Cabinet

7th March 2017

Report Title: *The Strategic Business Case for a Local Housing Delivery Company*

Ward: All

Strategic Director: Barra Mac Ruairi, Strategic Director for Place & Alison Comley, Strategic Director for Neighbourhoods

Report Author: *Nick Hooper, Service Director for Housing Programmes*

Contact telephone no. & email address *07825 315807 nick.hooper@bristol.gov.uk*

Purpose of the report:

Recommendation for the Mayor's approval:

1. **To approve the strategic business case, appended to this report, in favour of the establishment of a wholly owned local housing delivery company with initial projects being undertaken through joint venture(s) with external partners, subject to detailed business planning.**

2. **To commence detailed business planning as described in paragraph 8 for the establishment of the company to contribute toward delivering housing in the city as set out in this report, , for further consideration by Cabinet.**

3. **Expenditure of £250,000 in 2017/18 to undertake the work set out in 2. above.**

4. **To note that consideration of the incorporation of the new entity into the Bristol Holding Company's legal structure will form part of the detailed business planning.**

The proposal:

Summary

Bristol is in a housing crisis with far too few homes being built to keep pace with need and demand. Many people are being priced out of market – both owner occupation and renting. If Bristol is to build on its position as an economically successful city it needs to build more homes to support growth and help close the equality gap by providing for those on lower incomes.

There has been a "root and branch" review of the way in which the Council supports housing delivery and the direct role it can play. The findings of this review have now been incorporated into a new Housing Delivery Plan, subject to a separate report to Cabinet. The proposed new housing delivery 'vehicle' will add an additional channel through which the Council can directly control the development of new homes, both affordable and market, and which will complement other delivery channels.

The Proposal

Policy

1. The Mayor's manifesto of 2016 set out a number of commitments in relation to housing, specifically:
    - Building of 2000 new homes per year by 2020, of which 800 affordable.
    - The establishment of a wholly owned council housing company.

2. The Council's draft Corporate Strategy reiterates these policy objectives and outlines a vision:
    - where everyone benefits from the City's success and no-one is left behind, and
    - in which people have access to decent jobs and affordable homes.

3. Specifically the Council's Business Plan commits to producing the strategic business case for a new local housing company. This report fulfils that commitment.

Why Establish a Local Housing Company?

4. A local housing company is a generic name for a housing development or delivery 'vehicle', usually a separate legal entity either wholly owned or significantly influenced by the council. In recent years many local authorities have set up such vehicles for a range of reasons, but often with the objective of increasing housing supply. Other objectives have included site specific regeneration programmes and provision of temporary housing. Many councils have used the powers contained in the Localism Act 2011 to set up such vehicles.

5. The principal rationale in Bristol's case is to increase the supply of new homes, and there are a number of reasons why this is needed.
    - We need to maximise the number of different ways in which new homes are developed, to enhance our chances of successfully increasing housebuilding
    - It is impossible for the Council to undertake development itself as legally we are not allowed to build (or hold) new homes within General Fund, for income producing purposes
    - Income from rents received by social landlords (including the Council through the HRA) previously used to fund the development of new homes has been capped by government
    - The numbers of homes owned by the Council is gradually reducing through right-to-buy
    - The Housing Revenue Account has its ability to borrow money in order to build new homes restricted by government limits

- The council wishes to have greater control over how sites for new homes are developed and financial benefits; current arrangements give limited control over the new homes that are built as well as the timing of and financial benefits to the council

Strategic Business Case

6. In September 2016, the Council commissioned Lambert Smith Hampton (LSH), a land and property consultancy, to advise on and produce with the Council, a strategic business case for the establishment of a council-controlled housing delivery vehicle. The strategic business case follows the Council's guidance on the establishment of council–controlled companies and is structured in accordance with HM Treasury Green Book for public sector business cases.

7. The Green Book established the "5 case model" approach, and this is the approach followed here:
   - Strategic case – a case for change that provides a holistic fit with the Council.
   - Economic case – whether the intervention represents best "public value"
   - Commercial case – that the proposal is attractive to the market place, can be procured and is commercially viable.
   - Financial case –that the proposed spend is affordable.
   - Management case – from all interested parties' perspectives that it is achievable.

