

Derby Homes New Build

SUMMARY

- 1.1 The provision of affordable housing has risen up the political agenda, with the publication of the Government's housing green paper, 'Homes for the Future: More Affordable, More Sustainable', which includes increased targets for the provision of affordable housing. In order to meet these increased output goals the Housing Corporation has decided to work with a larger and more diverse range of delivery partners, including for the first time local authorities – through 3*Arms Length Management Organisations and local authority Special Purpose Vehicles.
- 1.2 Following a qualification process last year, Derby Homes have been approved as Housing Corporation Investment Partners and also Accredited Management agents.
- 1.3 ALMO new build properties would be outside the HRA subsidy system, and the properties would not be subject to the Right to Buy, RTB. They would instead be subject to Right to Acquire, RTA in line with Housing Association properties, limiting the discount available to tenants from a maximum £24,000 under RTB to £9,000 under RTA. The development of new build properties would provide the first significant assets on Derby Homes' balance sheet which could potentially be used to support borrowing in the future.
- 1.4 In November 2007, following consultation with Members and Officers at the Council, Derby Homes in partnership with Strata Homes– selected by Derby Homes as it's preferred development partner following an EU procurement process - submitted a bid to the Housing Corporation to secure grant funding that would support the development of 10 affordable homes and a further 29 market sale properties. This proposal would be developed across four Council owned sites.
- 1.5 In the longer term, in order to preserve the taxation and VAT status of Derby Homes, and also to ring fence development risk, it is recommended that a wholly owned subsidiary company of Derby Homes, limited by share and able to distribute profits, be set up. This is the most commonly used form of subsidiary and would enable a wide range of regeneration activity and possible future trading activity. The governance structure of the subsidiary, including Board membership, would need to be agreed by the Council. The establishment of a subsidiary would however be subject to a future report to Cabinet which would enable the consideration of these issues in greater detail. In the meantime, Derby Homes is intending to undertake this arrangement directly as Derby Homes rather than through a subsidiary company.
- 1.6 In order for the development to work, Derby Homes is also requesting the Council to:

- Transfer the land to it on a 99 year lease at a peppercorn rental with no lease premium
- Obtain permission from CLG to dispose of the land at less than full consideration in this way
- Lend Derby Homes £20,000 for each unit of affordable housing in the form of prudential borrowing – a total of £200,000
- Sign a form of performance guarantee in support of the grant application.

1.7 The land disposal would be subject to conditions from the Council in line with those imposed on Registered Social Landlords, RSL's by the Council. CLG approval is thought very likely as there is significant support for this type of development. The prudential borrowing would be secured on the affordable homes and should be serviced from the difference between future rentals and management and maintenance costs, given an adequate grant from the Housing Corporation and essentially free land plus cross subsidy from sales proceeds.

1.8 Subject to any issues raised at the meeting, I support the following recommendation:

RECOMMENDATION

- 2.1 That the Cabinet notes that Derby Homes have secured Housing Corporation Investment Partner - and Accredited Management Agent – status, which has enabled it to bid for Housing Corporation grant in the current bid round.
- 2.2 That the Cabinet authorises further negotiations to be undertaken with the Housing Corporation with a view to securing acceptable terms for the grant funding and the related formal Performance Guarantee required from the Council.
- 2.3 That Cabinet delegates authority to the Corporate Director for Corporate and Adult Services and Deputy Chief Executive to sign the Housing Corporation Performance Guarantee following consultation with the Cabinet Member for Neighbourhood, Social cohesion and Housing Strategy and the Corporate Director of Resources, if the terms are amended to become acceptable.
- 2.4 That Cabinet, subject to the Housing Corporation bid being successful, and CLG approval for the disposal, authorises the conclusion of a formal development agreement between the Council, Derby Homes and Derby Homes' development partner Strata Homes, for the disposal of the four sites identified in paragraph 5.1 to Derby Homes at nil value, with the plots for the ALMO houses being on a long lease basis.
- 2.5 That Cabinet recommends to Council that additional prudential borrowing of £200,000 be undertaken for this purpose, and that it is lent subject to conditions requiring full repayment in the event of the housing no longer being available for social housing in the future.

