Cabinet
Supplemental Agenda

Date: **Thursday 23 September 2021**

Agenda - Part I

KEY 10. Long Lease Opportunities to provide newly built homes for use as temporary accommodation or discharge of homelessness duty (Pages 3 - 18)

Report of the Divisional Director, Housing Services.

[The deadline for receipt of public and councillor questions is 12pm, 22 September 2021. Questions should be sent to publicquestions@harrow.gov.uk. No person may submit more than one question].

17. Exclusion of the Press and Public

To resolve that the press and public be excluded from the meeting for the following items of business, on the grounds that they involve the likely disclosure of confidential information in breach of an obligation of confidence, or of exempt information as defined in Part I of Schedule 12A to the Local Government Act 1972:

Agenda Item No	Title	Description of Exempt Information
20	Long Lease Opportunities to provide newly built homes for use as temporary accommodation or discharge of homelessness duty – Appendices 1 and 2	Information under paragraph 3 of Part I of Schedule 12A to the Local Government Act 1972, relating to the financial or business affairs of any particular person (including the authority holding that information).

Agenda - Part II

20. **Long Lease Opportunities to provide newly built homes for use as temporary accommodation or discharge of homelessness duty** (Pages 19 - 40)

Appendices 1 and 2 to the report of the Divisional Director, Housing Services.

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Report for:	**Cabinet**
Date of Meeting:	23 September 2021
Subject:	Long Lease Opportunity to provide newly built homes for use as temporary accommodation or discharge of homelessness duty
Key Decision:	Yes - it will result in incurring revenue expenditure of £500,000 and is likely to have a significant impact on the community in one or more electoral Wards.
Responsible Officer:	Julian Higson - Divisional Director, Housing Services
Portfolio Holder:	Cllr Philip O'Dell - Portfolio Holder for Housing
Exempt:	No, except for Appendices 1 and 2 which are confidential on ground 3 set out in the Access to Information Procedure Rule 12.4: Information relating to the financial or business affairs of any particular person (including the authority holding that information)
Decision subject to Call-in:	Yes
Wards affected:	Roxbourne
Enclosures:	Appendix 1: Draft Heads of Terms (Exempt) Appendix 2: Financial Appraisal and Business Model (Exempt)

Section 1 – Summary and Recommendations

This report sets out proposals for the council to acquire new homes on long leases funded by lease rental payments for use either as temporary accommodation or for discharge of homelessness duty.

Recommendations:
Cabinet is requested to:

1. Approve in principle entering into a 45-year lease for the proposal for new homes set out in the report and exempt Appendices.

2. Delegate authority to the Corporate Director of Community following consultation with the Portfolio Holder for Housing, the Portfolio Holder for Strategy, Regeneration, Partnerships and Devolution and the Portfolio Holder for Finance and Resources to finalise negotiations with the developer and enter into the Legal Agreements subject to the final terms being evidenced to represent the optimum deal for the council and value for money.

3. Delegate authority to the Corporate Director of Community following consultation with the Portfolio Holder for Finance and Resources and the Portfolio Holder for Housing to determine the long-term council ownership model for the Lease.

4. Delegate authority to the Corporate Director of Community following consultation with the Portfolio Holder for Housing to retain consultants to advise on the final negotiations and others as necessary to provide technical support to the council in delivery of the project, the costs to be contained within existing budgets.

Reason: (for recommendations) To secure additional housing to assist in meeting the council's statutory homelessness obligations and to provide a rental income stream

Section 2 – Report

Introductory paragraph

The proposal offers an opportunity to create additional homes available to the council for use as either temporary accommodation or for discharge of homelessness duty at an affordable rent as well as for market rent. It would allow the council to significantly increase its property portfolio and enable housing for Harrow residents, a good proportion of which would be affordable to households in receipt of Housing Benefit. This will address poverty and inequality by increasing the provision of affordable housing in Harrow as well as ensuring schemes with existing planning permission are built and contribute to a thriving economy.

