

Report of	Meeting	Date
Director of Business, Development & Growth	Council	18.09.2018

A CHORLEY HOUSING COMPANY

PURPOSE OF REPORT

1. To present to Members the financial and strategic case for establishing a wholly owned Local Housing Company (LHC) in order to enhance the quality of private rented homes in Chorley; to expand the provision of affordable homes for local people and to generate income for the Council. The policy option of establishing such a vehicle was contained in the Council's 2018 – 2020 Corporate Strategy.

RECOMMENDATIONS

2. Agree that a mixed tenure model incorporating private rented and affordable housing is the optimum model with private rented homes cross-subsidising the affordable provision.
3. Agree that to deliver a private rented and affordable homes model as outlined requires £13.8 million of loan investment from Chorley Council to be funded via PWLB borrowing.
4. Agree that the Council begin the process of establishing a LHC with the aim of holding the inaugural Board meeting in early 2019.
5. Agree that specialist financial, governance and legal advice will be procured to ensure that the company structure and detailed business case optimises the agreed financial and strategic outcomes.
6. Note the long term nature of the project and that, if more than 120 affordable homes are delivered, the Council will need to consider establishing an independent Registered Provider as a discrete subsidiary of the LHC.
7. Note that in line with all similar vehicles established to date, the approach requires a long term investment strategy of at least 10 years to benefit from the economies of scale associated with owning a significant property portfolio and particularly for the affordable homes element of that portfolio.
8. Agree that further detail including company structure, governance and reporting arrangements be brought back to Executive Cabinet for consideration with the intent being that the management of the LHC will be delivered in-house.

EXECUTIVE SUMMARY OF REPORT

9. Whilst inherently entailing a level of commercial risk, the establishment of a wholly-owned LHC offers Chorley Council an opportunity to both generate income and intervene in the local housing market to benefit local people.

10. By using a LHC vehicle, the Council has the freedom to act with flexibility as financing and governance arrangements mean that the Council can be proactive and innovative.
11. There is evidence of a significant and growing private rented sector in Chorley but with changes to that market not necessarily benefitting households or local communities.
12. There remains a significant and continuous demand for affordable homes despite the Council's notable success in delivering new affordable homes.
13. A noteworthy number of wholly-owned LHCs have been established by Local Authorities with most of them initially funded directly by their Local Authority. This investment has taken the form of loan and/or equity investment.
14. The initiative and associated investment needs to be long term in order to meet the Council's strategic goals. In many senses the Council will be assuming the role of a patient investor: investing to generate long term income alongside the delivery of wider social and economic benefit.
15. The Council will be investing in assets that can be sold or redeveloped in the future.

Confidential report Please bold as appropriate	Yes	No
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CORPORATE PRIORITIES

16. This report relates to the following Strategic Objectives:

Involving residents in improving their local area and equality of access for all		A strong local economy	✓
Clean, safe and healthy homes and communities	✓	An ambitious council that does more to meet the needs of residents and the local area	✓

BACKGROUND

17. A key project included in the Council's Corporate Strategy is the development of a Housing Strategy. One of the identified priorities for the Housing Strategy is the development of a business model for a Council-led Housing Company. The outcome of the work on this business model is reported here for Members' consideration. The development of a Housing Company also forms part of the Council's Medium Term Financial Strategy.

INTRODUCTION

18. The Government report "Fixing our Broken Housing Market" published in February 2017, recognised the importance of local authorities in enhancing residential supply:

"Increasingly and across the country local authorities are using innovative new models to get homes built in their area. There are a number of good examples of Local Development Corporations, local housing companies and/or joint venture models building mixed sites, which include new market housing for sale or private rent, as well as affordable housing. We welcome innovations like these, and want more local authorities to get building."

Given the Government's support for local authority innovation, Chorley Council determined to develop a business model for a Council owned LHC. A number of different scenarios have

been subject to extensive financial modelling and these considerations include the purchase of homes directly from developers; the development of homes on Council-owned land and the purchase of homes in the wider housing market. A working group has met several times to consider the options in more detail and research into other local authority owned LHCs has been undertaken.

