Finance and Resources Committee

10.00am, Thursday, 12 June 2018

City Deal New Housing Delivery Partnership Acquisition of Homes 2018/19

Item number	7.14
Report number	
Executive/routine	
Wards	All
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Executive Summary

In February 2018, the City of Edinburgh Council agreed to enter into agreements with Scottish Futures Trust (SFT) to establish two Limited Liability Partnerships (LLPs) to deliver 1,500 homes for market and mid market rent to be let to households on low to moderate incomes.

The new partnership will complement existing Council approaches to delivering affordable and low-cost housing and will be branded as Edinburgh Living.

The purpose of this report is to seek approval to transfer the first 105 mid market rent homes developed on mixed tenure sites, as part of the Council's housebuilding programme, from the Housing Revenue Account (HRA) to the new mid market rent LLP. The homes will be transferred on completion at a transfer price based on total development costs; including construction cost, land value and related short-term funding costs.

Committee is asked to note the lending and capital advances required for the LLP to complete the purchase and refer the report to City of Edinburgh Council for approval. The purchase will be funded through a mix of borrowing and Scottish Government grant. The HRA will receive a capital receipt.

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Report

City Deal New Housing Delivery Partnership Acquisition of Homes 2018/19

1. Recommendations

1.1 It is recommended that the Finance and Resources Committee:

1.1.1 Agrees the transfer of 105 homes constructed as part the Council's housebuilding programme, from the Housing Revenue Account (HRA), to the Housing Delivery Partnership mid market rent LLP in 2018/19.

1.1.2 Note the requirement for the Council:

1.1.2.1 to lend up to approximately £13m to the mid market rent LLP to purchase 105 homes;

1.1.2.2 to provide a corresponding capital advance from the Loans Fund based on a repayment profile using the funding / income method, as set out in paragraph 3.12; and

1.1.2.3 to amend the Loans Fund Repayment Policy to include the funding / income method repayment as set out in paragraph 3.14.

1.1.3 refers this report to Full Council on 28 June 2018 for approval of the above.

2. Background

2.1 On 17 September 2015, the City of Edinburgh Council agreed to enter into a partnership with SFT to accelerate housebuilding through acquisition of homes for market rent and mid market rent.

2.2 This proposal formed part of the housing programme in the Edinburgh and South East City Region Deal in 2017. This included Scottish Government consent for the City of Edinburgh Council to on-lend up to £248 million to two LLPs, one for market rent and one for mid market rent, for the purpose of delivering a minimum of 1,500 homes for market and mid market rent in Edinburgh.

2.3 On 18 January 2018, the Housing and Economy Committee agreed that the Council could enter into agreements with SFT to establish the LLPs to support the delivery of homes for market rent and mid market rent.

2.4 The same Committee agreed, in principle, that homes developed by the Council within mixed tenure developments for market rent and mid market rent could be transferred to the LLPs on vacant possession, subject to agreement by the Finance and Resources Committee.

2.5 The report was referred to the City of Edinburgh Council on 01 February 2018 to confirm the appointment of elected members and an Executive Director to represent the Council on the LLPs' Corporate Body.

2.6 The Council entered into agreements with SFT on 28 March 2018. The first meeting of the LLP's Corporate Body is due to take place on 04 June 2018.

3. Main report

Transfer and operation of homes

3.1 The purpose of this report is to seek Committee approval to take the next steps towards making the LLPs operational by approving transfer of homes scheduled for completion in 2018/19 and earmarked for mid market rent, from the HRA to the mid market rent LLP. The homes will be transferred on completion and let to tenants on low to moderate incomes.

3.2 In total, 105 of the homes to be delivered by the programme in 2018/19 have been earmarked for mid market rent. These are detailed within Appendix 1. The homes will be delivered on four sites across the city. The first of these homes will be available at Clermiston in August 2018. The remaining three sites are Greendykes G, Hailesland Place and North Sighthill. The homes are located within mixed tenure developments which include housing for social rent which will be held on the HRA and managed by the Council.

3.3 Once transferred, the homes will be owned by the LLP and let and managed by a Management and Maintenance Service Provider appointed by the Council. The Council has a 99.9% share in the mid market rent LLP with the remaining 0.01% held by SFT.