REASON FOR RECOMMENDATIONS

- 3.1 The performance guarantee would meet a Housing Corporation funding requirement, but prior to entering into this, the Council will need to conclude current negotiations with the Housing Corporation and be satisfied that the terms of the guarantee are reasonable.
- 3.2 The disposal of these sites at nil value is a fundamental assumption within the submitted bid. Housing Corporation funding is offered on the basis that land will not be valued at open market valuation in these circumstances.
- 3.3 The prudential borrowing is a fundamental assumption within the submitted bid.



Derby Homes New Build

SUPPORTING INFORMATION

1. The national context

- 1.1 The provision of new additional affordable housing has moved sharply up the national political agenda. The Government's housing green paper, 'Homes for the Future: More Affordable, More Sustainable', sets out the ambition to meet the country's need for social rented homes, to tackle affordability and to support quality and sustainability. In the next three years nationally, the supply of new social rented homes will rise by 50%, to at least 45,000 in 2010-11, and in each of these three years the Government will also help to fund 25,000 affordable homes for buyers in need of assistance. Over this three year period the Housing Corporation will invest at least £8 billion to deliver these new affordable homes – an increase of £3 billion.
- 1.2 In order to meet these increased output goals, the Housing Corporation has decided to work with a larger and more diverse range of delivery partners. In addition to Housing Associations, they will, for the first time, be investing through local authorities – through Arms Length Management Organisations and local authority Special Purpose Vehicles.
- 1.3 In 2007, the Housing Corporation ran a pre-qualification process to assess and approve these new entrants against the following requirements: good standing, the technical capacity to deliver development projects and the financial capacity to handle significant values of grant. As a result of this process Derby Homes was approved during the summer as an Investment Partner for the 2008-11 Housing Corporation bid round.
- 1.4 At the same time Derby Homes was approved under the Housing Corporation Housing Management Accreditation Scheme. As a result it is able to manage properties funded by the Housing Corporation but owned by other providers.
- 1.5 The 2008-11 Housing Corporation bid round commenced in early September and closed on 3 November 2007. Derby Homes, following informal consultation with Members and Officers submitted a bid which will deliver 10 Affordable homes and a further 29 market sale properties.
- 1.6 The market sale properties will be sold by Strata Homes, the development partner selected by Derby Homes with part of the profit from these homes cross subsidising the proposed rented units. This arrangement has enabled a more competitive bid to be submitted whilst at the same time delivering mixed tenure schemes which will contribute towards creating more mixed and sustainable communities.

2. The Derby Homes perspective

- 2.1 Derby Homes, having achieved the Decent Homes standard, now has the capacity to contribute to the wider agenda of neighbourhood management and mixed sustainable communities. It is considered that it also has the potential to take a lead role on wider new build and redevelopment schemes for affordable housing and mixed communities.
- 2.2 Derby Homes can bring added value to new build development that may not be brought by other providers. For example, Derby Homes has experience of working closely with the Council to deliver large scale projects and of providing the excellent services associated with a 3* ALMO. Through the Decent Homes Programme there was a commitment to incorporating training into contracts, while tenant involvement at all levels of Derby Homes governance is a significant strength for Derby Homes.
- 2.3 The development of new housing by Derby Homes would help to secure its future. Currently, the houses managed by Derby Homes are subject to reduction in numbers through Right to Buy – RTB - which has recently been in the region of 80 sales plus any demolitions each year. This loss leads to a reduction in the management fee of approximately £60,000 a year for the RTB losses. The long term impact without replacement could see a reduction in Derby Homes to a level where current levels of local services cannot be maintained. The ability of Derby Homes to deliver new build would allow it to replace some of the management income lost through Right to Buy sales and demolitions, helping it to maintain economies of scale, and maintain a level of income to help carry on with 3* services across the whole city.
- 2.4 Any new homes built by Derby Homes would be shown on the accounts of Derby Homes as an asset. As Derby Homes accounts are consolidated into the group accounts of the Council they will show as an asset of the Council. This is a distinct advantage over disposing of land to RSLs for new build, where the ownership of the properties is relinquished, typically for a period of 99 years.