19. As the Government report highlighted, the development of wholly-owned arms-length company vehicles is an increasing trend and a later section provides more detail of a number of these. This list is not exhaustive but demonstrates the breadth of such companies together with the associated Local Authority investment.
20. It is important to note that the Localism Act 2011 and the Local Government Act 2003 requires that where local authorities undertake commercial activities that generate income, this must be done via a Company. A wholly-owned Company would need to be established therefore for the acquisition and management of private rented homes.
21. There are many reasons why Local Authorities establish LHCs and often the purpose of those vehicles evolves over time. However, it is important to establish clarity of purpose from the outset not least because governance arrangements need to be developed which reflect Member priorities. This strategic context is outlined below.

CONTEXT

Affordable Homes

22. Despite significant housebuilding activity in Chorley over the last five years and in particular the addition of 638 new affordable homes, there remains a significant and continuous demand for affordable homes.

Plan period (1 st April-31 st March)	Net completions	Affordable completions
2013/14	582	129
2014/15	723	165
2015/16	597	85
2016/17	517	87
2017/18	661	172
TOTAL	3080	638

Over the last 2 years (only) over 80% of new affordable provision has been either 1 or 2 bedroom properties. According to Select List, demand is predominantly for smaller homes, with over 90% of those currently registered, looking for a 1 or 2 bedroom home. However, arguably this demand is driven in large part by current Housing Benefit under-occupancy rules which encourage families in receipt of Housing Benefit to rent smaller properties.

23. Although 638 new affordable homes have been developed in Chorley over the last 5 years, demand for affordable accommodation remains very high with 1,050 households currently registered on Select Move. New affordable provision is currently wholly dependent upon the delivery of S106 obligations and this is necessarily a function of the wider housing market and viability considerations for individual sites. In other words, the Council currently has limited means of positively influencing supply.

24. As part of a scrutiny task and finish group the Council has been engaging with residents in the social housing sector on housing standards. The findings of this work are yet to be published however it will form an evidence base which will form one element of the business case for investing in the affordable housing market in Chorley.
25. The Council can build or acquire 200 units without reopening the Housing Revenue Account (HRA). The Council currently holds 6 units at Cotswold House and is acquiring another 10 for Syrian Refugees and 65 at Primrose Gardens. This will leave up to 120 units that the Council could acquire and still remain under the HRA cap. Re-opening the HRA is not desirable as any surplus income must be ring-fenced and receipts from sales can be retained by central government with restrictions on how a local authority invests its retained receipts.

Private Rented Homes

26. Evidence from local agents indicates that the private rented housing market in Chorley is good and very good in certain geographical locations.
27. Census data in 2001 states that 2,639 households lived in the private rented sector (6.7% of all households) and by 2011, this had increased to 5,010 (11.1% of all households). This is an annualised increase of 9%. Applying this annualised trend from 2011 to 2016, results in an estimated 7,259 households living in private rented accommodation now. This data analysis gives results which are broadly in line with similar data analysis undertaken for Wigan and Bolton which experienced similar increases between 2001 and 2011.
28. Despite the growth in the private rented sector in Chorley, it is the case that there are poor management and maintenance practices evident in some areas. This is particularly the case in neighbourhoods with a preponderance of lower value properties, rented by people with limited choice. By taking a socially responsible approach, a Council-owned LHC would be able to address some of these issues and create a 'gold standard' of high quality management. The LHC would be able to work collaboratively with relevant Council teams to provide homes to those in need as well as those demanding a home commanding a higher premium in a sought-after location.
29. Currently the average private landlord in the UK owns only one or two properties and this is not conducive to either a long-term approach or wider neighbourhood interest. As well as generating revenue for the Council, long term ownership of residential properties will enable the Council to provide high quality individual property management and also enable broader neighbourhood issues to be addressed where necessary. This is only possible where a portfolio is significant and decisions can be taken with a strategic perspective which considers wider, more enduring issues. In other words the LHC can intervene effectively to benefit not only the Council and individual households but also the wider Chorley community and economy.
30. Given the complex context described above, it is proposed to develop a mixed tenure approach to the establishment of a LHC for Chorley. This flexible tactic will enable the LHC to include an optimum mix of affordable rent and private sector rent homes in order to deliver the Council's strategic aims. It may be possible, in time, for the Council to consider developing or promoting development on its own land in order to further the aims of the LHC. This is likely to accelerate the number of properties in the portfolio and create financially advantageous economies of scale sooner.