3.4 A procurement exercise has been initiated to select an organisation with suitable experience to manage and maintain the homes on behalf of the LLPs. The operational model is based on the successful approach in use under the National Housing Trust (NHT) initiative. The procurement process will have a strong emphasis on customer service and financial and operational performance. A report will be brought to a future meeting of the Finance and Resources Committee seeking approval to award the contract.

3.5 A proportion of the rents collected will be held by the LLP as a lifecycle reserve. This will ensure that funds are in place to enable the LLPs to maintain the homes in future years and carry out large lifecycle maintenance programmes; including the replacement of kitchens, bathrooms and door entry systems, for example, at the appropriate times.

Lending and corresponding capital advances

3.6 In the case of the mid market rent LLP, it is intended that the acquisition of each tranche of housing units is funded by a combination of grant from the Scottish

Government and a loan from the Council. In the case of the market rent LLP, the acquisition of each tranche of housing will be funded purely by loan from the Council.

3.7 The loans to the LLPs will be a 40-year annuity repayment structure, similar to a mortgage. For the mid market rent LLP, the rate of interest on the loan will be based on the Public Works Loan Board (PWLB) 40-year annuity rate available to the Council on the day each loan is advanced. For the market rent LLP, the rate of interest will be slightly higher than PWLB 40-year annuity rate to take account of the higher rent that will be charged through this initiative and the funding risk (100% loans).

Ministerial Consent and funding by capital advance

3.8 Scottish Government Ministers have the power to allow Councils to borrow for purposes other than the strict criteria outlined in the Local Authority (Capital Financing and Accounting Scotland) Regulations 2016, including giving consent to lend to third parties. The Council has been given consent by the Scottish Government to borrow for the loans to both LLPs, which in turn permits capitalisation of this lending. This means that the loans will be funded by a capital advance from the Council's Loans Fund in the same way that any other capital expenditure made by the Council (and funded by borrowing) would be.

3.9 The loans will increase the Capital Financing Requirement (CFR) of the Council and hence the Council's underlying need to borrow. The anticipated loans have already been included as a separate line in the borrowing CFR approved as part of the budget process and 2018/19 Treasury Strategy. The loans have also been included in the Authorised Limit and Operational Boundary Prudential Indicators.

3.10 The Council does not need to borrow externally specifically to make the loans to the LLPs but the consent allows it to borrow if it chooses to do so. However, while the Council may wish to make the advantageous PWLB interest rates available to the LLPs to assist them in delivering the provision of affordable housing for rent, the Council will wish to mitigate the interest rate risk in doing so. As set out in the 2018/19 Treasury Strategy, it is likely that matching back to back arrangements for external borrowing will be considered when each loan to the LLPs is made.

New Borrowing Regulations

3.11 In 2016, the Scottish Government introduced a new set of regulations governing local authority borrowing in Scotland. Some the changes brought in by the regulations were required to support the City Deal structures in Scotland, and one of these key changes was the introduction of a range of options available to repay the principal on capital advances.

3.12 Until now, the Council has continued to apply the statutory repayment profile to advances from the loans fund which is the same method used before the introduction of the new Regulations. However, the funding / income method gives the Council the ability to sculpt capital advance repayments to the income that will be generated by the expenditure or other future funding. In granting their consent to borrow on behalf of the LLPs, the Scottish Government have provided formal consent on the basis that the funding / income repayment method be used.

3.13 It is therefore intended that the repayment profile for the capital advance is a 40-year annuity to match the loan to the LLP, based on the life cycle maintenance provision proposed. It should be noted, however, that should the LLPs fail to make their loan principal or interest repayments, the Council's General Fund will need to fund the shortfall from elsewhere in its own budget.

Amendment to Loans Fund Repayment Policy

3.14 Under the 2016 Regulations, the Council is required to maintain a Loans Fund Repayment Policy. The current Policy, approved as part of the 2018/19 Treasury Strategy requires to be amended to include the funding / income method of repayment. It is recommended that the new Policy reads:

Loans Fund Repayment Policy

3.15 The Council operates a consolidated loans fund under the terms of the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016. Capital payments made by services are financed by capital advances from the loans fund.

3.16 With the exception of advances in relation to Edinburgh Living LLPs, all advances from the loans fund in the current year have a repayment profile set out using Option 1 – the statutory method. These capital advance along with previous years' advances from the loans fund are being repaid using the previous hybrid annuity structure with fixed principal repayments.

3.17 For capital advances for loans to Edinburgh Living LLPs, all advances from the loans fund in the current year have a repayment profile set out using Option 4 – the funding / income method and these capital advance will be repaid using an annuity structure with fixed interest rate and principal repayments.