3. The City Council perspective

- 3.1 Councils can, in theory, still build new homes themselves. The problem is that the financial system – in particular the system of calculating Housing Revenue Account – HRA - housing subsidy – works against that outcome. At the moment, every additional home provided by this Council would reduce the subsidy we receive by £760 a year (£15 a week). This 'negative subsidy' is set to increase to £25 a week by 2013 (5 years time) and to £50 a week in thirty years time on current forecasts. This is one of the main factors effectively preventing new build Council homes at present, along with Right to Buy being available on such properties.
- 3.2 At the moment it is unclear how the rules might change in future for Councils seeking to build new homes. A working party at national level has been exploring the potential of one possible scheme with six Councils – three with ALMOs and three without. The premise is that 'high performing' Councils would be able to apply to Communities and Local Government –CLG- for the opportunity to 'opt out' of the subsidy system. Such a change would allow those that opted out to avoid the penalty aspects of new build mentioned above. This debate is continuing but will take some considerable time to resolve in detail – so the likely date for

implementation is still some years off unless the deal is made extremely attractive for those Councils opting to move in this direction. To date, it would appear that any settlement would be broadly neutral and not have the sort of benefit that resulted from the setting up of an ALMO. The opportunity to undertake new build would be one of the few attractions of such an option. The government has now also announced a further review of the entire subsidy system to be undertaken in 2008 and 2009 with a view to more fundamental reform still. It is unclear at this point what the impact will be on both the existing stock or opportunities for new stock.

- 3.3 The other option, even under current rules, is to allow Derby Homes – either directly or through a subsidiary – to build new homes. Even under current legislation, it is possible for them to build homes without them being caught in the subsidy system, so the subsidy penalty faced by the Council is avoided. In addition, it can apply for Housing Corporation funding when the Council cannot. The building of affordable dwellings without grant is possible, but there would need to be a greater proportion of sale properties in any development to cross subsidise the rented.
- 3.4 The key advantages at the moment therefore of Derby Homes' new build are avoiding subsidy – which may or may not change for Councils in the near future – and applying for Housing Corporation grant. ALMO housing – unlike Council housing – would also not be subject to the Right to Buy – RTB , but rather to the lesser discount available under 'Right to Acquire' for those properties funded by the Housing Corporation.
- 3.5 The Government is currently considering responses to the Housing Green paper consultation. One possibility is that the Government may allow Councils to include future new build properties within the HRA – but outside the subsidy system. It remains likely though that the Housing Corporation or its successor will continue to be unable to give grants directly to Local Authorities. Obviously, this position may change through the consultation process.
- 3.6 If this position comes about, it is likely that Housing Corporation grant will only be available to the Council through the Derby Homes subsidiary route. The Council could in future adopt a position where such homes are developed through Derby Homes' subsidiary, while new homes without subsidy were developed directly within the HRA but outside subsidy. At the moment, however, the opportunities for the current Corporation bid round are restricted to ALMOs approved by the Corporation – including Derby Homes.
- 3.7 If Council housing becomes viable directly through the HRA in the future, this would probably be the most effective and least risky option for the Council. At the moment, however, the rules are sufficiently punitive to prevent any material level of Council home building. If the rules change, we may therefore need to review the position at least in respect of projects that do not require Housing Corporation funding. At the moment, however, it is proposed that ALMO housing be further developed – in particular possible governance arrangements - to keep this option open so long as the advantages listed above remain.

4. Ownership of new build Derby Homes properties

- 4.1 The development of new houses through the existing ALMO would minimise governance and administration costs and create a clean asset disposal chain.

However there is an element of uncertainty connected to the existing ALMO structure for building, owning and renting property. This is connected to taxation and VAT issues and to the question of development risk.

