

# Finance and Resources Committee

3.00pm, Tuesday, 4 December 2018

## Edinburgh Living LLPs: Acquisition of Homes 2019/20

Item number	7.14
Report number	
Executive/routine	
Wards	All
Council Commitments	<a href="#">1</a> , <a href="#">6</a> , <a href="#">10</a>

### 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. Governance is now in place and following a procurement exercise, Wheatley Group have been appointed to manage the homes for Edinburgh Living.

As part of the governance arrangements, the Finance and Resources Committee will be asked to approve the transfer of mid-market and market rent homes being constructed through the Housing Revenue Account (HRA) as part of the Council's mixed tenure housebuilding programme to Edinburgh Living on an annual basis.

In June 2018, this committee approved the transfer of 105 mid-market rent homes to be completed in 2018/19. Twenty-two of these homes were purchased by Edinburgh Living November 2018, the remainder of the homes in the first tranche will be completed and transferred in the next four months. The homes due to be transferred on completion in 2019/20 are currently under construction and will be transferred from April 2019 onwards at a 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 Edinburgh Living to complete the purchase and refer the report to City of Edinburgh Council in February 2019 for approval. The purchase will be funded through a mix of borrowing and Scottish Government grant. The HRA will receive a capital receipt for expenditure it has already incurred in delivering the homes.

## Edinburgh Living LLPs: Acquisition of Homes 2019/20

### 1. Recommendations

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- 1.1 It is recommended that the Finance and Resources Committee:
  - 1.1.1 Agrees the transfer of 222 homes constructed as part the Council's housebuilding programme, from the Housing Revenue Account (HRA), to Edinburgh Living in 2019/20;
  - 1.1.2 Note the requirement for the Council
    - 1.1.2.1 to lend up to £25.901m to the mid-market rent LLP to purchase 222 homes; and
    - 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 3.19;
  - 1.1.3 Refers this report to Full Council on 07 February 2019 for approval of the above; and
  - 1.1.4 Notes that a contract was awarded to Wheatley Group to provide Management and Maintenance services to the Edinburgh Living LLPs, under delegated authority, as agreed by this Committee in October 2018.

### 2. Background

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- 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 Scotland 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 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.
- 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 This 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, alongside a Director from SFT.
- 2.6 The Council entered into agreements with SFT on 28 March 2018 and the first meeting of the LLP's Corporate Body took place on 04 June 2018.
- 2.7 In June 2018 the Finance and Resources Committee agreed that 105 homes constructed as part of the Council's mixed tenure housebuilding programme would be transferred on completion to the Edinburgh Living mid-market rent LLP in the financial year 2018/19.
- 2.8 The report was referred to Council to agree a facility allowing the Council to lend money to the LLP to purchase the homes.
- 2.9 Wheatley Group was appointed as the management and maintenance supplier for Edinburgh Living in October 2018 following this Committee's decision to delegate the award of contract to the Executive Director of Place, in consultation with the Convenor and Vice Convenor of the Finance and Resources Committee.

### **3. Main report**

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- 3.1 The Edinburgh Living LLPs are now operational and following the decision taken by this Committee in June 2018 allowing the Council to transfer 105 homes to the LLPs in 2018/19, Edinburgh Living MMR LLP purchased its first 22 homes at Clermiston on x November 2018. The remaining 83 homes from the first tranche, at Greendykes, North Sighthill and Hailesland, are nearing completion and are due for transfer and let in 2019.
- 3.2 It was agreed as part of the Edinburgh Living governance structure that on an annual basis, the Finance and Resources Committee would approve the transfer of mid-market rent and market rent homes being constructed by the Council from the HRA to Edinburgh Living.
- 3.3 The purpose of this report is to seek Committee approval to continue the growth of Edinburgh Living by approving the transfer of mid-market rent homes scheduled for completion in 2019/20, 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.
- 3.4 The Council currently has 899 homes under construction as part of the mixed tenure council house building programme. In total, 222 of the homes to be delivered by the programme in 2019/20 have been earmarked for mid-market rent. These are detailed within Appendix 1. The homes will be delivered on five sites across the city at North Sighthill, Dumbryden, Royston, Pennywell phase 3 and Pennywell Town Centre. The homes are located within mixed tenure developments which include housing for social rent to be held on the HRA and managed by the Council.
- 3.5 Once transferred, the homes will be owned by the LLP and let and managed by the newly appointed lettings, management and maintenance service provider, Wheatley

Group. The Council has a 99.9% share in the mid-market rent LLP with the remaining 0.01% held by SFT.