Options considered

The following options have been considered:

1. The council entering into a long lease on the terms set out in the confidential appendices with the intention to maximise the number of homes let at Local Housing Allowance (LHA) rents which will be affordable for use as temporary accommodation and the remainder let at full market rent, apart from those required to be available as Affordable Housing under the S106.
2. The council entering into a long lease purely as a commercial venture to maximise the rental income stream to the council by letting the homes at full market rent.
3. Not to pursue the opportunity because of the inherent risk in the obligations of a 45-year lease.
4. To continue solely with the established Property Acquisition Programme to purchase existing properties for use as temporary accommodation. This relies on the council having ongoing access to capital finance.

Option 2 does not provide the council with any opportunity to use any of the homes to meet priority housing needs (other than those required under the S106 Agreement.

The Leasing option does not require the council to use its capital resources (borrowing) as long lease opportunities are revenue-based transactions with the rental payment made by the council offset by the rental income received. However, this is balanced against the long-term lease transactions being a potential strain against the General Fund revenue budget if all costs, including the lease payments, are not contained within the rental income received. The risks of this which result in Option 3 can be managed with the mitigations set out in the Risk Implications section and Appendix 2.

Option 1 would provide additional newly constructed homes to complement the existing Property Acquisition Programme.

Option 1 is the recommended option subject to the final negotiated terms being evidenced to represent the optimum deal for the council and value for money.

Background

The council faces increasing demand from homeless families because of Covid-19, adding to the existing demand. The council currently has around 1200 families in temporary accommodation. More than ever the council needs to find creative solutions to increase the supply of housing to meet the needs of those households who are not able to afford market rent housing. the council has received a number of approaches from developers/investors whereby institutional investors, such as a Pension Fund, want to invest for long term revenue income in the residential market. The council guarantees the rental income stream by entering into a long lease and in return is able to use the housing to meet local housing needs. At the end of the lease term the freehold ownership is transferred for a nominal sum to the council.

Proposal

1. The council has been approached by a developer with a proposal to build new homes on a site in Harrow with an existing planning permission. The developer has funding identified through an institutional Pension Fund investor looking for a long-term income stream, rather than an upfront capital receipt. The developer will build the homes and lease them to the council or a council vehicle on a 45-year full repairing & insuring lease agreement which can be assigned once. The council would pay an annual lease payment starting on 75% of current Local Housing Allowance (LHA) levels. The rents would increase annually by CPI+1% with a collar and cap from 0% - 4%. At the end of the 45 year lease the council will acquire the freehold at a peppercorn value. Throughout the lease period the council has to let any affordable rent homes agreed in the S106 agreement at the agreed affordable rent but all other properties can be let at rents of its choosing. The council can let as many as financially viable at LHA levels or at market rents depending on need over the 45-year period. The draft Heads of Terms are set out in Appendix 1.

2. The proposed scheme has a S106 requirement to provide 20% affordable housing. The majority of these are to be provided as affordable rent homes and these will be let at London Affordable Rents. There is a small proportion of shared ownership homes and it is proposed that the Local Planning Authority is approached to vary the S106 to substitute these with a Discounted Market Rent tenure which would be let at LHA rents and affordable to homeless households.

3. The option to enter into Agreements to enable this proposal to move forward is time limited. The identified site already has planning permission and the site owner will put the opportunity on the open market if the council is unable to support the developer to complete on its current option agreement.

4. The council has engaged Savills to provide independent advice on the proposal and they have developed a financial model to test the viability of the proposal, seeking to provide a number of homes for letting at LHA levels which will be affordable to most homeless families. The detail of the modelling is set out in Appendix 2. The key points are:

    - True additionality in terms of the council being able to access and control and eventually own new homes, a significant proportion that would be affordable and at an increased level than required under the existing planning permission (42% affordable compared to 20% secured under the S106).
    - No capital contribution is required from the council as the scheme is funded through a revenue lease payment.
    - The council is responsible for all income and expenditure liabilities.

