Finance and Resources Committee

10.00am, Thursday, 29 October 2020

Telford NHT 2011 LLP: Sale of Homes to LAR Housing Trust

Executive/routine	**Executive**
Wards	
Council Commitments	

1. Recommendations

1.1 It is recommended that Finance and Resources Committee:

1.1.1 approves the sale of the Telford NHT 2011 LLP homes to LAR Housing Trust for the sum of £11.6 million, on the terms and conditions outlined in the report;

1.1.2 delegates approval to the Executive Director of Place to conclude the disposal; and

1.1.3 following the conclusion of the sale and the wind up of the LLP, the Council as developer is expected to receive an estimated £0.200m in unspent reserves. Committee is asked to approve ring-fencing of these reserves to support the delivery of affordable housing.

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Executive Director of Place

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Report

Telford NHT 2011 LLP: Sale of Homes to LAR Housing Trust

2. Executive Summary

2.1 The purpose of this report is to seek approval for the Council to sell 89 homes held in the Telford NHT 2011 Limited Liability Partnership (LLP) to LAR Housing Trust, to be retained as affordable rented housing whilst ensuring that those tenants who are willing and able to purchase a home within the development are provided with an opportunity to do so.

2.2 In October 2011, the Council entered into an LLP with Miller Homes Limited (Miller) and Scottish Futures Trust (SFT), to own and manage 89 homes for mid-market rent at Telford North. The homes were developed by Miller Homes under the National Housing Trust (NHT) initiative which has a provision for developers to exit the LLP between years five and ten. In 2018, (after five years) Miller indicated their intention to exit the LLP within a short time period. In January 2019, the Council acquired the developer's share in the LLP enabling homes to be retained as rented housing within the LLP, whilst a long-term solution could be explored that would secure positive outcomes for all tenants regardless of whether they were able to exercise their option to purchase their home.

2.3 Miller accepted an offer from the Council of £2.850m for their share of the LLP and £0.598 million was required for Land and Buildings Transaction Tax (LBTT), bringing the total cost of acquiring the developer's stake from Miller to £3.448m. This was funded from the Council Tax Discount Fund (CTDF).

2.4 The sale to LAR for £11.6m would result in a Council loan to the LLP of £10.298m being repaid along with £1.302m being returned to the CTDF, which can be used to fund affordable housing going forward. £2.146m of CTDF funding will continue to support the units at the Telford North site to enable homes which are not sold to continue to be rented at mid-market rent levels.

2.5 The sale of homes to LAR Housing Trust will deliver positive outcomes to tenants. Those tenants wishing to purchase will be given enhanced timescales to maximise their ability to purchase. Those tenants who are unable to purchase will be able to remain in their homes, with rent increases capped at CPI.

3. Background

3.1 In 2010, the Scottish Government (SG) and the SFT launched the NHT initiative to deliver homes for mid-market rent in areas of high demand, while at the same time stimulating house building activity following the market crash of 2008. The Council agreed to participate in the initiative in August 2010 and has provided on-lending to support the delivery of over 800 affordable homes across the city.

3.2 Under the NHT model, the Council procures a developer to build the homes and enters into a LLP with the developer and SFT. The LLP purchases the completed homes, using a loan from the Council which is guaranteed by the SG and must be repaid within ten years. The homes are let as mid-market rent for a minimum of five years, with the developer given the option to exit the vehicle between years five and ten.

3.3 In the NHT delivery model, the developer supplies the land and builds the properties to a specified standard and timescale. The Council, developer and SFT all sit on the LLP board which oversees the development programme. The LLP purchases the completed homes, using a loan from the Council which is guaranteed by the SG. The homes are let as mid-market rent tenancies for between five and ten years, at which point the developer can trigger an exit from the LLP by selling the homes. Tenants are given first option to purchase their home. The Council's loan must be repaid in full, with interest, by year ten.

