Colchester	**Cabinet**	Item **7(ii)**
	30 January 2019	

Report of	**Assistant Director Policy & Corporate**	**Author**	**Andrew Tyrrell** ☎ **282390**
Title	**Ownership of the New Affordable Housing Delivered by Colchester Amphora Homes Ltd (CAHL)**		
Wards affected	Mile End, Highwoods, Castle, New Town and Christ Church		

1. Executive Summary

1.1 Against a backdrop of changing Government policies that halted most Local Authority housebuilding in 2015, the Council has remained clear on its ambitions to continue to deliver new affordable homes. Colchester Amphora Homes Ltd (CAHL) was created as a wholly-owned company that could deliver these new homes, and in October 2018 it was agreed that they would complete the purchase of 4 sites from the Council, then develop over 300 new homes, and over 100 affordable homes, on those sites.

1.2 However, as highlighted in the October Cabinet Report, financial advice highlighted that there would be less favourable financial implications if CAHL were to retain the completed affordable units that they delivered. Simplistically, this is because a development company operates differently to a holding company and developing to sell has different taxation rules to a company developing to rent. Consequently, it was agreed by the Council that CAHL would not hold the completed homes and that an alternative option for the transfer of the affordable rental properties would be sought, with the priority of retaining all of the new affordable housing within Council control or ownership. This paper sets out how the Council will achieve this aim, and secure over 100 new Council-owned affordable homes from the 4 sites being developed.

1.3 Under these proposals, Colchester Borough Council will be the landlord (owner) of the newly built affordable units. The new affordable properties will then be let to households already waiting for suitable homes from the Council's housing needs register according to the allocations policy (see Gateway to Homechoice).

2. Recommended Decision

2.1 To use "prudential borrowing" now available to the Housing Revenue Account (HRA) to purchase all of the completed affordable housing units that are delivered from the first programme of development by Colchester Amphora Housing Ltd (CAHL).

2.2 To enter into a Development Agreement with CAHL which will see all of the affordable housing units on their 4 sites be transferred to the Council, upon completion, at an appropriate market value for affordable housing.

2.3 To delegate authority to the Assistant Director Policy and Corporate, in conjunction with the Portfolio Holder for Housing and Communities, to conclude the final legal agreements and financial matters in respect of all of the above.

2.4 To note that completion of the Development Agreement shall be simultaneous with the conditional contract CAHL will enter into with the Council for the initial sale of the sites to the company that was agreed by Cabinet in October 2018.

2.5 To note that provision for the acquisition of the first affordable homes has been incorporated into the 2019/20 Housing Revenue Account budget also on this agenda, and would then be included in subsequent budget setting processes in following years, as the new homes are delivered.

3. Reason for Recommended Decision

3.1 The Council has an established desire to build new affordable homes. CAHL, as a development company, is the delivery vehicle that will build new homes in the Borough including over 100 new affordable homes on behalf of the Council. However, due diligence as part of the Company set up has shown it is not economically beneficial if CAHL hold any of the completed stock once the developments are built..

3.2 The Council already owns affordable housing stock, but was unable to borrow more money within the HRA due to policies that the Government introduced in 2015, and the Government imposed HRA debt cap. That meant that the Council could not finance development of affordable homes. However, there was a fundamental change in Government policy in October 2018; with the Government’s Autumn Budget providing a sudden announcement that the HRA debt cap was to be abolished with immediate effect, a response to recent feedback from Councils across the country (including Colchester) regarding the biggest barriers to affordable housing development. This significant relaxation on the restriction of HRA borrowing means that the Council can now utilise a new capacity to borrow so that it can purchase the completed stock as new Council-owned affordable homes.

4. Alternative Options

4.1 The Council could set up a new wholly-owned rental holding company that would acquire the affordable housing units. The newly established subsidiary company would secure the properties under Council control, although the stock would be owned by the company rather than the Council. Following the abolition of the HRA debt cap, this would now be a more complicated option that is now likely to be more expensive than a direct purchase by the Council. More detail is set out further below.

4.2 The Council could agree that CAHL could sell the rental units to a Registered Provider (RP) and generate a capital receipt. The Council would receive 100% nomination rights upon first let and a minimum of 75% on second let. However, the Council would not own the properties and has no control over the future disposal of them (one of the key aims from developing these sites), so it is not explored further herein.

4.3 The Council could agree that CAHL should retain the completed stock, but this would adversely affect the financial model for the development for both the company and, subsequently, to the Council.

5. Background Information

5.1 The Council previously built 34 affordable homes (2012-2015) and had always intended to continue to build new affordable homes until the plans were halted by the Governments 2015 decision that there would be a 1% rent reduction for 4 consecutive years. This removed around £140m of rental income from the 30-year HRA Business Plan, meaning the HRA could no longer afford to build new homes.

5.2 As a proactive response, the Council set up CAHL as a wholly-owned company, with the aim to continue to build new affordable homes (cross-subsidised by private market homes for sale). The initial consultant advice for creating a new company included assumptions that the housing development company would develop market homes for sale, and hold affordable property for rent. The advice highlighted that the financial implications of this were complicated and would require further detailed exploration.

