Appendix A

CAPITA

Northampton Borough Council

Review of Housing Development Proposition - Executive Summary October 2017

CAPITA

1. Contents

1. Introduction

Northampton Partnership Homes (NPH) have prepared a proposition and draft Development Agreement for the creation of a new 10-year new build housing programme.

The approach set out within the proposed development agreement is that the Council and NPH will enter into a non-legally binding development agreement which operates as a framework under which the Council and NPH will seek to identify sites which can be developed to achieve 80 new homes per annum for 10 years. The developments will proceed either on the basis of Model A or Model B

- Model A - Development will be undertaken by NPH as a development agent for NBC on HRA land.

- Model B – Where RTB 1-4-1 receipts have been exhausted or schemes are to be developed with properties for sale or market rent or where development within the HRA is not viable, land will be transferred from NBC to NPH at minimum cost and the new development undertaken within NPH ownership.

The business case put forward by NPH is multifaceted but stems from the need for more affordable rented housing. Other benefits identified within the Development Agreement as supporting the business case are:

- Strategic mechanism for the use of RTB retained 1-4-1 receipts

- Diversity within the housing market – different tenures and rents as well as the option for market sale housing

- Revenue from rents, council tax, inward public and private investment and the new homes bonus

- Benefits for the local economy, stemming from development activity and improving land values

- Protection from rent decreases and RTB requirements

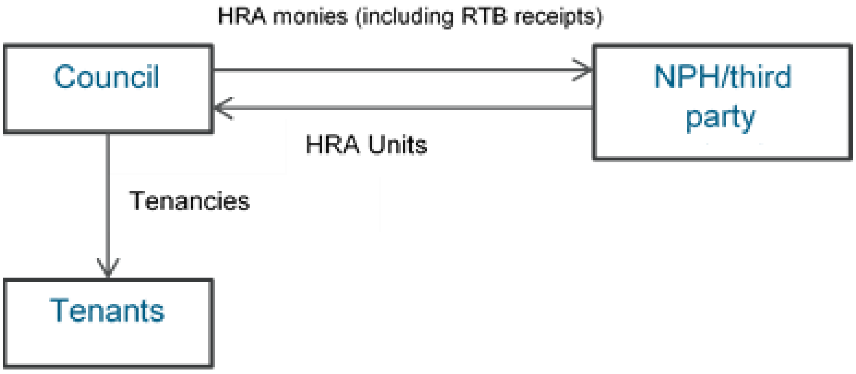
2. Legal Framework

Model A involves development within the Council's HRA.

The Council is entitled to rely on its powers under Section 9 of the Housing Act 1985 to justify the development of housing for housing need within its administrative area. There are no other powers that the Council needs to rely upon in the context of Model A.

From a procurement perspective, we would anticipate that the relationship between NPH and the Council is such that the Teckal exemption can be relied upon in relation to the procurement of NPH's services. The build works, whether contracted for directly by the Council or via NPH will need to be subject to public procurement regulations.

Diagrammatically, Model A looks like this:-



With Model B there are a number of additional legal considerations. These involve the statutory provisions associated with the transfer of land, the provision of financial assistance and state aid rules:

- Subject to state aid compliance, vacant HRA land which is to be developed as privately let accommodation can be transferred to NPH at any price provided the Council is not entitled to manage or maintain the properties under a pre-existing agreement or arrangement; and

- If the disposal is at an undervalue (as Model B anticipates) and involves general fund land, the recipient of that land must be a registered provider (which NPH is not).