3.4 In October 2011, the Council entered into an LLP with Miller and SFT, to own and manage 89 homes for mid-market rent (MMR) at Telford North. In January 2018, Miller notified the Council of their intention to exit the LLP within an 18-month period which, under the terms of the NHT contract, triggers a housing disposal process. Sitting tenants have an option to purchase homes prior to the homes being sold at full market value to a local authority nominee or on the open market. Whilst Miller's decision to exit the LLP was not unexpected, it was recognised that the short timescales proposed would make it difficult for tenants to exercise the option to purchase their home, should they wish to do so, or find other suitable housing if they chose not to.

3.5 On 11 October 2018, Finance and Resources Committee gave approval for the Council to purchase Miller's share of the LLP, enabling the 89 homes to remain within the LLP with the Council and SFT as members up until year ten. The purchase concluded in January 2019, and homes have continued in mid rent.

3.6 On 25 October 2018, the City of Edinburgh Council ratified the use of reserves held in the CTDF to enable the Council to purchase Miller's share of the LLP for £2.850m. £0.598m was required from the CTDF for LBTT, which was also approved by Committee on this date.

3.7 LAR Housing Trust was set up in 2015 with plans to build around 1,000 homes for mid-market across Scotland. LAR is a Scottish Charitable Incorporated Organisation (SCIO). Their initial funding came from a 25-year loan of £55m from Scottish Government. In addition, in July 2017, LAR secured £65m of private funding in a deal arranged by Bank of Scotland Commercial Real Estate through its partnership with Scottish Widows. This private finance has helped LAR to boost its portfolio of mid-market properties across Scotland. They currently have 499 tenanted units, with a further 300 at construction or planning stage, spread across ten sites in Scotland. Two of the completed developments are in Edinburgh, at Westwood House and Elfin Square.

4. Main report

4.1 Miller Homes Limited were the original developer for the Telford NHT 2011 LLP. A total of 89 homes were delivered at Telford North, with the final completions in July 2013. The Council's loan to the LLP was £10.298m and this is required to be repaid by year ten (2023/24).

4.2 In January 2019, transfer of Miller Homes' share of the LLP to the Council took place in order to give tenants a meaningful option to purchase over a longer period of time and to secure positive outcomes for those tenants in the development who would be unable to purchase their home. Following the acquisition of the Telford homes, an officer working group was established to consider exit options and bring forward a recommendation that would enable those homes that will not be sold to sitting tenants to be retained as long term, affordable rented housing. Appendix 1 sets out the options analysis, including the preferred option of selling the homes to LAR Housing Trust as a bulk sale.

4.3 In 2018 the Council established the Edinburgh Living LLPs to own and manage housing for mid-market and market rent. Edinburgh Living currently owns and manages 182 homes and continues to grow as the Council takes handover of mid rent homes from contractors. Edinburgh Living expects to acquire 550 homes over the next few years through the Council's housebuilding programme. The option to sell to both sitting tenants and on the open market, with any remaining homes transferring to Edinburgh Living's market rent vehicle or MMR vehicle was considered. Despite potential benefits in delivering a pipeline for the market rent vehicle, it was concluded that it was not financially viable, largely due to the cost of the borrowing which would be required.

4.4 Edinburgh Living does not get grant for market rent homes and so borrowing needs to be covered by rental income alone. Rents are set on a site by site basis, taking into account local market area and project viability. The cost of purchasing homes and ongoing management and maintenance costs could not be recovered from rental income at Telford North.

4.5 It was also concluded that the option to transfer units to Edinburgh Living's MMR vehicle could have a detrimental impact on the health and standing of the MMR vehicle. The Edinburgh Living model assumes that a lifecycle fund will build up over time. The NHT model does not do this and due to the age of the properties, Edinburgh Living would not be able to cover the lifecycle costs that will be necessary at Telford over the next few years without having a detrimental impact on the ability of the LLP to pay for lifecycle commitments associated with the existing stock.

4.6 In June 2020 discussions began with LAR Housing Trust on the potential purchase of the homes at Telford North. In relation to NHT homes, LAR have undertaken a similar arrangement with Aberdeen City Council, taking ownership of homes within three NHT developments there.