4. Measures of success

4.1 The establishment of two LLPs to deliver 1,500 homes for households on low to moderate incomes.

4.2 The LLPs have a key role to play in delivering the Council's housing strategy and the coalition commitment to deliver 20,000 homes over ten years. The development of the LLPs will also have a positive impact on the local economy, through creating opportunities for local businesses as well as jobs in construction.

4.3 Support the delivery of more social rented homes by operating at scale.

4.4 Support the delivery of mixed tenure housing led regeneration of brownfield sites.

4.5 High quality, well managed homes and outstanding customer service for tenants.

4.6 Positive impact on the local economy through creation of jobs and regeneration opportunities.

5. Financial impact

Housing Revenue Account

5.1 The mid market rent LLP will purchase 105 completed homes from the HRA for a Capital Receipt of £15.18m. The transfer price is based on total development costs; including construction cost, land value and related short-term funding costs. The financial impact of this mechanism on the HRA will be cost neutral and the capital expenditure associated with funding the construction forms part of the approved Housing Revenue Account Budget Strategy for 2017/18 to 2021/22. This approach will also be applied to future transfers as it ensures that the HRA is not impacted financially as a result of front-funding these developments.

LLPs

5.2 The mid market rent LLP will fund the purchase of these homes from £12.87m in borrowing received through Council lending and £2.310m of Scottish Government grant funding. Approval is required from the City of Edinburgh Council to lend funds to the LLP in order to fund the purchase of these homes. The costs associated with the lending will be recharged to the LLP, who will meet these costs from net rental income generated from letting the properties.

5.3 A viability test has been carried out to ensure that the 105 homes purchased by the mid market rent LLP are capable of generating a sustainable income stream that can cover running costs and repayment of principal and interest on the lending provided by the Council's General Fund. A prudent allowance is also required to be earmarked to cover future life-cycle maintenance.

5.4 The test uses Debt Service Cover Ratio (DSCR) as a measure of financial viability. DSCR is a measure of the cash flow available to pay debt servicing and is calculated as:

$$\frac{\text{Net Income (excluding lifecycle provision)}}{\text{Debt Servicing costs}} = \text{DSCR}$$

5.5 A minimum DSCR of 1.02 times is used to measure financial viability to the LLPs. This is defined as the net cash flow available after all running costs have been met (excluding lifecycle provision) being at least 2% higher than debt servicing costs. If the DSCR is 1.02 times or greater, the acquisition is considered to have met the minimum financial viability criteria. The test will be run for every acquisition made by the LLPs.

5.6 The viability test requirements were met, with projected net rental income (excluding lifecycle reserve provision) against loan repayments representing a debt service cover ratio of 1.13 times. Furthermore, the proposed rent levels for these homes have been compared to local housing market rents and considered to be appropriate and affordable. Rent levels will be within local housing allowance levels. Detail of the output of the financial viability test is included within Appendix 2

5.7 The lending to the mid market LLP in order to acquire 105 homes for mid market rent will be £12.87m, supplemented with £2.310m of grant funding from the Scottish Government (£0.022m per mid market unit has been provided through City Region Deal). The overall indicative loan charges associated with this capital advance over a 40-year period will be a principal amount of £12.87m and interest of £9.850m, resulting in a total cost to the LLPs of £22.72m based on an average facility interest rate of 3.125%. The annual loan charges will be £0.568m and will be fixed for the 40-year borrowing period. The annual loan charges will be repaid through the net rental income generated from letting the homes. This is projected to be £0.639m per annum in the first full year of operation and will be subject to annual inflationary increases.

General Fund

5.8 The viability test results project that the LLPs will generate sufficient net rental income to repay the Loans Fund capital advances relating to borrowing provided for the acquisition of homes and meet life-cycle maintenance requirements. The LLPs will monitor the actual operating position and adapt their business plan on an ongoing basis to ensure that this remains the case. It should be noted, however, that should the LLPs fail to make their loan principal or interest repayments, the Council's General Fund will need to fund the shortfall from elsewhere in its own budget.

5.9 Financial risk to the General Fund in the event of LLP default is mitigated by the Council having first ranking security on the homes after repayment of Scottish Government Grant provided for the mid-market rent LLP.