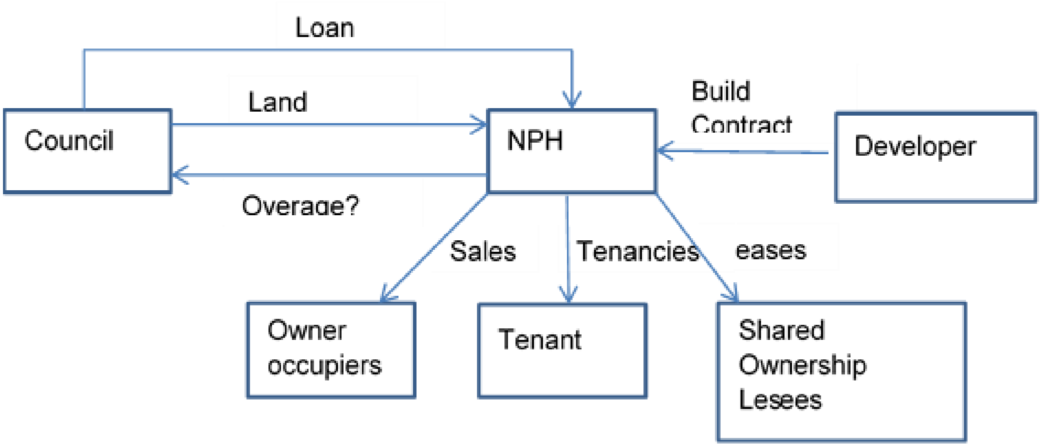
- The council is able to provide financial assistance which takes the form of a loan or a grant for the purposes of (or in connection with) the provision of privately let accommodation.

- Where a local authority is providing financial assistance to a third party, consideration needs to be given to whether it is providing that assistance in compliance with state aid rules. There are two exemptions which are noteworthy within the context of this report and NPH's proposals:

    i. The market economy investor principle. This asserts that a public body is not providing state aid when it is acting like a private investor in the market economy. The test is whether a private investor would invest on comparable terms.

ii. where the financial assistance is provided to facilitate the provision of assets which are of social or general economic interest (**SGEI**), that assistance may constitute permitted state aid. Social (or affordable) housing is capable of benefitting from this exemption.

Diagrammatically, Model B looks like this:



The reference to "overage?" is intended to flag the fact that some form of contractual arrangement would need to be in place for the Council to benefit from any future uplift in value realised in relation to units developed with the benefit of the Council's funding – due to NPH's asset lock.

3. HRA Capacity for funding new build

To evaluate what is affordable within Model A we have prepared an up to date HRA business plan model to test the capacity for the HRA to support additional new provision.

At the start of 2017/18 there was £5.7m unused RTB 141 receipts available to support the associated costs. This component of total RTB receipts have to be used within three years on eligible new provision expenditure, otherwise they must be paid to the government with interest at 4% above the base rate. However, a significant constraint arises as only 30% of eligible costs can be met from RTB 141 receipts, so the balance must be met from other capital resources.

Our modelling indicates that:

- The Council is not able to fully use all the projected 141 receipts because its available resources (to fund the 70% proportion) are constrained. Unless the Council can work with a partner then we are projecting that from 2020/21 a proportion of RTB 141 receipts will have to be repaid. These repayments are expected to total £6m by 2026/27. In addition the interest charge on these repayments is expected to total £855k.

- In addition to the 192 new dwellings included in the existing HRA capital programme, there is capacity for a further 308 new dwellings over the next 10 years, making 500 in total to year 2026/27.

4. Advantages of Model B

Advantages of Model B include:

- NPH already exists, has a core development team and its leadership is ambitious to pursue a development partnership with the council. It is already managing the existing NBC housing stock and is acting as development agent for the current new build programme.

- Unlike the Council's HRA NPH is not constrained by a debt cap and is able to borrow to fund the cost of new development.

- NPH can build affordable rented and market rented housing, shared ownership and market sale housing

- NPH is not a registered provider. Under current rules the housing it owns will not be covered by the right to buy and will not be subject to HCA rent controls.

- Margin on loan to NPH - The council will be able to generate revenue by charging a higher rate of interest to NPH than it incurs either through its own borrowing or use of balances. Charging NPH interest at a commercial rate means that NPH can deduct its interest charges from taxable profits.

- New Homes Bonus – New affordable rented housing attracts government funding equivalent to the national average band D council tax + £350 for each of the four years following construction. Our modelling indicates this will bring in £3.4m of revenue between 2022/23 and 2034/35.