4.7 Due to the unique way LAR is funded (combination of SG loan and private finance) and the strength of their portfolio, they are able to purchase the homes, give tenants the option to purchase or remain in their home at MMR levels. Annual rent increases would be capped at CPI, below the original NHT rent structure of CPI +1%.

4.8 A price of £11.6m has been offered by LAR for the properties. This would enable the Council loan of £10.298m to the LLP to be repaid along with £1.302m of CTDF being returned which will be used to support development of more affordable homes.

4.9 Importantly, the sale to LAR will replicate the original NHT agreement in terms of tenants having an opportunity to purchase a home, with LAR offering a potential enhancement to the terms as they are keen to work with tenants to understand what timescales will suit them best in terms of buying a home and maximising their ability to purchase. LAR recognises that the COVID-19 pandemic could have a detrimental impact on the number of tenants who will be able to buy a home. Tenants who cannot buy a home will continue to rent, with rent increases capped at CPI.

4.10 Securing this positive outcome for tenants is not only beneficial for the tenants themselves but will prevent tenants having to seek alternative accommodation, potentially through the homelessness route, which could have cost implications for the Council. MMR homes are generally for low to middle income households (with maximum income criteria applied to applicants) who may have limited alternative housing options if purchasing a home is not viable.

4.11 Lowther Homes are the current Management and Maintenance agents for the homes at Telford North. They have been informed of the proposed transfer and are aware that the current arrangement for managing these homes will come to an end when the properties are transferred to LAR, who have their own management and maintenance company.

5. Next Steps

5.1 Following approval of the terms by Finance and Resources Committee, solicitors will be instructed to complete the legal documentation for the disposal of the properties to LAR Housing Trust. The opportunity for tenants to purchase a home within the development will be covered in the condition of sale.

5.2 Tenants will be informed of the transfer of ownership when the legal documentation has been agreed.

6. Financial impact

6.1 On 25 October 2018, The City of Edinburgh Council approved the use of reserves held in the CTDF to purchase Miller's share of the LLP, by the Council for £3.448m (including £0.598m for LBTT), enabling homes to be retained as rented housing within the LLP, whilst a long term solution could be explored that would secure positive outcomes for all tenants regardless of whether they were able to exercise their option to purchase. The CTDF can be used by local authorities to support revenue and capital expenditure related to a range of affordable housing activity, including, but not limited to, purchasing off-the-shelf houses from private developers for affordable housing use.

6.2 The Council's loan to the LLP is £10.298m and this is required to be repaid by year ten (2023/24). LAR Housing Trust have offered to purchase the homes at Telford North for £11.6m. The loan will be repaid from the sale monies from LAR and £1.302m will be returned to the CTDF and can be used to fund affordable housing projects going forward. Income from the CTDF is currently ring-fenced to support the Council's new build programme as part of the Housing Revenue Account (HRA) Business Plan. The remaining £2.146m which came from CTDF to pay for Miller's share of the development (including cost of LBTT) will continue to support the unsold units at the Telford North development. It is anticipated that the number of homes sold to sitting tenants will be low, based on the experience of NHT developments elsewhere.

6.3 The LLP will have an estimated £0.200m in reserves following transfer to LAR. The reserves can be retained by the Council as Developer partner in the LLP. Committee is asked to approve ring-fencing of these reserves to support the delivery of affordable housing.

6.4 A variety of options were considered and worked through in terms of financial viability, positive outcomes for tenants and the ability to secure the maximum number of homes as affordable, these are summarized in Appendix 1. The Council is unlikely to achieve a higher value unless an open market disposal approach is taken, however, it would mean that the homes would not be retained as affordable housing. It would also bring the same challenges in respect of displacement of existing tenants that the Council sought to minimise in acquiring Miller's share in the LLP.

6.5 A significant factor for LAR in considering this development is the wish to continue to provide affordable accommodation for the existing tenants. The value offered by LAR recognises that it is a bulk purchase of properties, which are tenanted rather than vacant. LAR will also be responsible for costs involved in sales transactions and are taking full risk in terms of sales in an uncertain housing market.