8. If approval is given to the strategic business case then a full business case will need to be prepared which will include amongst other things a detailed business plan, financial plan, investment plan, procurement plan, legal structures, full risk plan and implementation plan.

9. A set of strategic objectives and criteria were developed by the Steering Group and signed off by the Council's Executive Board in October and are set out in the appended strategic business case at section 2.8.

10. Following this a number of alternative models were examined, along with the "do nothing" status quo position (the long list) and evaluated using the previously agreed objectives and criteria in order to produce a short list. This is set out in the strategic business case at section 3.3.3. Two short listed options – a corporate joint venture (JV) with priority returns (essentially a model that distributes returns on a pre-agreed basis) and a wholly owned company (WOC) - were then compared in detail against the "do nothing" status quo. The detailed evaluation included running a cost-benefit analysis for each, as well as a qualitative assessment. This analysis included taking three sample council-owned sites – one city centre, one outer suburban in the north; and one inner suburban in the south – and using a set of development assumptions examined the feasibility of developing them using the short listed vehicles. The sample site information was also extrapolated to a larger group of sites drawn from the Council's sites pipeline.

11. The more detailed financial option appraisal work has also been supported by examining legal, wider financial issues and risks. There has also been high level soft market testing to determine if there is a commercial case. The conclusion of the work is that a wholly owned company best matches the strategic objectives, criteria and benefits (financial and non-financial) that were set.

Amongst other things these objectives included developing affordable homes at policy compliant levels of 30% or 40%.

Establishing a Wholly Owned Company with Joint Venture Partners

12. Following a review of the risks, including specifically financial, managerial and reputational, it was concluded that the initial projects developed by a WOC should be undertaken as a specific joint venture between the wholly owned company and partners. This is because:
    - Joint venture partners will bring considerable commercial expertise which the Council or WOC does not have, and which it will be costly and difficult to buy in
    - Partners will bring their own investment, alongside that of the Council, thus reducing the Council’s financial contribution
    - The experience of partners will mitigate the potential reputational risk
    - The WOC will have the ability to develop subsequent projects either acting independently or entering into additional joint venture arrangements.

13. The financial models, using the sample sites, were then re-run to test this option. The effect of a JV type arrangement significantly reduces the risks set out above. However it should be noted that sharing of risk also has several consequences:
    - Any returns/surpluses made by the JV will also be shared between the WOC/Bristol City Council and partners
    - It will take longer to set up a WOC and procure JV partners, than to set up a WOC alone, and thus the start on site and delivery of homes will be scheduled to start later than if the WOC was a developer in its own right (however noting that the JV should be better placed to ultimately manage timely delivery owing to the expertise of JV partners).

14. It should be emphasised that a WOC is a flexible structure that enables future projects to be taken forward through other joint venture arrangements with partners, or not, depending upon financial, market or other prevailing conditions and risks. Each project or group of projects will require specific decisions about the delivery and JV arrangements. The next step is to fully test the model through detailed business planning (as set out above) which will include detailed and specific financial implications for the Council, as well as any set–up costs and cash flow that the Council will need to fund in order to establish the vehicle.

Implications for the Council

15. If the Council wishes to be a direct developer of new homes, or have a legal interest, then it can currently only do so within the housing revenue account (HRA), and then only for rented homes. The establishment of a council owned vehicle enables the council to develop new homes outside the HRA and General Fund, with the benefits of that arrangement set out above. The HRA has a significant number of other restrictions, set out in the rationale for a new vehicle above.

16. The Council has the powers to establish a wholly owned company and is also able to finance its establishment through set up costs and ongoing investment in the form of loans, grants and land on commercial terms. Furthermore in February 2016, Full Council, as part of its budget setting process, agreed an amendment to the budget to “Transfer [£9m of] of funding into Tier 2 [of the

capital programme] to create a private housing delivery company. This will enable the Council to build housing for sale (a proportion of which will be affordable homes in accordance with the Bristol Local Plan). Sale proceeds to be reinvested in further new housing developments". This amendment was subject to the development of a business case setting out options for the delivery of affordable housing in Bristol.