National Comparators

31. It is estimated that there are probably as many as 150 LHCs in England. They have been established across the political spectrum and by different types and size of Council.

However, the largest concentration is in London and the South East. Many LHCs have been established because of frustration with the pace, scale and cost of delivery by house builders and housing associations. The majority of LHCs are wholly owned by their Local Authority which provides loan finance and in some cases, land. There is a significant momentum associated with the establishment of such vehicles as local authorities exploit the flexibility offered to benefit local people.

32. The scale of investment in LHCs inevitably differs significantly with some London Boroughs including investment into schools and other community facilities as well as housing. Blackpool Council have invested over £27 million into Blackpool Housing Company with that LHC targeting former B&Bs in central Blackpool. Ermine Street Housing, established by South Cambridgeshire Council are investing £100 million in private rented homes in order to generate income for the Council's general fund. In the North West a number of local authorities have established LHCs including Salford and Liverpool City Councils in order to accelerate residential growth and in particular address issues of affordability.
33. Although every LHC is unique and the level of investment necessarily bespoke to that vehicle, the enduring factor is the long-term nature of the investment and the desire of most LHCs to deliver wider social and economic aims as well as income to the Council as investor.

FINANCIAL MODELLING

34. In order to make a financial contribution to the Council's general fund and above all improve provision of housing in the Borough the model suggests the following mix of private rented and affordable properties over a seven year period up to 2025/26. Further analysis is provided in Appendix 1.

<i>Capital Expenditure</i>	Private Rental	Affordable	Subtotal
Total Number of Homes	71	50	121
Cumulative Borrowing	£8,424,400	£5,330,100	£13,754,500
<i>Income</i>			
Net Annual Income	(£512,900)	(£300,000)	(£812,900)
Annual Deficit/(Surplus) Housing Company	(£4,900)	£69,700	£64,800
Annual Borrowing Costs to LA (2.56%)	£299,700	£189,600	£489,300
Annual Repayment of Loan from HC (4%)	(£392,200)	(£217,500)	(£609,700)
Annual Deficit/(Surplus) Chorley Borough Council	(£92,500)	(£27,900)	(£120,400)
Annual Deficit/(Surplus) TOTAL	(£97,400)	£41,800	(£55,600)

35. As outlined in appendix A the estimated annual deficit/(surplus) in the first 10 years are summarised below, the cumulative deficit rises to £225k with a payback period of 9 years. This can be mitigated further by bringing the number of properties forward more quickly.
36. Private Rental Assumptions and Explanations:
- Purchase price assumptions and rental levels have been confirmed with several local agents and are also reflective of the Council's experiences of purchasing properties for the Syrian Refugee Resettlement Programme.
 - Purchase prices vary from £80k to £160k.
 - Rental levels vary from £450 to £800 per month.

- It is assumed that 50% of the purchases will be new-build – this reduces the required repairs and maintenance fund.
- Annual 1% rent increases above CPI are assumed but private rents are necessarily driven by the market with certain areas of Chorley commanding a premium with other areas of concentrations of terraced housing, facing greater competition.
- Void rates are between 6.5% and 8% depending on the property types to reflect that terraced homes have generally slightly higher void rates. The bad debt provision is 2%. Bad debt and void levels have been tested with others involved with the creation of local housing companies and are considered reasonable.
- The model assumes that the Council borrows from PWLB at 2.56% and lends on to the Housing Company at 4.0%. This requires external legal and financial confirmation but is in line with other LHCs.
- The rate of 4.0% should reflect a commercial rate so as to not breach State Aid rules. Too high a rate will cause unsustainable losses for the Company. Advice will be sought regarding this issue as well as advice regarding other methods of financing the LHC including purchasing shares and options for the LHC to refinance its loan in future years.
- The Council will need further formal guidance regarding its ability to borrow from PWLB and lend it on to the LHC as well as the treatment of the repayment of the loan.