5.3 Since that time, further due diligence work identified that is it not economically beneficial for CAHL to hold the rental stock. As a development company, the development of properties for sale is zero rated for VAT purposes; no VAT is charged on selling price, whilst the VAT incurred on purchasing land or during construction is recoverable. However, if a development company retains stock for rental purposes then it will not be able to recover any VAT incurred on the attributable costs.

5.4 The financial considerations were set out in the Cabinet reports of 10 October 2018, alongside details that the company had worked to finalise schemes for 4 housing sites at Military Road, Creffield Road, St. Runwald Street and Mill Road. These sites would deliver over 300 new homes, including over 100 much needed affordable homes. Consequently, the Council agreed the sale of the sites and agreed that options for the transfer of the affordable rental properties would be explored further. The options to be explored had the core objective of securing the affordable homes within the Council's ownership or control, for the benefit of our communities.

5.5 Following that decision, came the fundamental change in Government policy, with the announcement of the abolition of the HRA debt cap. The combination of the changes to the financial model of the Council's company, and unexpected change in the borrowing capability for the Council, mean that it is now more favourable for the Council to own the affordable homes itself; securing the future of the new affordable homes for the residents on our housing needs register who will benefit from these new homes.

5.6 To do so, the Council will borrow money within the Housing Revenue Account (HRA) through the new relaxed rules under "prudential borrowing" (for example through the Public Works Loan Board), in the same way that the General Fund is able to. The prudential borrowing code states that the borrowing must be "affordable", so that the financing costs of any new borrowing can be met over the long term. This is now the only limitation on HRA borrowing.

5.7 The HRA budget report on this Agenda expands upon this, but in effect the Council can afford to borrow more based on its "Loan To Value"(LTV) and the assumptions on future income and expenditure. The Council already owns nearly 6,000 social housing units, so adding to the existing stock would be a continuation of a well-practiced affordable housing model. The Council can continue to lead in its strategic role and legal duties as the local housing authority, where the Council has a responsibility to assess and meet housing need, and duties to homeless households.

5.8 In practice, this would now mean that CAHL will now progress the agreed sites through the planning phase, develop the sites, and then sell all of the homes delivered (the private market properties to homeowners and the affordable homes to the Council). In order to formalise this arrangement, the Council will enter into a Development Agreement with CAHL. The Development Agreement acts, essentially, as an early decision and legal commitment to secure the transfer of the built homes (from CAHL to the Council) that removes risks and enables financial efficiency throughout the process. The Development Agreement will give the Council more certainty about the purchase timings, specifications and costs. In turn it will provide CAHLthe assurance of a secure capital receipt for the affordable homes.

5.9 The Council will take legal ownership as units are completed to a previously agreed specification. In terms of other details, the Agreements normally set out development timings and milestones, payments, requirement to carry out the particular development in line with agreed plans and specifications, measures to ensure the quality of the development and a longstop date for completion. This also fits with the financial modelling previously agreed by the Council at Cabinet in October, which assumed sales upon completion. The properties will then be managed by Colchester Borough Homes (CBH), the Council's ALMO, as is the management arrangement for the Council's existing affordable housing stock.

5.10 This is now a better option than those available before the HRA debt cap abolition. Prior to the Government policy changes the best option was to set up a new Council-owned rental holding company. That new wholly-owned company would have been registered to hold assets rather than build them, so could have bought the homes from CAHL. It would have required equity to do this, which would need to be borrowed (or invested) from the Council. The company would have to demonstrate that, as a company, it could afford the borrowing based on a return on investment so it was a sustainable company in economic terms. However, the loans from the Council would have to be set at a commercial interest rate (under the Market Economic Investor Principles) to comply with state aid rules. This would be higher than the rate at which the Council can borrow, and adds more complexity, in order to purchase the same properties that the Council would now be purchasing.

5.11 In addition, it is understood that whilst a rental company benefits from certain taxation exemptions for income, it is likely that the management services, future maintenance and any necessary refurbishments are not exempt for a rental company, which would become an additional cost. The Council benefits from "non-business" tax relief through the VAT Act s.33, and can reclaim some comparable exemption on such activities through the de minimis regime that is applicable to some of its taxable activities.

6. Equality, Diversity and Human Rights implications

6.1 The proposals are considered to have a positive impact. Mixed-tenure sites, which will be the outcome of the CAHL development, include all elements of our communities together in an integrated approach. There is a wealth of research that highlights the many benefits this can bring. This also includes the advantages to those within protected groups that benefit from the availability of affordable housing. Provision of greater choice and supply of affordable housing contributes to tackling social inequality and helps to create a fairer society. The homes will help to improve the living conditions for lower-income households, people with disabilities and families on the housing needs register.