- The Lease takes effect from Practical Completion (or just beyond), so development risk is with the developer/investor.
- 12-year collateral warranties provided and standard defects clauses.
- The baseline financial modelling for the scheme assumes homes are let on the following basis: 14% at London Affordable Rent (LAR), 28% at Local Housing Allowance (LHA) and 58% at market rent. The homes let at LHA rents can be offered for use either as Temporary Accommodation or as discharge of duty.
- Management and maintenance costs are allowed for in line with expenditure (and projected expenditure) on similar schemes. The total operating cost assumptions are relatively prudent and in line with those being adopted by other boroughs modelling such proposals.
- Various scenario's have been modelled to assess the impact of indexation variations. Whilst indexation in the lease rent is locked into the lease over the full 45-year term and cannot be changed (subject to cap and collar provisions), inflation on rents cannot be similarly guaranteed. This is the key risk to the proposal. In the worst case scenario rental income falls below the lease rent payment. This can be mitigated by the adoption of an Indexation Reserve. This approach would involve placing any short-term surpluses into reserve in order to mitigate future indexation risks - explicitly set out within the vehicle as a policy to effectively "self-insure" against market and affordable rent increases that are lower than CPI+1%. Additionally, the Council could also switch more of the properties to market rent over time, in order to raise additional gross rent income thereby offering additional financial resources towards the lease rental and operating cost obligations over time.
- The council will be able to influence the final design and specification of the homes to ensure they meet our standards for management and maintenance
- The homes are transferred into the council's ownership at the end of the Lease period.

5. There will be an opportunity for further negotiations with the developer before entering into an Agreement for Lease, to ensure the funding offer is the best value deal that can be secured and offers the best value for money to the council.

6. The council can enter directly into the long lease but it cannot let the homes on secure tenancies as they are not permanent council homes held within the council's Housing Revenue Account. As the council cannot directly let homes on Assured Shorthold Tenancies (AST's) the homes to be let at LHA rents levels would be let as Temporary Accommodation on non-secure tenancies under the council's statutory housing duties.

7. The council can use a vehicle such as a directly owned housing company to hold and manage the market rent properties which could be let on AST's. Assignments to other council vehicles are permitted under the proposed Heads of Terms In this option the LHA homes could also be

let on Assured Shorthold Tenancies (AST's) which means they could be used to enable discharge of homelessness duty, rather than as Temporary Accommodation.

8. There will be a period of 6 weeks after entering into an option agreement whilst finalising the Legal Agreements for the council to review and agree the final ownership arrangements and vehicle for the Lease. Delegated authority is requested to finalise the ownership arrangements and vehicle on receipt of legal advice.

Ward Councillors' comments

The scheme already has planning permission. If the proposal proceeds, Ward councillors will be consulted on the detailed design as it is developed and the approach to letting, managing and maintaining the new homes.

Performance Issues

There are around 1200 households in temporary accommodation and this has increased due to the impact of Covid 19. There are around 324 households in Bed and Breakfast and nightly purchased accommodation compared to 229 a year ago. The supply of both affordable private rented homes and affordable homes continues to be insufficient to meet demand. Solutions such as this would increase the supply of accommodation within the council's control, a proportion of which would assist families meeting their housing need locally in Harrow.

Environmental Implications

Newly built homes will have high standards of energy efficiency to reduce CO2 emissions as well as reduce fuel poverty. The developer will work within the planning consent to deliver a Net Zero Carbon Building in operation. This will result in a highly energy efficient development powered from on-site and/or off-site renewable energy sources, with any remaining carbon balance offset.

Other environmental improvements required for new housing developments include: provision of green roofs, solar thermal hot water systems, improved biodiversity as a result of increased tree planting and landscaped communal open spaces, provision of Sustainable Urban Drainage Systems, and green travel plans to encourage use of public transport and walking.

Data Protection Implications

None

Risk Management Implications

Risks included on corporate or directorate risk register? **No**

Separate risk register in place? **In progress**

The relevant risks contained in the register are attached/summarised below. **Yes**

The following key risks should be taken into account when agreeing the recommendations in this report:

Risk Description	**Mitigations**	**RAG Status**
Rental income inflation is lower than CPI+1% which means the income received by the council is insufficient over the 45-year lease period to cover its liabilities – lease rent, management, and maintenance	▪ Financial modelling and different scenario testing has been carried out and is set out in Appendix 2. A key option to manage this risk is that a policy to adopt an Indexation Reserve (or similar) is agreed and the Reserve is regularly topped up to an agreed formula whereby additional income received in the early years when the lease rent is below the LHA/market rent, is set aside for use when the lease rent exceeds LHA rents. This would also apply to any additional income if the proportion of homes let at market rent is increased. Independent advice considers that such an approach, when seen in the light of a net break even NPV, represents an appropriate risk-adjusted approach to modelling the cashflow projections over the term of the lease ▪ The council also has the option to increase the number of homes that are let at full market rent to cover any projected shortfalls in the later years of the lease. Illustratively, switching to a scheme based on 100% market rents would increase gross rents offering additional financial resources towards lease rentals and operating cost obligations over time.	Amber

Risk Description	Mitigations	RAG Status
	• Payment of lease rentals and maintaining the properties in a lettable condition are both key FRI terms within the lease. Further control of operating costs is therefore also a key mechanism to ensure that the lease rental cost is able to be met.	
Management and maintenance cost pressure with costs not able to be met from available net income	▪ Regular monitoring and control of operating costs ▪ Cost risk transfer to suppliers/agents through management agreements	Green
Major repairs cost pressures with costs not able to be met from available net income	▪ Ensure high build quality with the Council inputting into the design specification and signing off build-quality at Practical Completion ▪ Deferral of expenditure to later or beyond the end of the lease where possible	Green
Initial development costs increase pre-deal leading to increased lease rent	▪ Ensure developer/investor share fixed cost risk when Heads of Terms signed	Green
Development cost overruns leads to increased lease rent	▪ Lock development costs into lease rental levels from the outset	Green
The private rental market collapses	▪ In this unlikely and extreme event, it may be possible to convert the entire scheme to affordable housing – the need for affordable housing is likely to continue and the quality and location of this scheme is likely to be desirable compared to older existing housing stock. Public subsidy options would be explored with the government to assist with this conversion either for the council to buy the homes outright in the Housing	Green

Risk Description	Mitigations	RAG Status
	Revenue Account or to subsidise the lease rent.	
The development is delayed or not completed.	▪ Development risk sits entirely with the developer. ▪ The council is not liable for any lease rent payments until the scheme is practically complete in accordance with the agreed specification and appropriate collateral warranties in place.	Green
There is no demand for market rent and discounted market rent housing	▪ Housing demand projections demonstrate a continued need for high quality rented accommodation in London.	Green
The building does not meet current and future Health and Safety standards, in particular relating to the construction of tall buildings.	▪ The specification must meet the required standards and the council will have input into the specification as well as these being assessed and certified through the Building Control process, appropriate certifications will be required and provided to enable Practical Completion. ▪ The council will be responsible for managing the building and complying with all requirements relating to the Health and Safety requirements of tall buildings.	Green
The optimum deal for the council / value for money is not achieved.	▪ Negotiations with the developer prior to entering into the Legal Agreements ▪ the final terms being evidenced to represent optimum deal/vfm	Green

Procurement Implications

The recommendations set out in this report have no procurement implications. Any purchase or sale of property, interest in land, transactions in land and lease transactions are excluded from the Contract Procedure Rules.

Legal Implications

The Council can rely upon its investment powers in section 12, Local Government Act 2003 and has the power to acquire land for the purposes of any of its statutory functions or for the improvement of its area pursuant to section 120 of the Local Government Act 1972.

Once acquired, the Council may hold property interests in its General Fund if the units will be used as Temporary Accommodation. The lease would have to be held in the Housing Revenue Account (HRA) if the units are to be used for any other tenure.

The council can use a different ownership model for any property interests described in this report. For example, the Council has power to establish and participate in an LLP where:

(i) it is done to facilitate or is conducive or incidental to the discharge of any of its functions (s. 111(1) of the Local Government Act 1972); and

(ii) it is done other than for a commercial trading purpose (s. 1 of the Localism Act 2011)

The Council has statutory authority to hold property for a variety of purposes including those mentioned in section 120(1) of the Local Government Act 1972 which include for the benefit, improvement and development of their area. The Council also has the power to invest for any purpose relevant to its functions under any enactment; or for the purposes of the prudent management of its financial affairs (s.12 Local Government Act 2003).

The Council's decision to use an LLP could be based on it being conducive, facilitative, or incidental to the discharge of its investment function.