6.6 Offering tenants the option to purchase could bring management challenges and additional costs where sales result in 'pepper-potted' stairs with a mix of tenants and owners. LAR do not have any other developments where stairs are mixed in this way but are willing to be flexible in relation to the Telford homes. LAR are willing to take these risks while maintaining the option for tenants to purchase and capping annual rent increases at a maximum of CPI. They assert that the price offered is roughly equivalent to the cost to LAR of buying and developing a similar flatted block, within Edinburgh, on the open market, without the same rent and tenant purchase agreements.

7. Stakeholder/Community Impact

7.1 There are no negative equality or human rights impacts arising from this report. The sale to LAR will help to retain the homes for affordable and low-cost rent with the option of tenant purchase helping to ensure a range of housing options are available in the city.

7.2 Tenants will receive communication about their change of landlord, which will include contact details and a reassurance that their tenancy rights remain unchanged. They will also be given information on future opportunities to purchase a home.

7.3 NHT homes were built on brownfield sites and meet the needs of people on low to moderate incomes.

8. Background reading/external references

8.1 Minute of 11 October 2018 Finance and Resources Report (B agenda report).

8.2 Minute of City of Edinburgh Council report 25 October 2018 (B agenda report).

9. Appendices

9.1 Appendix 1 – Options Analysis

Appendix 1 – Options Analysis

Option	Analysis	Conclusion
Option 1 - selling properties to both sitting tenants and remaining units transferring to Edinburgh Living's MMR Vehicle.	• Proposed rent levels would not be enough to cover the cost of borrowing required to facilitate the purchase. In addition, the age of the properties and lack of life cycle reserves make the ongoing maintenance unaffordable. • Sales to sitting tenants would result in pepper-potting within the development, bringing management challenges. • Current rent structure of annual increases of CPI +1%, would have to reduce to CPI increases only once in the MMR Vehicle, reducing viability further. • Grant funding set out in Edinburgh Living heads of terms cannot be used to subsidize second-hand homes. Even if grant could be secured through the AHSP (£47k per home); homes still do not pass the viability test (debt service cover ratio of 1.02). Using grant funding would divert grant from other affordable housing projects, which is not the case for other options such as the preferred option to sell to LAR.	**Not financially viable** on basis of rent levels, age of property and lack of lifecycle reserves.
Option 2 - Selling to sitting tenants and remaining units transferring to Edinburgh Living's market rent Vehicle.	• Proposed rent levels (taking into account local market area and project viability) would not be enough to cover the cost of borrowing required to facilitate the purchase. In addition, the age of the properties and lack of life cycle reserves make the ongoing maintenance unaffordable. • Further modelling was carried out to see if there was an optimum number of homes that could be purchased to achieve viability, with the remaining homes sold on the open market. A maximum of 15 homes could be transferred; however, a combination of very specific flat types (larger properties) would be required. Larger properties can be more difficult to let, adding additional risk, as well as the wider management challenges of being a minority owner in a very pepper-potted development.	**Not financially viable** on basis of rent levels, age of property and lack of lifecycle reserves. Majority of homes would need to be sold, creating a Pepper-potted development.

Option 3 - Fully exiting the LLP by selling to both sitting tenants and on the open market by 2023/24.	• In line with original NHT objectives. • No homes retained for affordable. • Tenants who were unable to purchase would have to find alternative accommodation. • In the current market the Council would take on all the risk of selling homes and securing enough income to repay the loan by 2023/24.	**Does not achieve positive outcomes to tenants or retain any homes as affordable.** Tenants would have to be moved on to alternative accommodation to meet sales target and loan repayment deadline.
Option 4 – Properties sold to a third-party retaining tenant option to purchase, with remaining homes available for MMR.	• Bulk sale to third party (LAR Housing Trust); loan repaid by 2023/24. LLP dissolved. • Tenants given option to purchase, those unable to purchase are able to remain as MMR tenants. • LAR take on sales risk and management risk of pepper-potted development. • Homes not sold to sitting tenants are supported by earlier CTDF contribution to remain as affordable. • No grant required to support this option.	**Preferred option.** Tenants have security of tenure. Majority of homes remain as affordable, with no grant input required.