37. Affordable Assumptions and Explanations:

- To deliver 50 homes the council would borrow approximately £5.3m; this assumes £0.9m grant funding from Homes England. This assumes that 60% of the homes purchased for affordable rent will be eligible for the grant funding. Grant from Homes England is included but with no further discount to open market value assumed; this is regarded as prudent.
 - Rents are set at 80% of market rents.
 - Purchase prices vary from £90k to £140k.
 - Rental levels vary from £360 to £640 per month.
 - Voids are modelled lower than the PRS model at 6% due to lower expected turnover of tenants with bad debts at 2%.
 - The Council will loan to the LHC at a rate of 4% (CBC's cost of borrowing is currently 2.56%).
38. Based on the analysis provided, the LHC makes a loss in both the delivery of PRS and affordable. However, due to the loan repayment by the LHC to Chorley Borough Council there is a net surplus of £97k to the Council under the PRS model and a £42k loss with affordable provision. The affordable provision is subsidised by income from the private rented properties; however, the acquisition of affordable properties is still reliant on external funding.
39. A grant from Homes England at £30k per plot is assumed for 60% of the affordable properties. The Council is able to access this grant as we are a Registered Provider and have experience of managing specialist accommodation at Cotswold House and shortly Primrose Gardens, for which we have previously secured Homes England funding. There is currently limited general needs management experience and this would need to be addressed if the option of acquiring and managing affordable homes under the HRA limit is pursued. It is suggested that the experience of staff in managing specialist accommodation could be further explored as higher grant rates are currently available for specialist accommodation, and this could be a further strategy development for the LHC at some point.
40. Another potential area of investigation for the LHC is empty homes. The Council has had some success in bringing empty properties back into use but no grant has been secured from Homes England to pursue a more systematic approach. It is estimated that there are

at any one time, approximately 150 long-term voids in the town. A pro-active LHC could seek to secure Homes England financial support and acquire much-needed homes for affordable rent. The blight that such houses cause would also be addressed.

41. If the volume of affordable units exceeds 200 (gross), then an option would be to establish a new RP under the auspices of the LHC. It is estimated that the process would take some time and cost approximately £65k. This is the cost of establishing a legal entity with a long term business plan to a standard approved by the Independent Regulator. In addition to this, a full integrated housing management system would need to be established, together with a staff structure and Independent Board.

RISK

A high level risk register has been completed and this will be developed further once the full professional team have been appointed. The risks that have been captured to date include but are not limited to the following:

Risk	Risk Description	Mitigation Measures
Conflicting Purposes	Different stakeholders have different views about the purpose of the housing company.	Ensure that comprehensive briefings and reports are taken to relevant meetings and clear agreement reached. Establishment of officer Working Group to that all internal stakeholders are included.
Government Policy Changes	A number of Government policy changes could impact adversely on the Company. Changes could range from the ability of Local Authorities to finance 3rd party enterprises using PWLB finance to changes in Right to Buy or other pertinent legislation.	The development of the financial model is being undertaken on a very prudent basis although no planning can take account of unforeseen changes.
		Monitor Government announcements; analysis of the broad policy direction of travel is ongoing.
		The Council could consider the involvement of 3rd party investors to mitigate any potential adverse changes.
		Changes to Right to Buy legislation are considered a small risk with PRS and also very low Right to Acquire rate in Chorley. Ensure that business plan includes appropriate sensitivity testing.
Incorrect Financial Assumptions	The range of assumptions in the financial model are incorrect or incomplete. This impacts adversely on the Company's ability to repay its loan to the Council.	Extensive benchmarking is being undertaken to ensure that the financial assumptions are based on actual performance reality.
		Advice has been sought from external specialist advisors who have indicated that the assumptions currently being made are broadly correct. Further specialist advice will be sought during the development of the Detailed Business Case.
MTFS	Adverse impact on MTFS	MTFS updated with latest income generation profile as and when project plan is updated.
Market Collapse	The market for rented homes in Chorley collapses.	Extensive local market research has taken place to gauge the strength of the local rented market.
		In the event of market collapse, the company can sell its property portfolio.

IMPLICATIONS OF REPORT

42. This report has implications in the following areas and the relevant Directors' comments are included:

Finance	✓	Customer Services	
Human Resources		Equality and Diversity	
Legal	✓	Integrated Impact Assessment required?	
No significant implications in this area		Policy and Communications	

RISK

A risk register has been completed	Yes	No
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COMMENTS OF THE STATUTORY FINANCE OFFICER

43. The financial implications are discussed in the body of the report and indicate that under the set of assumptions in the model the Housing Company in the initial years would generate an overall loss until year 6. The payback period is estimated to be in year 9.
44. Members should note that whilst the assumptions have been tested they are subject to variation, in particular when considering the long-term nature of the project.
45. Further specialist financial advice will be sought during the development of the detailed business case and governance arrangements.