- Land Transfers – Any capital receipt from the disposal of land to NPH would not be subject to capital receipts pooling and would be usable for any legitimate capital purpose. There will need to be a downward adjustment to the HRA capital financing requirement (and a consequent impact on General Fund capital charges) if the receipt from housing land disposals is used for any purpose other than housing or regeneration.

5. Alternative Models

Our approach, in identifying alternative options, has been to focus on aspects of NPH's offer which are arguably sub-optimal. We identify these to be the following:

- RTB 141 Receipts - The rules concerning the use of RTB 141 receipts prevent these receipts being used by a body in which the council has a controlling interest. Without an alternative development partner the council will continue to be required to repay an estimated £11m of 141 receipts and £1.6m of interest (30 years);

- NPH's status as a company limited by guarantee, meaning that the Council is unable to receive profits derived from development activity in the form of distributions which can be received as revenue within the general fund;

- NPH's non charitable status meaning it is unable to obtain relief from corporation tax

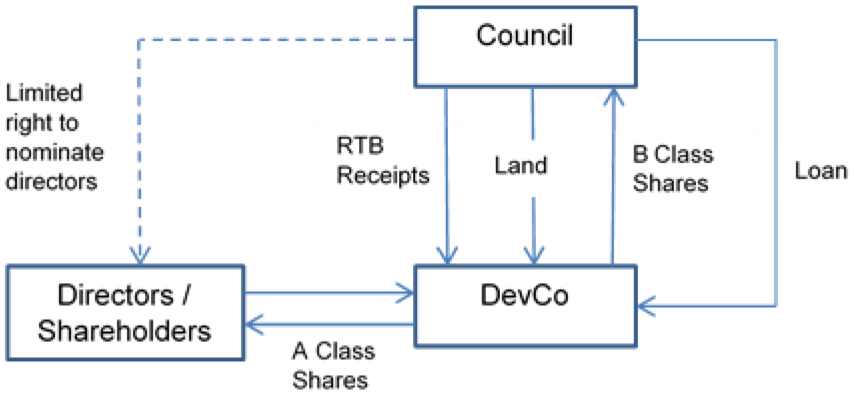
- NPH's unregistered status and its status as a company limited by guarantee – meaning that no relevant housing provider or group SDLT relief is available in respect of land disposals from the Council to NPH.

Having regard to these shortcomings three alternative options are considered:

5.1 Option 1 – Invest in independent DevCo

This involves the establishment of one new entity to undertake all development activity envisaged. This entity would be established as a company limited by shares but structured so that the Council's influence falls short of constituting a controlling interest, whilst it remains the primary beneficiary of distributable profits. A means by which this can be achieved is creating two classes of shares, one which entitles the shareholder to dividends (but few or no voting rights) and one that entitles the shareholder to voting rights but little or no dividends. This would mean it would be able to receive RTB 141 receipts from the council (NPH cannot receive RTB 141 receipts) and distribute profits back to the council.

Diagrammatically, Alternative Option 1 looks like this:



5.2 Option 2 – Controlled DevCo and Independent Charity

Option 2 involves the establishment of two separate entities, a company limited by shares (DevCo) and a community benefit society (CBS).

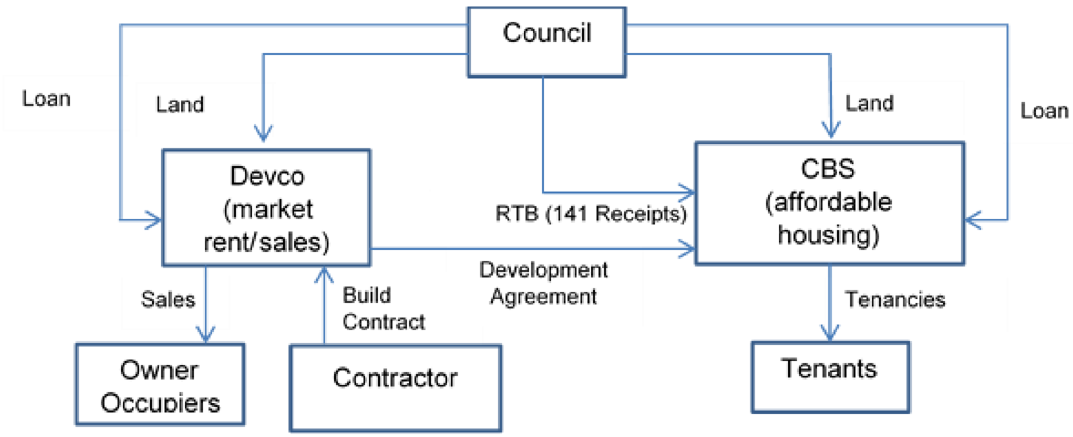
The DevCo would undertake the development of:

- Affordable rented housing - to be owned and managed by the CBS.
- Market rented / market sale housing – to be owned and managed by the DevCo.

This entity could be wholly owned by the Council or jointly owned with NPH or another person. By establishing the DevCo as a company limited by shares, profits generated within the entity would be capable of being distributed to its shareholders. Any monies flowing back to the Council through distributions would be payable into the general fund. If the Council owned more than 75% of the share capital in the company it may also benefit from SDLT group relief in respect of any land transferred by the council.

The CBS would purchase and manage the affordable rented housing envisaged within Model B. It would be established on terms which permit the Council to have a level of influence, but influence which falls short of constituting a controlling interest. This would enable RTB 141 receipts to be received by that entity, thus maximising the RTB monies available to the Council. The CBS could be established with or without charitable objects.

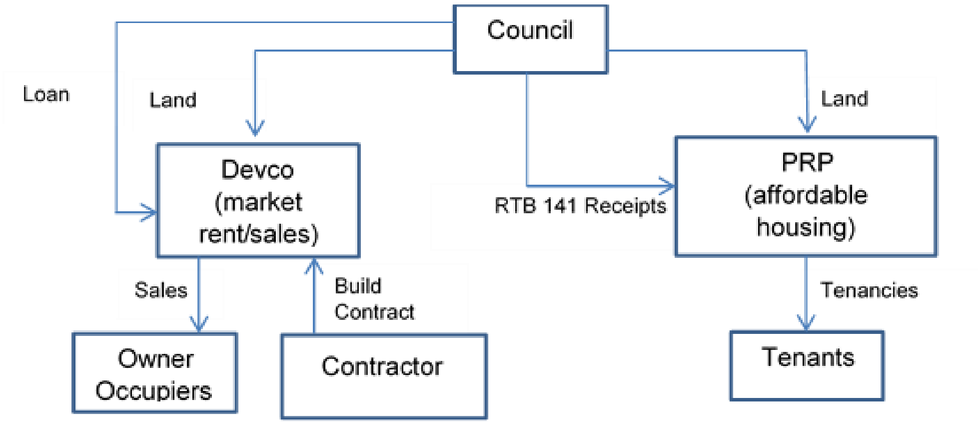
Diagrammatically, Alternative Option 2 looks like this:



5.3 Option 3 – Controlled DevCo and PRP Grant Funding

This is a variant on Option 2 but relies on an existing PRP to fund and deliver affordable rented housing in return for grant (funded from RTB 141 receipts). Grant funding a PRP is a traditional route to funding affordable rented housing. Typically, the local authority provides resources for the PRP to develop new homes in return for giving the council nomination rights over the development.

As with Option 2 a controlled DevCo could develop market rented housing, with council support in the form of loans and land. This is illustrated below.



This option protects the council from exposure to development risk in respect of the affordable rented housing. This is weighed against the lack of ownership and control on the council's part. Nomination rights will be subject to negotiation and may be limited.

Although this provides an option to use 1-4-1 receipts that would otherwise be returned to government in some cases it may prove difficult to find a local provider able to use the receipts within the Council's timescale.