<u>Timelines</u>

17. A detailed Business Plan and establishment of the new vehicle, once the business plan is approved, is expected to take several months and will require cabinet approval. There are costs in undertaking this work, for which there is provision in the budget, and approval is sought to draw these down. Meanwhile work will commence on considering which are the most appropriate council-owned sites for a WOC/JV to develop, start on pre-development work, such as obtaining outline planning consent, site investigation and other preparatory work. The need to procure a JV partner will add to the time taken before actual work on site can commence.

18. **Consultation and scrutiny input:**

19. **Internal consultation:**

The process of preparing the strategic business case has been overseen by a Steering Group comprising Nick Hooper, Service Director Housing Programmes; Abigail Stratford, Service Manager, Major Projects; Robert Orrett, Service Director, Property; Nicky Debbage, Head of Strategy and Governance, Housing Services; Robin Poole, Finance Business Partner and Eric Andrews, Senior Solicitor, Legal and Democratic Services.

In autumn 2015, the joint Neighbourhoods and Place Scrutiny Commissions conducted an enquiry day into housing delivery and recommended the establishment of a local authority housing company as a means of increasing supply. Neighbourhoods Scrutiny Commission reviewed the strategic business case in February 2017.

The Board of the Bristol Holding Company has been briefed on the draft Strategic Business Case and is aware that there will be implications for it if at detailed business case stage a decision is made to establish it as a subsidiary of the Holding Company.

14. External consultation:

The Bristol Homes Board, largely comprised of partners external to the Council, has been kept briefed on the preparation of the strategic business case. In addition as part of the process six development companies were engaged through soft market testing to gauge market appetite for the short listed ideas.

Other options considered:

A range of possible options were considered, including continuing with the status quo of disposal of council-owned land. The various long list options were tested against objectives and criteria. All but two options were rejected at this stage and the rationale for this is set out at length in section 3.3.3 of the strategic business case, (Appendix 1).

Risk management / assessment:

Housing development is an inherently complex business with a number of different and interrelated risks such as financing, build cost, sales and reputation. This is not an area of activity familiar to most councils and the ability to use public assets in a market, as well as manage impact and operate commercially, requires very careful risk mitigation. For that reason the flexibility offered by operating initially through a joint venture with the wholly owned company, is an effective way to deal with those risks. Whilst financial returns will be lower the benefit of the experience and the investment capacity of a partner is essential in the early days of the proposed company.

The Council will also have governance and strategic capacity risks, whether the new vehicle is part of the Bristol Holding Company or whether it is standalone, and those will be fully explored at detailed business case stage.

A full strategic level risk assessment of the preferred option has been undertaken and is set out in section 3.4.3 of the strategic business case. In summary the key risks are;

FIGURE 1

The risks associated with the implementation of the *(subject) decision* :

No.	RISK Threat to achievement of the key objectives of the report	INHERENT RISK (Before controls)		RISK CONTROL MEASURES Mitigation (ie controls) and Evaluation (ie effectiveness of mitigation).	CURRENT RISK (After controls)		RISK OWNER
		Impact	Probability		Impact	Probability	
1	Change in Council housing strategy or policy	Med	Low	Focus vehicle on key long term housing challenge and arms-length to protect from day to day political / organisational changes	Low	Low	Alison Comley
2	Reputational risk of non delivery	Medium	Medium	Communication strategy, including with JV partner, explaining progress and regular delivery updates to key partners and media	Low	Low	Alistair Reid
3	Risk of conflicting Council objectives which stall delivery e.g. quality vs. financial returns vs. affordability	High	Medium	As part of the detailed business case overriding company objectives will be finalised and will be enshrined as part of creating a legal entity. In addition there will be a focus on key outcomes and an annual programme in advance, to be updated through periodic business planning process and ensure its potential impact is limited to future sites prior to transfer.	Low	Low	Abigail Stratford
4	Private sector is not attracted to either partnership or site opportunities	Medium	Medium	Mitigated through soft market testing and structuring of clear, simple proposition	Low	Low	