6. Risk, policy, compliance and governance impact

6.1 The LLP is made up of two partners, the City of Edinburgh Council and SFT.

6.2 The day to day management of the LLPs is delivered by a Senior Management Team made up of Senior Officers of the Council and a Senior Officer from SFT. The LLPs are governed by the two Members, the Council and SFT, and meet as a Corporate Body represented by four elected members, the Executive Director of Place and a Director from SFT.

6.3 Reports will be delivered to both the Housing and Economy Committee and the Governance, Risk and Best Value Committee providing updates on the operations of the LLPs.

6.4 Scottish Government consent is required to allow the Council to transfer land out of the HRA. In 2016, the Scottish Government published guidance setting out the procedures that the Council should follow when disposing of land on the HRA.

6.5 The majority of disposals are now dealt with through a General Consent rather than needing to apply to the Scottish Government for consent on an individual basis.

6.6 This disposal will fall under the General Consent, ensuring that best consideration has been achieved for the HRA.

6.7 Financial risk to the Council in the event of LLP default is mitigated by the Council having first ranking security on the homes after repayment of Scottish Government Grant provided for the mid-market rent LLP. For example, if demand for rented homes was to diminish in the future and demand for homes for ownership increased, the homes could be sold.

7. Equalities impact

7.1 An integrated impact assessment has been carried out for this project. A range of positive impacts have been identified. These include:

7.1.1 More accessible homes that are suitable for people who have mobility difficulties;

7.1.2 More affordable homes to enable people to have a good standard of living;

7.1.3 More people able to access housing which enhances rights in relation to privacy and family life; and

7.1.4 Community benefits secured through housing contracts can enhance rights to education and learning through development of links with schools.

8. Sustainability impact

8.1 The partnership will support the delivery of new homes on brownfield sites, reducing pressure on Edinburgh's green belt.

8.2 New build homes are built to high standards in terms of energy efficiency and sustainability. There will be a strong emphasis on providing homes that are cheap to heat and affordable to manage for tenants.

8.3 Community benefits secured through housing contracts can enhance the local environment.

9. Consultation and engagement

9.1 Consultation has taken place on accelerating house building and establishing housing LLPs with a range of partners including; RSLs, housing developers, land agents, institutional investors, Scottish Government and the SFT.

9.2 There is strong support from Council tenants for delivery of more affordable homes and strong demand for housing at mid market rent levels.

10. Background reading/external references

10.1 Accelerating House Building – referral from the Health, Social Care and Housing Committee, City of Edinburgh Council, Thursday 17 September 2015

10.2 21st Century Homes – Housing Development at Fountainbridge and Meadowbank, Health Social Care and Housing Committee, Tuesday 19 April 2016

10.3 City Housing Strategy Update, Health, Social Care and Housing Committee, Tuesday 13 September 2016

10.4 City Deal – Proposal for New Housing Partnership with Scottish Futures Trust, Housing and Economy Committee, Thursday 02 November 2017

10.5 City Deal – New Housing Delivery Partnership Implementation, Housing and Economy Committee, Thursday 18 January 2018

10.6 City Deal – New Housing Delivery Partnership Implementation – Referral from the Housing and Economy Committee, City of Edinburgh Council, 01 February 2018

10.7 Annual Treasury Strategy 2017-18 - referral from the Finance and Resources Committee, City of Edinburgh Council, Thursday 16 March 2017

10.8 Annual Treasury Strategy 2018-19, City of Edinburgh Council, Thursday 15 March 2018

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11. Appendices

11.1 Appendix 1 – List of homes to be transferred on completion

11.2 Appendix 2 – Output of financial viability test

Appendix 1

Mid market rent homes to be delivered in 2018/19

Site	Number of homes for mid market rent	Approximate date of first phase handovers
Clermiston	22	August 2018
Greendykes G	56	September 2018
Hailesland Place	11	November 2018
North Sighthill	16	January 2019
Total	**105**	

Appendix 2

Output of Financial Viability Test

Site	Total acquisition price £m	Scottish Government grant £m	Projected Net Income (per annum – first full year of operation) £m	Debt Servicing costs (per annum) £m	DSCR
Clermiston	3.12	0.484	0.131	0.113	1.16
Greendykes G	8.11	1.232	0.343	0.305	1.12
Hailesland Place	1.53	0.242	0.061	0.057	1.07
North Sighthill	2.42	0.352	0.104	0.093	1.12
Total	**15.18**	**2.310**	**0.639**	**0.568**	**1.13**