6. Emerging Government Policy Implications

6.1 Context

Since the introduction of self-financing there have been a host of government policy initiatives that have been to the detriment of local authority housing finances:

- A series of government imposed 1% rent reductions for 4 years from 1 April 2016;
- Encouraging right to buy (RTB) by increasing RTB discounts;
- Extending the RTB (and the associated discounts) to housing association tenants to be paid for by a levy charged to local authorities;
- The introduction of Universal Credit and Benefit Cap;
- Local Housing Allowance from 2019/20 - housing benefit received by tenants will be capped at this level and thus where/if rents are greater than the LHA there will be a greater likelihood of rent arrears and bad debts;

- Spare Room Subsidy which, since April 2013 has limited the level of housing benefit available to tenants who have one or more 'spare' bedrooms and are therefore deemed to be under occupying.

The Housing White Paper, published in February 2017 included the following headline proposals:

- Improving Accountability – A standardised approach for assessing housing requirements and a new housing delivery test will be introduced.

- Expanding the definition of affordable housing – To include Starter Homes, Discounted Market Sale Housing, Affordable Private Rented Housing and Intermediate Housing.

- Reducing the emphasise on Starter Homes – The requirement that 20% of all homes on developments over a certain size be Starter Homes is to be dropped and replaced by an expectation that 10% of homes on housing sites be a mix of affordable housing types

- Extended support for the Help to Buy Equity Loan Scheme - £8.6bn committed to 2021

- Build to Rent – There is a separate consultation on a range of measures to support Build for Rent. The new Affordable Private Rented tenure, now included in the definition of affordable housing, is suitable for development under this scheme

- Right to Buy – The government want to see tenants of local housing companies offered a right to buy (equivalent to what is available to tenants of council owned housing)

More recently at the Conservative Party conference on 4th October Teresa May pledged to spend an additional £2bn on affordable housing. She said "We will encourage councils as well as housing associations to bid for this money and provide certainty over future rent levels".

Following the conference further details on the government's proposals for rent increases were published. Increases are to be capped at CPI + 1% for 5 years from 2020. The modelling prepared for this report is based on increases of CPI + 0.5% during this period so this announcement will be beneficial both in respect of the council's HRA and the viability of social and affordable rented housing development.

6.2 What does this mean for Northampton?

The implications of policy changes since 2012 and the 2017 White Paper announcements are pertinent because:

1. Expectations for the capacity of the HRA to contribute to the delivery of new affordable homes has fallen as a result of the significant loss of HRA revenues resulting from the imposition, through the Welfare Reform and Work Act, of 1% rent reductions between 2016 and 2019. From 2019/20 HRA finances will come under further pressure as a result of the Higher Value Voids Levy.

2. Following the 4th October speech by the prime minister there is now a prospect of some government support for local authority new build

3. There is an emphasis on neighbourhood development plans. Authorities will be required to have a rolling programme of potential sites and an appraisal mechanism which offers local communities an opportunity to have a voice in the design of new housing.

4. The White Paper emphasises the government's backing for Local Authorities to build and its intention to address issues that hold back house building

7. Evaluation

7.1 Modelling Assumptions

For the purpose of this review we have prepared a bespoke financial model based on the delivery of new units from 2020/21 which, when combined with the HRA affordable programme, result in 80 new dwellings per year. Our programme therefore delivers 480 new (non HRA) dwellings as set out below.

Year	HRA Programme	Used to Evaluate Model B	Total
2017.18	24	0	24
2018/19	106	0	106
2019/20	141	0	141
2020/21	41	39	80
2021/22	39	41	80
2022/23	39	41	80
2023/24	38	42	80
2024/25	24	56	80
2025/26	24	56	80
2026/27	24	56	80
2027/28	29	51	80
2028/29	31	49	80
2029/30	31	49	80
Totals	**591**	**480**	**1071**

We have added a scheme of 100 market/intermediate rented units, being constructed in 2020/21 to the programme of 480 affordable rented homes. Rents of £160 per week have been modelled for these dwellings, compared to an average of £115 per week for the affordable rented housing. The inclusion of market rented housing is for three reasons:

1. The government has indicated that it will not be supportive of the use of council owned companies to get around HRA borrowing constraints. However, mixed tenure housing programmes, addressing a wider set of priorities than HRA newbuild, are likely to be more acceptable.