5	Change in local authority funding / financing rules	Medium	Medium	Vehicle has flexible source of funding and can be financially sustainable, value taken regularly by the Council as shareholder, fixed rate borrowing	Low	Low	Robin Poole
6	Complexity of vehicle takes a long time to establish, therefore new homes slow to deliver	Medium	Medium	Development of a strong management and governance framework. Respond to short term supply constraints through wider housing delivery programme.	Low	Low	Abigail Stratford
7	Non-performance of partner/developer/contractor	Medium	High	Partner selection will be specific to each project/group of projects. Rigorous due diligence at selection stage, panel approach to create options, termination clauses in contract.	Low	Medium	Director of the company or Head of Housing Delivery
8	Changes in policy/legislation, specifically proposed changes in recent White Paper	Medium	Medium	Scan government policy announcements and proposed law changes. Modify governance structure and company objectives. Review White Paper proposals, and consider specific implications in Detailed Business Case.	Med	Low	Nick Hooper for detailed business case. Company Directors (when and if vehicle is established)
9	Governance, as part of Bristol Holding Co or otherwise, proves ineffectual	Medium	Medium	Regular governance and capacity audits of company arrangements	Low	Low	Chief Executive

FIGURE 2

The risks associated with <u>not</u> implementing the *(subject) decision*:

No.	RISK Threat to achievement of the key objectives of the report	INHERENT RISK (Before controls)		RISK CONTROL MEASURES Mitigation (ie controls) and Evaluation (ie effectiveness of	CURRENT RISK (After controls)		RISK OWNER
		Impact	Probability		Impact	Probability	
1	Reputational risk – establishment of vehicle was a manifesto commitment	High	High	Approval of strategic business case shows intent	Low	Low	Nick Hooper
2	Failure to meet Mayor's housing delivery target.	High	High	Other delivery channels would have to work harder towards of Mayoral term	Medium	Medium	Alistair Reid/Nick Hooper

Public sector equality duties:

The Equality Impact Assessment (see appendix) is approved. In due course, once the company commences development it will need to consider, from an equalities perspective, who will be represented on its board and to which households the new homes will be allocated.

Advice provided by: Anne James, Equalities and Social Inclusion Manager
Date: 26 January 2017

Eco impact assessment:

There will be no direct environmental impact from the establishment of a wholly-owned company, so there is no need for a full eco-impact assessment. The new company will be subject to direct Bristol City Council planning requirements, and any planning requirements that may be jointly agreed under the West of England devolution deal. However, the environmental impacts of what the company will need to do in order to deliver more new housing in Bristol will be very significant, and may go well beyond meeting planning requirements. The company, at the detailed business planning stage, will consider whether it wishes to meet higher energy and environmental standards, which in turn will be reflected in the financial case. The impacts are likely to include decisions concerning design, location and material use that may affect future climate resilience, waste, modes of transport used by residents, visual impact, efficiency, energy security, renewables, use of heat networks and emissions. During construction works there will also be significant use of vehicles and plant, remediating areas affected by contamination or non-native invasive species, building on former habitat, decisions about flood risk, and the potential to create dust, noise, or other nuisances. It is therefore recommended that the eco-impact assessment is applied to the approval process for the business, investment, and implementation plans that will be developed for the proposed company.

Advice provided by: Giles Liddell, Environmental Project Manager

Resource and legal implications:

Finance

a. Draft Financial (revenue and capital) implications as at 6 February 2017:

The purpose of the strategic case has been to assess the options for taking forward the Council's plans for housing delivery and the approach for making this assessment has been based on the development of three sample sites, as such it is one possible scenario. Whilst this report is not seeking approval for the required expenditure for this scenario, the Council does need to consider what the financial implications would be of such an approval in order to assess whether a more detailed business plan has the potential to be affordable.

For context the housing outputs achieved in this scenario are as follows:

Table 1: Forecast housing outputs achieved by the strategic business case scenario

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	Totals
	Units	Units	Units	Units	Units	Units	Units	Units
Private				15	162	54		231
Affordable				10	145			155
Total				25	307	54		386

Affordable %				40%	47%	0%		40%

The financial implications of developing this scenario, from the Council's perspective, has been set out in section 5 of the business case and reproduced in the table below. The modelling has been based on three sample sites, and this will require testing across future projects at detailed stage.