- 4.2 Currently, Her Majesty's Revenue and Customs (HMRC) has issued national guidance on the treatment of ALMO surpluses. The guidance is of the view that ALMOs set up using the template Memorandum & Articles of Association are not trading Companies whilst the core of their activity is working under a Services Agreement for the parent Local Authority. This means that all income and expenditure connected to managing the Council housing stock is not subject to Corporation Tax. The guidance issued is subject to change by the HMRC should it be considered that the non-local authority activities of the ALMO – such as those associated with property development - have grown to a point where the whole Company is considered to be trading and subject to Corporation Tax. If this were to occur it would have a major impact on Derby Homes.
- 4.3 The HMRC guidance does not extend to VAT matters. However, it is considered that development on a significant scale could have an impact on the VAT status of Derby Homes.
- 4.4 Development does inevitably carry risks, in particular when the success of schemes depends upon the sale of some properties to cross subsidise affordable dwellings. In particular risks revolve around there being cost increases that were not anticipated, and/or sales receipts that are either not achieved or are delayed.
- 4.5 Legal advice obtained by Derby Homes from Anthony Collins Solicitors, recommends that these taxation, VAT and development risks can be best managed by setting up a wholly owned subsidiary company of Derby Homes, limited by share and able to distribute profits. The subsidiary would prevent the Derby Homes taxation and VAT position being 'tainted' by development activities and also ring fence to some extent the development risk. Derby Homes would then provide management services on behalf of the subsidiary. The Council's own legal opinion broadly agrees with this interpretation.
- 4.6 This is the most commonly used form of subsidiary and would enable a wide range of regeneration activity and possible future trading activity. The governance structure of the subsidiary, including Board membership, would need to be agreed with Derby Homes. As this structure would enable the distribution of surpluses in a manner determined by the Directors of the Subsidiary - this could be back to the original ALMO, to a charity, returned to the Council or any combination of these options. Decisions would also have to be made concerning these matters in due course. The issues around the establishment of a subsidiary are complicated and at the same time Government is still considering the responses to the Green Paper. A proposal for the establishment of a subsidiary Company will therefore be subject to a future report to Cabinet which would enable the consideration of these issues in greater detail and in the light of emerging Government guidance.
- 4.7 In the meantime and in order not to lose the current opportunity through the Housing Corporation grant offer, it is proposed that Derby Homes undertakes this small scale development directly. Indeed, Housing Corporation rules currently insist on it being the ALMO and not a subsidiary company. This will be kept under review for the future.

5. Proposal

5.1 The success of Derby Homes current new build proposal is dependent upon the disposal of land by the Council at nil value. Derby Homes does not have reserves to draw upon to subsidise the purchase and development of land, nor any land of its own. The bid to the Housing Corporation assumes the transfer of the following four sites;

- Land at Rodney House, Penalt Close, Allenton
- Land at Sandcroft Court, Harpur Avenue, Littleover
- Land at the former City Training Site, Swallowdale Road, Sinfen
- Land at Martin Drive, Chaddesden

5.2 The proposed affordable housing mix to be retained by Derby Homes is indicated below:

- Rodney House – 2 x 4 bed houses
- Sandcroft Court – 2 x 4 bed houses
- Martin Drive – 1x 4 bed house and 1 x 2 bed flat
- Former City Training Site – 3 x 4 bed houses and 1 x 2 bed flat

It is envisaged that Strata Homes would develop all 39 homes. The 10 plots to be owned and managed by Derby Homes would then be passed over at nil value on a long term lease basis. The remaining 29 plots for market sale would be passed on a freehold basis.

5.3 The Housing Corporation has stated that it expects Local Authorities to provide land at nil value if Housing Corporation Grant is to be made available. This applies equally to bids submitted either by ALMOs or Housing Associations where Local Authority land is involved. It has also indicated that it will view the disposal of land to ALMOs at reduced consideration as evidence of a strategic fit when considering the best value of schemes.