2. There is a need for more good quality market/intermediate rented housing in Northampton

3. Revenues from market/intermediate rented housing will improve investment returns on a programme otherwise focussed entirely on affordable rented housing.

We have made two further changes to the assumptions used by NPH:

- We have assumed that rather than being at a nominal value, land transfers from the council will be at an indicative market value.

- We have used 52 rent weeks rather than 48.

7.2 Model A – HRA Housing

New build within the council's HRA has a number of advantages over other options:

- The council retains ownership and control over the housing
- RTB 141 receipts can be used (they can't be used where ownership is with an entity controlled by the council, such as NPH)
- There are no tax implications
- Any revenues are retained by the council in the HRA
- New housing can be managed by NPH with minimal marginal costs
- Borrowing does not impact on the general fund Capital Financing Requirement

Using NPH as the development agent is advantageous because:

- There are already close links between the council and NPH
- NPH already acts as the council's development agent
- NPH should not have to pay corporation tax in respect of any profits generated from this activity. Grant Thornton have advised NPH that confirmation from HMRC should be obtained in advance that the proposed design and build services would still qualify for ALMO status and not be subject to corporation tax. The council should make sure this confirmation is obtained.

An alternative development agent may have greater experience of developing schemes and procuring contractors but it is likely that NPH could buy in any additional expertise required and develop further its own development team. In our main report we have identified where we consider there are gaps in the existing NPH staff structure.

7.3 Model B – Development Partnership Arrangements

We have reviewed each of the alternative partnership arrangements. They each present differing financial attributes which we have set out in the table below.

	Use of 141 Receipts	Access Distributable Profits	SDLT Relief	Corporation Tax Relief	Avoid RTB	Avoid Rent Controls
NPH - Model B NPH - Ltd by guarantee / Wholly owned	x	x	x	x	√	√
Alternative Option 1 DevCo - Ltd by shares / not controlled / Could be PRP	√	√	√ (only where RP & HCA funding)	x	√ (if not RP)	√ (if not RP)
Alternative Option 2 DevCo Ltd by shares - controlled by NBC Market Sales Market Rent CBS - not controlled Affordable Rent	√	√ (in respect of DevCo operations)	√ (DevCo - group relief; CBS charity or not for profit RP or grant funded RP)	√ (if CBS charitable)	√ (if CBS not RP)	√ (if CBS not RP)
Alternative Option 3 DevCo Ltd by shares - controlled by NBC Market Sales Market Rent Independent PRP Affordable Rent	√	√ (in respect of DevCo operations)	√ (DevCo - group relief; PRP charity or not for profit RP or grant funded RP)	√ (if PRP charitable)	x	x
Approx. Value of Attribute	£18.7m years 3-12	Opt 1 - £83m Opt 2 - £30m Opt 3 - £31m years 33-50	£392k years 3-12	NPH - £39m Opt 1 - £46m Opt 2 & 3 - £11m years 8-50	mitigated by cost floor rules	Dependant on future rent policy

When modelled against our indicative programme these variations in attributes mean that the financial implications of delivering a development programme differ quite considerably between the options.

The net present value of the cashflows arising from the respective options are summarised below along with the year when associated council lending would be repaid.

50 Year Net Present Value (5% discount rate – no residual value)					
Structure Options	**Council** £m	**DevCo** £m	**CBS** £m	**Total NPV** £m	**NBC Debt Repaid**
NPH	(7.1)	(12.4)		(19.4)	Year 28
Alternative Option 1	3.1	(7.7)		(4.6)	Year 22
Alternative Option 2	1.0	(2.6)	2.9	1.3	Year 21
Alternative Option 3	7.2	(2.8)		4.4	Year 10

Case for the NPH Proposition

Given the urgent requirement for more affordable rented housing in Northampton it is important that a structured mechanism is established to generate a pipeline of development schemes. There is some momentum behind the NPH proposition and it will be a quick and relatively cheap option to set up.