Table 2: Financial implications of the strategic business case scenario

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	Totals
	£000s	£000s	£000s	£000s	£000s	£000s	£000s	£000s
Capital receipts [1]		5,095						5,095
Capital expenditure [2]	(820)	(6,979)						(7,799)
Net capital position	**(820)**	**(1,884)**						**(2,704)**
Revenue income [3]				450	8,422		2,840	11,711
Total surplus/(deficit)	**(820)**	**(1,884)**		**450**	**8,422**		**2,840**	**9,007**
NPV (3.5%)	7,164							

[1]Capital receipts – receipts generated from purchase of land from the Council and repayments of loans provided by the Council to the WOC
[2]Capital expenditure – debt and equity provided by the Council to the WOC
[3]Revenue income – loan interest receive by the Council from the WOC; dividend payments received by the Council; overage

Based on this scenario the Council would provide equity and debt to the company totalling £7.799m during 2017/18 and 2018/19, classified as capital expenditure. £5.095m (65%) of this is in the form of a loan (debt) which the company uses to purchase the three sample sites from the Council; classified as a capital receipt for the Council. £2.704m (£7.799m less £5.095m) of capital expenditure is invested by the Council in the company as equity and is used to fund pre-development works on the three sites. Joint venture partners would provide equity and source development finance to fund the development of the three sites (this is not shown in the above table as it is from the Council's perspective only).

This scenario currently assumes that there is no requirement for the Council to make a minimum revenue provision (MRP) in its annual general fund revenue budget in respect of this capital expenditure. This is because the structure is predicated on short term investment that is repaid upon completion and sale of the units. If MRP was required then this has been estimated at £390k per annum (see further comments below regarding MRP).

The equity the Council has invested generates a dividend payment totalling £11.711m when the sites are sold upon completion in 2020/21 and 2021/22. This has been shown here as revenue income received by the Council; however in practice whether dividends are paid back or retained by the company for a specified purpose will be subject to the policies established by the Council. Note that these amounts are pre-tax cash-flows and work is required at the next stage to understand tax implications for the joint venture, the company and the Council.

The net position generates an overall surplus for the Council of £9.007m, or discounted at 3.5% it provides a net present value (i.e. what the investment would be worth today) of £7.164m. This can be compared with the potential capital receipt of simply selling the sites of £5.095m (noting that this value is based on exceeding policy compliant housing use and other uses may generate higher sales values). Whilst the use of a joint venture allows the Council to draw-in expertise and external finance that limits the scale of the Council's financial risk, this structure still carries risk for the

Council as any cost-overruns or adverse movement in sales values will erode the Council's return first as joint venture partners and the provider of the development finance have priority returns.

This is an indicator as to what the financial implications could be of setting up a housing delivery company and providing approval for it to develop sites through a joint venture structure as described in the strategic business case.

The Council's draft capital programme, which is due to be considered by Full Council on 21 February, has included a financial allocation for the set-up of the housing company of £0.5m in 2017/18. The amount of expenditure requested for approval in this report is up to £0.25m to conduct the detailed business planning. Therefore, subject to Full Council approval, the budget will be in place to fund this next stage of activity.

The draft capital programme also includes allocation for supporting the local housing company of £34m per annum from 2019/20. This had been predicated upon the company acting as a developer and funding the developments itself, as opposed to what has emerged as the preferred option of utilising external finance via a joint venture partner. This element of the capital programme had been assumed to be financed taking into account the potential income that could be generated by a housing delivery company. As such it is consistent with the scenario presented in table 2 above, i.e. it does not give rise to a minimum revenue provision.

Under the new preferred option there still needs to be a more detailed assessment of the approach to financing and whether a minimum revenue provision is required or not. The upper limit for this, based on this scenario of three sample sites, has been estimated at £390k per annum. This is a worst case scenario as it could be reasonably expected for this to be offset at least in part by scheme income, e.g. rental income. However, there remains a possibility for additional revenue implications to emerge during detailed business planning and these would then need to be assessed in subsequent annual budgeting processes as there is currently no revenue budget provision for this.

