 4 of the Localism Act 2011, section 95 of the Local Government Act 2003, section 24 of the Local Government Act 1988 and sections 2 and 3 of the Local Authorities (Land) Act 1963.

5.2. The Council must approve a business case before the WOC commences any activities. This is the business case presented with this report.

5.3. The Council must also approve the WOC's business plan. This report recommends that this approval is delegated to the Managing Director in consultation with the Cabinet Members for Co-operative Council and Partnership and Finance and Enterprise subject to the business plan being

consistent with the approved business case and approvals given by Full Council at its meeting in September 2014.

- 5.4. All dealings between the Council and the WOC must be on a commercial basis so as to avoid the provision of unlawful state aid by the Council to the WOC. The Project Board will ensure that the terms of the commercial agreements between the Council and the WOC are on this basis under previous delegations given by Cabinet and Full Council.
- 5.5. The Council has been advised that formal EU procurement for this project should not be needed. As with many procurement issues, the procurement without advertisement is not entirely free from risk though the risk is considered small and manageable.
- 5.6. The WOC must have at least one director. The Council has been advised that having a minimum of three directors would be appropriate in order to ensure both the necessary range of skills are available and that the WOC is able to take operational decisions quickly in what is a commercial environment. As sole shareholder in the WOC, the Council has power to appoint (and indeed remove) directors. The initial directors need to be identified and it is proposed that the Managing Director will appoint existing officers as set out in the recommendations. The Managing Director may decide that he should be one of the initial directors.
- 5.7. Given the importance of this project in terms of the social and economic benefits to the Borough and the significant investment of the Council in the WOC it is right that the Council (through Cabinet) should retain a power of decisive influence over the WOC including approval of the initial strategic direction and purpose of the WOC, any amendments to its direction and purpose, approval of the business case and any amendments to it, the governance structure, the Council's investment (both in terms of cash and land) in the WOC, monitoring overall performance and deciding what action to take should the WOC's activities vary materially from the assumptions made in the business case, the business plan or the financial projections. The WOC would otherwise have relative freedom to operate subject to remaining consistent with the business case and business plan.
- 5.8. As the WOC will be a commercial venture it will need to take decisions outside of the normal Cabinet meeting schedule. Some of those decisions may need to be referred to the Council for approval. In addition, and in particular in the early stages of the WOC's life, the Council will monitor the WOC's performance in more detail and on a regular basis. The Project Board would be a suitable body for this role. It is also proposed that delegation of the approval of the WOC's business plan and any amendments to it are delegated to the Managing Director as the Senior Officer of the Project Board in consultation with the Cabinet Members for Co-operative Council and Partnership and Finance and Enterprise.
- 5.9. This report therefore recommends a governance structure which splits these responsibilities between Cabinet, a more formalised Project Board and the WOC Board of Directors. The accompanying revised terms of reference describes this split and the suggested composition of the Project Board and a more detailed list of potential decisions which fall outside of this Board is contained at Appendix A3.

6 IMPACT ASSESSMENT – ADDITIONAL INFORMATION

The opportunities and risks associated with a project of this size and complexity are significant and were indicated in the Cabinet report of the 24th July 2014. As part of the work undertaken to date, these have been considered and mitigated or reduced. There are still a number of key risks that relate to the delivery stage of the programme that are fully detailed within Appendix A4 of the BC and should be considered by Cabinet as part of the decision making process.

7 PREVIOUS MINUTES

Housing Investment Programme Cabinet report 25th April 2013.
Housing & Property Investment Programme Cabinet report 24th July 2014.
Housing Investment Programme Full Council Report 11th September 2014.