6.2 Further Equality Impact Assessment can be found here

7. Strategic Plan References

7.1 The following Strategic plan References are met:

Growth: Ensuring all residents benefit from the growth of the borough
- Help make sure Colchester is a welcoming place for all residents and visitors
- Ensure residents benefit from Colchester's economic growth with skills, jobs and improving infrastructure

Opportunity: Promoting and improving Colchester and its environment
- Promote initiatives to help residents' live healthier lives

Wellbeing: Making Colchester an even better place to live and supporting those who need most help
- Encourage belonging, involvement and responsibility in all the borough's communities
- Create new social housing by building Council homes and supporting Registered Providers
- Target support to the most disadvantaged residents and communities

8. Consultation

8.1 There is no specific need for consultation related to these decisions. The individual sites will undergo public consultation during the planning application process and some have been subject to consultation during the Local Plan process to date.

9. Publicity Considerations

9.1 There are no specific publicity considerations directly related to the decision(s).

10. Financial implications

10.1 Modelling has been undertaken using the Councils existing 30 year HRA business plan model, which Cabinet will be aware forms part of the annual budget setting process presented in January each year (and found elsewhere on this Agenda). Assumptions have been made, which include:
- The cost of purchasing the rental units from CAHL;
- Rental income and void loss;
- Management & maintenance costs;
- Future capital costs (e.g. kitchens / bathrooms etc); and
- Financing costs (e.g. interest payable on the borrowing to purchase the units).

10.2 The modelling shows that the interest costs (relating to the additional borrowing to purchase the properties) and estimated running costs can be met from the additional annual rental income. The model demonstrates that there is the likelihood that a proportion of the additional borrowing can be repaid over a 30 year period, which is consistent with the existing HRA stock and associated debt. However, this projection is over a 30 year period and is derived from a number of assumptions in the financial model, many of which are out of our direct control, for example inflation. Therefore this projection should be viewed entirely as indicative.

10.3 It is also anticipated that retained 1-4-1 Right to Buy receipts would be able to be used to partially fund the purchase costs of the units. Right to Buy receipts can only be used to help provide "additional" affordable homes that would otherwise not be provided. The current Local Plan policy is to provide 20% affordable housing so Right to Buy receipts can only be used to fund the additional 10% of the properties being provided, above that. The exception to that is Military Road and Creffield Road, which are small sites that would not normally be required to provide any affordable housing; so all of the units in these schemes will qualify as "additional" affordable homes and can be part-funded through Right to Buy receipts.

10.4 It should be noted that tenants will be able to exercise their "Right to Buy" to purchase the new property. However, the current cost floor rules apply for an initial period, which means that the Council would not sell any new property for an amount which is less than the cost to the Council of purchasing and maintaining the home for the first 15 years of its lifecycle. Nationally Right to Buy has been decreasing, and this has been observed in Colchester, but the above consideration would also reduce the probability of losing the new properties in this manner. Additionally, if a new home was sold, the authority would be able to retain the whole receipt with no conditions (provided it is spent on affordable housing, regeneration, or paying down housing debt). Those receipts could then be reinvested in replacement affordable housing.

10.5 Wider financial implications on the HRA budget are also included in the Housing Revenue Account Budget estimates and Housing Investment Programme reports, also being considered on this Agenda.

11. Health, Wellbeing and Community Safety Implications

11.1 Health, wellbeing and community safety would be positively influenced by the provision of new affordable housing that help improve the quality of life for future occupants. Mixed-tenure communities, integrating affordable homes with private home-ownership, encourages community cohesion and there are strong links between improving housing and reducing health inequalities. Energy efficient homes which are easier and cheaper to heat are likely to have a positive influence on the health and wellbeing of occupants.

11.2 New, well-designed, affordable homes within mixed-tenure sites has been shown to influence the rate of crime and disorder when people feel part of their community. Additionally, under-used sites, such as Military Road can sometimes attract anti-social behaviour. The future development of these sites will improve such neighbourhoods by reducing crime and the fear of crime.

12. Health and Safety Implications

12.1 There are no concerns regarding the impact on the health and safety of the general public.

13. Risk Management Implications

13.1 A summary of the main risks and mitigation measures for the overall development of the 4 sites was outlined in the confidential part of the report on 10 October 2018 (Appendix A). These primarily related to the assumptions made by CAHL in assessing costs and income from the proposed development and their sensitivity testing for some of these key assumptions. This report has been based on the same assumptions to consider the ownership of the affordable rental properties. However, the assumptions are based on a number of variables, over time, and will inevitably be subject to changes. Housing development is an inherently complex business with a number of different, interrelated risks, such as build costs, construction delays, market forces etc. This will affect the price at which the properties are purchased at the time that they are completed.

13.2 If the development of Creffield Road and Military Road did not proceed it will impact on the Asset Management Strategy which has previously been approved. The agreed Strategy aims to balance the economic value of assets with the social and economic needs of residents given the long term viability of properties. Creffield Road requires investment to meet standards; which does not represent best value for money to the HRA and resulted in the previous agreement for disposal. If these sites did not proceed the HRA would need to fund alternative developments and make amendments to the business plan, but there would, as a minimum, be a significant delay to realising any potential from these assets.