- 3.6 It is anticipated that a report on the transfer of the third tranche of homes to Edinburgh Living will be brought to this committee at the end of 2019.

### **Management and Maintenance of the homes**

- 3.7 The operational model for the day to day management of Edinburgh Living is based on the successful approach in use under the National Housing Trust (NHT) initiative. Edinburgh Living has no staff and in order to provide a consistent level of service, the Council will supply the services that allow the LLPs to operate. Where the Council cannot supply a required service, it will procure them on the LLPs behalf.
- 3.8 The Council does not currently have the requisite experience in delivering management and maintenance services to mid-market and market rent homes let under a Private Rented Tenancy agreement. As a result, a service provider experienced in this field was required.
- 3.9 A procurement exercise took place between June and October 2018 to select an organisation with suitable experience to manage and maintain the homes on behalf of Edinburgh Living. On 5 November 2018, Wheatley Group, an organisation experienced in managing homes across a number of tenures throughout Scotland, was appointed as the lettings, management and maintenance service provider for Edinburgh Living. Wheatley Group will provide services to the LLPs over the next three to six years.
- 3.10 The Council will manage the contract, which includes monthly progress meetings, and ensure that the tenants and Edinburgh Living receive a high level of customer service from the procured supplier. Wheatley will attend the Edinburgh Living Senior Management Team meeting on a quarterly basis.
- 3.11 In addition to meeting the cost of the day to day management and maintenance, a proportion of the rents collected will be held by Edinburgh Living as a lifecycle reserve. This will ensure that funds are in place to enable Edinburgh Living 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**

- 3.12 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.
- 3.13 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**

- 3.14 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.
- 3.15 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 been included as a separate line in the borrowing CFR approved as part of the budget process and 2019/20 Treasury Strategy. The loans have also been included in the Authorised Limit and Operational Boundary Prudential Indicators.
- 3.16 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 2019/20 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**

- 3.17 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.
- 3.18 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.
- 3.19 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.

## 4. Measures of success

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- 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 affordable 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

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### Housing Revenue Account

- 5.1 The mid-market rent LLP will purchase 222 completed homes from the HRA for a Capital Receipt of £30.785m. 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 £25.901m in borrowing received through Council lending and £4.884m 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 222 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:

## Net Income (excluding lifecycle provision) = DSCR

### Debt Servicing costs

- 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 for this tranche of acquisitions were met, with projected net rental income (excluding lifecycle reserve provision) against loan repayments representing a debt service cover ratio of 1.10 times. On a total portfolio basis, including the 105 homes acquired in 2018/19, the projected DSCR is 1.12 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 222 homes for mid-market rent will be £25.901m, supplemented with £4.884m 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 £25.901m and interest of £22.579m, resulting in a total cost to the LLPs of £48.48m based on an average facility interest rate of 3.6%. The annual loan charges will be £1.212m 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 £1.329m 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**

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- 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**

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- 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**

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- 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**

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- 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**

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- 10.1 [Accelerating House Building – referral from the Health, Social Care and Housing Committee, City of Edinburgh Council, Thursday 17 September 2015](#)
- 10.2 [21<sup>st</sup> 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](#)
- 10.9 [Edinburgh Living: Management, Maintenance and Letting Services – Award of Contract Under Delegated Authority, Finance and Resources Committee, Thursday 11 October 2018](#)

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**11. Appendices**

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- Appendix 1            List of homes to be transferred on completion
- Appendix 2            Output of financial viability test

**Mid-market rent homes to be delivered in 2019/20**

Site	Number of homes for mid-market rent	Approximate date of first phase handovers
North Sighthill	72	April 2019
Pennywell Town Centre	11	April 2019
Dumbryden Phase 1	19	May 2019
Royston	22	September 2019
Pennywell Phase 3	97	January 2020
<b>Total</b>	<b>222</b>	

## 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
North Sighthill Phase 2	9.873	1.584	0.422	0.385	1.10
Dumbryden	2.767	0.418	0.120	0.111	1.08
Royston	2.504	0.484	0.110	0.095	1.16
Pennywell Town Centre	1.551	0.264	0.065	0.057	1.14
Pennywell Phase 3	14.090	2.134	0.612	0.564	1.09
<b>Total</b>	<b>30.785</b>	<b>4.884</b>	<b>1.329</b>	<b>1.212</b>	<b>1.10</b>