The case of Peters v Haringey LBC (2018) clarified the general power of competency in the Localism Act and the limitations set out in section 4 of that Act. Should the Council choose to make use of a vehicle such as an LLP, that will be lawfully permitted because the dominant purpose of this project is not commercial. It is social and affordable housing and the relief of homelessness.

Financial Implications

The full financial implications and associated risks of the proposed investment are contained in the exempt document at Appendix 2.

The council has appointed Savills as their independent expert to advise on the proposal. The analysis has been prepared utilising a financial modelling platform developed by Savills based on the latest Heads of Terms sheet contained in Appendix 1.

The proposal is for a developer to build new homes on a harrow site which has obtained planning permission. The developer has funding identified through an institutional Pension Fund investor looking for a long-term income stream, rather than an upfront capital receipt, to secure the land and build out the development. The pre-development and development costs will be met by the Developer. Consequently, the council will not be responsible for development cost overruns. At Practical Completion, the Council will take on the lease and begin payments.

The majority of the scheme will be let as market rented housing. The lessee must be a subsidiary company (or third-party entity) as the Council cannot make direct provision of market rented housing. The Council has the option to utilise an existing company or set up a new company, and to provide a guarantee of the obligations within the lease.

The lease obligations are Fully Repairing and Insuring (FRI) and therefore the Council and its subsidiary will be responsible for all operating costs during the term of the lease.

Rent will be raised from tenants which will then be spent on paying the lease payments (to investor) and the operating costs relating to the properties with any surpluses being retained by the lessee. The lease payment will be a legally binding payment which will be payable irrespective of the gross rent received from tenants within the scheme and the costs of operating the scheme.

Gross, rents, lease payments and operating costs will all be subject to indexation and inflation.

The scheme will be funded by a fixed lease rental payment which is proposed to increase at CPI+1% for a lease period of 45 years subject to collar and cap of 0%-4%. Therefore, it does not require capital resources or borrowing

The arrangement is such that the Council will own the freehold to the land at the end of the lease term for a peppercorn because the Institutional Funder will have fully amortised their debt over the lease term and Council will in turn benefit from increased land value growth over this period.

However, this proposal is not without risk. This lease-finance model carries with it an inherent risk for the council that gross income through rents will not increase at the same rate as the lease rental payment (to investor), thereby placing a “squeeze” on the net income retained to deliver operating costs. Whilst indexation in lease rentals is locked into the lease over the full 45-year term and cannot be changed (subject to the cap and collar provisions), inflation on rents cannot be similarly guaranteed.

Officers have reviewed the financial modelling provided by our independent advisers Savills which indicates that for:

- Baseline assumption- assuming alignment of income inflation with lease-rent indexation at 3%(CPI +1%) and operating cost inflation at 2.5%(CPI +o.5%) ,sufficient income would be generated to cover both lease rentals and operating costs in all years and that the financial model is net cashflow positive throughout the 45years lease term and beyond.
- A series of scenarios in which gross income does not increase at the same rate at lease rentals, differing by 0.25% ,0.50% and 1% pa every year of the lease term, and a maximum downside scenario in which gross rents only ever move at CPI pa.

If the differential is 0.25% pa over time, there is a point at which rent income retained after paying the lease rental falls below projected operating costs – at year 14.

If this differential is 0.50% pa over time, this point would be reached at year 7, however there remains considerable levels of retained income throughout the term

As the differential increases to 1% pa, the “crossover point” is year 6 to the point where, by the end of the lease term, lease rentals are at the same level as gross income leaving no net retained income for expenditure on the properties.

Whilst the long-term differential between income inflation and indexation is unlikely therefore to be 1% every year for 45 years, the modelling does illustrate the need for the Council to adopt appropriate hedging and income management techniques in order to manage the risks associated with index-linked finance.

Mitigations to manage this are set out in the Risk section and in the Savills report at Appendix 2 but may include:

- Adoption of an Indexation Reserve -placing any short-term surpluses into reserve in order to mitigate future indexation risks to effectively “self-insure” against market and affordable rent increases that are lower than CPI+1%.