A separate approval is being requested at March 2017 cabinet for pre-development work to take place on a list of Council owned priority sites with expenditure to be approved of £3.7m. This funding will need to be used to fund pre-development work for any sites, including those to be developed by the company, which has been estimated here at £2.704m for the three sample sites.

In terms of the capital expenditure for the loan to the company of £5.095m to finance its purchase of land from the Council, the current assumption that it is repaid by the capital receipt from the company and therefore has a net nil position. However a feature of the joint venture structure being considered is the risk that the Council does not recover the value of the land in the longer term through the joint venture structure. The potential impact of this on the Council's forecast capital receipt programme will need to be fully assessed as part of future decision making.

Given the nature of the preferred option identified by the strategic business case and the financial resources provisionally allocated in the draft capital programme, there is the potential for a more detailed business plan to be affordable for the Council. However there are major variables that will need to be assessed at the next stage that will have a bearing upon the financial implications and affordability of a detailed business plan:

- The scale of development, i.e. number of units and sites;
- The choice of sites developed;
- The timing of delivery;
- The mix of tenure developed;
- Whether units are sold or held for rent by the Council; and
- The level of risk for any income forecast.

Lastly, the actual financial implications that will arise out of investment in a new housing delivery company will in large part be determined by the strength of the management and governance arrangements that are put in place and therefore these should be given significant attention and scrutiny.

Advice given by Robin Poole, Finance Business Partner, Neighbourhoods

Date 6 February 2017

c. Legal implications:

The business case addresses the authority to establish companies, (the Council has the power under both the 2005 Local Government Act and 2011 Localism Act), identifies procurement issues for each option, and includes an appendix, produced by Grant Thornton, which provides an assessment of some of the other key issues associated with the operation of the various options, including matters such as the transfer and ownership of assets, State Aid (ie financial and other support would be expected to be on commercial terms), financial reporting and some other financial considerations (eg dividends). These matters will need to be developed as the project progresses, and once Cabinet has adopted its preferred option, and addressed in the business case. In addition, the intention to work with a partner, at least initially, will necessitate careful consideration of the form and content of the joint venture arrangement and a robust agreement to address this, and will also require a Public Contract Regulations compliant procurement process in connection with the selection of the partner.

Advice given by Eric Andrews, Senior Solicitor
Date 17th January 2017

d. Land / property implications:

The recommendations in this report have significant implications for Council property. This may include transfer of ownership of sites. Issues concerning delivery of development, the objectives for that development and the arrangements to achieve that are fundamental to this matter. The property and capital receipts obligations will be carefully considered as work on the detailed Business Plan progresses. This will include reference to the legal powers and duties of the Council in relation to property disposals.

Advice given by Robert Orrett, Service Director, Property
Date 11th January 2017

e. Human resources implications:

While it is understood that there is no intention to TUPE any existing staff, the roles that are created in the new company would need to be examined carefully when developing the full business case to ascertain whether legally TUPE would apply if they are undertaking duties that are similar to those currently provided in-house.

If as expected TUPE does not apply, decisions will need to be made around whether the in-house service (from which the newly created company is expected to buy expertise) needs to change in shape / numbers, and if so, the staff within this team will need to be fully consulted with about any changes to their terms and conditions in line with Bristol City Council's management of change policies. In any case, the relationship between any remaining in-house team and the newly established company workforce would need to be clearly articulated.

Further, consideration will need to be given to the terms of conditions of the staff working within the company, since it is proposed to be wholly owned by Bristol City Council, however there is precedent that has been set within BCC with other companies that have been established.

Advice given by Alex Holly, HR Business Partner
Date 4th January 2017

Appendices:
Appendix 1 – Strategic Business Case
Appendix 2 – Equality Impact Assessment

Access to information (background papers):

Bristol City Council, Governance of Council interests in Companies – Code of Conduct
HM Treasury, "Green Book" Public Sector Business Cases using the five case model (2015 updated)
Bristol City Council, Brief for Local Housing Company Strategic Business Case