Alternative Options 1 and 2 both require partnerships with companies that will not be controlled by the council. This will require the preparation of appropriate contractual and governance arrangements so that the council's interests are protected.

Our risk assessment identifies greater risks associated with the alternative Options 1 and 2. The difference primarily concerns the possibility of delays and extra costs setting up new companies and the risk of failing to realise the revenues from RTB 141 receipts, either because of a change in government policy or a reduction in RTB sales.

Case for Options 1 & 2

During the ten year construction phase in our modelling the biggest single cause of the variance between the NPH proposition and options 1 and 2 is the availability of RTB 141 receipts.

The two alternative partnership options evaluated deliver improved investment returns, both in respect of total revenues and revenues directly attributable to the council.

Whilst Alternative Option 1 provides the higher NPV for the council, Option 2 provides the greater overall NPV with surpluses accruing within the CBS being ring-fenced in accordance with its charitable objects and, subject to contract terms, within Northampton. The Council is able to repay its debt under Options 1 and 2 six years and seven years earlier respectively than under the NPH proposition.

Case for Option 3

Option 3 is the traditional housing association grant funding approach but with, for the sake of a consistent evaluation against the other options, a scheme of market/intermediate rented dwellings being delivered through a wholly owned company limited by shares.

The financial assessment reveals a higher NPV and earlier debt repayment for this option compared with any other option. It would also be the simplest option to implement, with no new corporate entity required in respect of the affordable rented housing. The risk profile associated with this option is also lower than with any other option.

However, against these advantages we need to consider:

1. Whether there will be a willing PRP, prepared and able to develop affordable rented housing in Northampton and to grant nomination rights to the council in respect of that housing in return for RTB 141 receipts funding at 30% of the development costs.

2. In our modelling of this option (and the other options) we assumed council land would be sold at market value. If an arrangement with a PRP partner relied on land being transferred at a nominal value this would reduce the resulting NPV for the council.

3. Under this option the council would not have a long term interest or control in the affordable rented housing, other than through nomination rights which are likely to be limited.

8. Recommendations

8.1 HRA Development

Explore scope to obtain government agreement to a relaxation in HRA financial controls so that additional affordable rented housing can be funded from within the HRA and, following Teresa May's 4th October speech, explore the potential for attracting government funding to support HRA new build.

Work with NPH to develop a legally binding development services agreement with respect to HRA new build schemes (Model A) but review the wording of that Agreement, as set out in Chapter 5 of our main report.

8.2 Partnership with a PRP

The council needs to consider whether long term influence over the entity that owns the affordable rented housing is an overriding priority. If so, the PRP grant funding route (Alternative Option 3) should be set aside or at least its financial and practical merits weighed against the requirement for long term control of the housing.

If, however, the council's priority is new affordable rented housing, whether or not owned by the council or a council influenced entity, then a partnership arrangement with one or more existing PRPs is recommended as the most efficient way of achieving this. This will however rely on the council finding suitable PRP partners, able to deliver a long term programme and enter into a financial arrangement which is satisfactory to the council.

In this event the council could also invest in new market/intermediate rented housing either through NPH or by setting up a new entity which is more tax efficient and able to distribute surpluses back to the council.

8.3 Alternative Options

NPH could become a constituent of the approach envisaged for Option 2. This could be achieved by setting up a subsidiary company, limited by shares and jointly owned by NPH and the council, and also an independent community benefit society to take ownership of the affordable rented housing. NPH could then enter into a management agreement to manage the affordable rented housing on behalf of the CBS.

This would protect profits from the affordable rented housing business from corporation tax and provide an exemption from SDLT. The CBS, as under Option 2, could also be a recipient of RTB 141 receipts. The new subsidiary could operate the market/intermediate rented housing business and distribute any profits to the council.

If insufficient progress can be made with obtaining government financial support, partnering with an existing PRP and/or making the NPH proposition work, as set out above, then Option 2 (Council owned DevCo and independent CBS) is our preferred option. Of the options that give the council a residual and long term interest in the housing it delivers the best overall investment return and enables council loans to be repaid the earliest.