- Cost control - securing terms with managing agents and suppliers (the Council or 3rd parties) in which some risks are passed across under the terms of any service or management agreements.

- Switching more properties to market rent tenure- in order to raise additional gross rent income.

If the lease rental payment and operating costs cannot be met by gross rent income or the Indexation Reserve, then any difference would need to be met from the Council's General Fund. If this situation arises, mitigations have been identified to minimise the risk to the housing General Fund budget.

Negotiations are still on going with the developer and it would be prudent to further interrogate the key financial factors which affect the level of lease rental payable by the Council, to ensure the value generated in the scheme is allocated appropriately between the Council, the investor and the developer. This report recommends that prior to finalising negotiations and entering into a legal agreement the Council has evidenced it has assured itself that the final terms represent the optimum deal for the Council and represents VFM.

Should Housing require external consultants to advise on the final negotiations and provide technical support to the council in delivery of the project, the costs will be contained within existing budgets

Lease Classification:

- The lease from the Institutional Investor to the Authority will be deemed a finance lease as substantially all the risks and rewards associated with the asset are passing to the Authority.

- This will result in the asset being recognised on the balance sheet with an equivalent liability recognising the payments to be made to the Institutional Investor over the lease term. Each lease payment made will split between reducing the outstanding liability and servicing the interest costs implicit within the lease.

- The Authority will recognise the asset as operational asset , classified as Other: Land & Buildings, as it is being held to meet the Council's strategic objectives.

Equalities implications / Public Sector Equality Duty

When making policy decisions, the Council must take account of the public sector equality duty (Section 149 of the Equality Act 2010) and any potential impact on protected groups. An Equalities Impact Assessment (EqIA) was completed when the Housing Strategy and Homelessness and Rough Sleeping Strategy was approved by Cabinet in November 2019. The EqIA endorses the priority to increase the supply of affordable housing in Harrow as this will have a positive impact on several protected characteristics.

For example, Homelessness affects all communities regardless of ethnicity. However, it seems that a disproportionately substantial number of Black households are affected each year. In 2017/18, 8.6% of Harrow's population were Black but they constituted 27% of homeless acceptances. This may reflect issues of housing need within this group. 2018/19 indicative data suggests this figure to be around 30%. The Housing Strategy priorities of increasing the supply of affordable housing, improving standards in the private sector, and meeting the needs of vulnerable people will have a positive impact on people from all ethnic groups.

Council Priorities

1. **Improving the environment and addressing climate change**

   The new homes will be built to meet government carbon reduction targets and the developer will work within the planning consent to deliver a Net Zero Carbon Building in operation.

2. **Tackling poverty and inequality**

   A significant number of the new homes will be affordable for households with the highest priority housing needs and on longer term tenancies than usually available in the private rented sector.

3. **Building homes and infrastructure**

   This proposal will enable the construction of new homes in Harrow

4. **Addressing health and social care inequality**

5. **Thriving economy**

Section 3 - Statutory Officer Clearance

Statutory Officer: Dawn Calvert
Signed by the Chief Financial Officer
Date: 21 September 2021

Statutory Officer: Matthew Dineen
Signed on behalf of the Monitoring Officer
Date: 15 September 2021

Chief Officer: Dipti Patel
Signed off by the Corporate Director
Date: 15 September 2021

Head of Procurement: Nimesh Mehta
Signed by the Head of Procurement
Date: 7 September 2021

Head of Internal Audit: Susan Dixon
Signed by the Head of Internal Audit
Date: 21 September 2021

Mandatory Checks

Ward Councillors notified: YES

EqIA carried out: NO

An EqIA was completed when the Housing Strategy and Homelessness and Rough Sleeping Strategy was approved by Cabinet in November 2019. The EqIA endorses the priority to increase the supply of affordable housing in Harrow as this will have a positive impact on several protected characteristics. This proposal will contribute to increasing the supply of affordable housing in Harrow.

EqIA cleared by: N/A

Section 4 - Contact Details and Background Papers

Contact: Alison Pegg Head of Housing Regeneration, Tel**: 07592 110410.** Alison.pegg@harrow.gov.uk

Background Papers: None

Call-in waived by the Chair of Overview and Scrutiny Committee

NO

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