COMMENTS OF THE MONITORING OFFICER

46. Under the legislation the Council are required to set up a trading company where the main purpose of the scheme is income generation. In this instance although the report properly identifies the social benefits of the proposal in delivering social rents, the income aspect should not be ignored and it is clearly beneficial to establish the LHC vehicle at an early stage to ensure the Council are legally compliant.

Mark Lester
 Director of Director Business, Development & Growth

There are no background papers to this report.

Report Author	Ext	Date	Doc ID
Claire Nangle	5725	10.09.2018	Housing Company Council 18.09.18

Appendix 1: 10 Year Profile of Private Rented and Affordable Homes

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
<i>Capital Expenditure</i>										
Homes Owned at the Start of the Year - PRS	5	20	35	49	62	71	71	71	71	71
Homes Owned at the Start of the Year - Affordable	5	14	23	32	41	50	50	50	50	50
Homes Owned at the Start of the Year - Total	10	34	58	81	103	121	121	121	121	121
Value of Homes Purchased in Year	1,071,000	2,733,600	2,790,900	2,711,900	2,652,300	2,267,900	0	0	0	0
Fees and Tax (3%)	32,200	82,000	83,700	81,400	79,600	68,000	0	0	0	0
Homes England Grant (£30k per house) - Affordable only	(90,000)	(180,000)	(180,000)	(150,000)	(150,000)	(150,000)	0	0	0	0
Total in year Borrowing	1,013,200	2,635,600	2,694,600	2,643,300	2,581,900	2,185,900	0	0	0	0
Cumulative Borrowing	1,013,200	3,648,800	6,343,400	8,986,700	11,568,600	13,754,500	13,754,500	13,754,500	13,754,500	13,754,500
<i>Income</i>										
Rental Income	(56,200)	(208,000)	(370,800)	(535,000)	(701,900)	(848,300)	(873,700)	(900,000)	(927,000)	(954,700)
Voids (PRS 6.5% or 8%; Affordable 6%)	3,800	14,500	25,900	37,400	48,900	59,000	60,800	62,500	64,400	66,300
Net Rental Income	(52,400)	(193,500)	(344,900)	(497,600)	(653,000)	(789,300)	(812,900)	(837,500)	(862,600)	(888,400)
<i>Expenditure</i>										
Bad Debt (2%)	1,100	4,200	7,500	10,700	14,000	17,000	17,500	18,000	18,600	19,100
Repairs and Maintenance Fund	10,000	40,000	90,000	110,000	130,000	140,000	142,800	145,600	148,600	151,600
In-house Management - PRS	33,300	33,300	33,300	33,300	33,300	33,300	33,300	33,300	33,300	33,300
In-house Management - Affordable	37,200	37,200	37,200	74,400	74,400	74,400	74,400	74,400	74,400	74,400
Repayment of Loan to LA (4%)	47,200	162,000	282,100	399,300	513,700	609,700	609,700	609,700	609,700	609,700
Total Expenditure	128,800	276,700	450,100	627,700	765,400	874,400	877,700	881,000	884,600	888,100
Deficit/(Surplus) Housing Company	76,400	83,200	105,200	130,100	112,400	85,100	64,800	43,500	22,000	(300)
Borrowing Costs to LA (2.56%)	36,000	129,800	225,600	319,700	411,500	489,300	489,300	489,300	489,300	489,300
Repayment of Loan from HC	(47,200)	(162,000)	(282,100)	(399,300)	(513,700)	(609,700)	(609,700)	(609,700)	(609,700)	(609,700)
Deficit/(Surplus) Chorley Borough Council	(11,200)	(32,200)	(56,500)	(79,600)	(102,200)	(120,400)	(120,400)	(120,400)	(120,400)	(120,400)
Deficit/(Surplus) TOTAL	65,200	51,000	48,700	50,500	10,200	(35,300)	(55,600)	(76,900)	(98,400)	(120,700)