5.4 The following approach is therefore recommended:

5.5 That the Cabinet note that Derby Homes have secured Housing Corporation Investment Partner - and Accredited Management Agent – status, which will enable them to bid for Housing Corporation grant in the current bid round,

5.6 That the Cabinet notes that the Council has been asked by the Housing Corporation to guarantee the performance of Derby Homes through a formal guarantee for any project that they secure. This guarantee, as currently drafted, contains some requirements that are not currently acceptable to the Council. In particular, the proposed agreement as currently drafted requires Derby Homes to retain its 3 star status. If Derby Homes were to drop to a two star rating or lower, the Housing Corporation, or its successor, could then 'claw back' the grant that had been awarded. Clearly, this current position poses an unacceptable risk to the Council.

5.7 The Housing Corporation has however advised that it recognises that this and other proposed conditions may be unreasonable and indeed unduly punitive when compared to the regulations that apply to RSL's. Accordingly the Housing Corporation has indicated that following further discussions, it is likely to relax these requirements to a position which is likely to be acceptable to this Council and others.

Assuming agreement can be reached, the underwriting of ALMO housing would not be by the HRA but by the General Fund, as the premise of avoiding the subsidy system is that such homes are not in fact Council homes in the HRA but are Derby Homes’.

- 5.8 That Cabinet, subject to the Housing Corporation bid being successful, authorises the disposal of the four sites at nil value.

OTHER OPTIONS CONSIDERED

- 6.1 The Council has successfully for a number of years worked with a range of development partners in Derby to provide affordable housing. The Government, through its’ affordable housing agency the Housing Corporation, has recently given a role in the provision of new affordable housing to local authorities – either through 3*ALMOs or Special Purpose Vehicles. The proposals in this report are designed to provide a role for Derby Homes in achieving this Government objective.
- 6.2 The current proposal to deliver 10 new affordable homes can be regarded as a pilot. The developments will be reviewed both in terms of quality and overall value for money to determine whether in terms of both Strategic and Value for Money considerations the Council should support future ALMO developments. As part of these considerations comparisons will be made with the outcomes that could alternatively have been achieved had the Council worked in partnership with a Housing Association or Developer to deliver these sites.
- 6.3 Building by the Council, directly within the HRA is not currently feasible, but will be kept under review in case it becomes more viable in future – for instance through exemption from the subsidy system.

For more information contact:	Ian Fullagar Tel (01332) 255185 e-mail ian.fullagar@derby.gov.uk
Background papers:	None
List of appendices:	Appendix 1 – Implications

IMPLICATIONS

Financial

- 1.1 The proposals would have extensive financial implications as there would be requirements for additional prudential borrowing to be undertaken by the Council as well as a guarantee to be underwritten by the Council in the event of failure to perform by Derby Homes. The chance of this occurring has to be reassessed each year and provision made in the accounts of the Council and Derby Homes should that assessment conclude that there is a chance of the guarantee being called in.
- 1.2 Information relating to the valuation of the four sites and the Houses to be retained by the ALMO is contained in the confidential attachment to this report.

Legal

- 2.1 Under current rules the proposed disposal of these sites to Derby Homes will require formal Secretary of State consent under the Local Government Acts 1972 and 1988 and the Housing Act 1985.
- 2.2 As well as the disposal of the sites there will be a need to conclude a formal development agreement between the Council, Derby Homes and Derby Homes' development partner – Strata Homes, so as to secure the development of the sites in accordance with the agreed scheme.
- 2.3 The Housing Corporation has produced a draft of the grant funding agreement which it will require ALMOs such as Derby Homes to enter into. This contains extensive obligations and conditions some of which are causing concern among local authorities and their ALMOs. There will be further negotiations to try and arrive at an acceptable form of agreement. The Corporation will require the Council to formally guarantee the performance of the terms and conditions of the funding agreement by Derby Homes.
- 2.4 Other legal implications are as set out in the main body of the report.

Personnel

3. None directly arising from this report

Equalities impact

4. The provision of additional affordable housing will help meet the needs of all groups, including minority ethnic communities, disabled people, general needs and older people.

Corporate priorities

5. The provision of affordable housing will help to promote the Council's priorities of **making us proud of our neighbourhoods and Leading Derby towards a better environment.**