APPENDIX A

Title: Dunmail Housing Scheme	
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Appendix A: Further essential background / detail on the proposal

Background

1. The former Dunmail primary school site of 2.7 hectares (6.67 acres) was marketed by the council for residential development in 2015. The intention was to secure housing of an improved quality and environmental standards over normal market and affordable housing. The housing is to be built to a higher build specification that would be more sustainable and aimed at reducing occupational costs to improve affordability. It was planned that this housing scheme could provide a template for mixed tenure housing that might be used elsewhere across the city. This is a very important site in north Bristol, and will demonstrate the Council's commitment to building new homes, to creating mixed and balanced communities and developing homes to high design and environmental standards. In many ways this will be an exemplar scheme for the city.

2. United Communities/HAB (UC/HAB) were selected as developers for the site in an OJEU compliant procurement process. An OJEU process was necessary as the council specified the homes' environmental, quality and sustainability standard in excess of what the market normally will provide through market disposals.

3. UC/HAB's bid was the successful bid in a second marketing exercise. Reasons for the general lack of market interest in the site included
    - Market uncertainty on open market sales values in the area
    - OJEU process
    - BCC's requirements for higher environmental, quality and sustainability standards.

4. The number of homes proposed by UC/HAB has increased from 150 to 161. 52 are to be affordable housing (32%) consisting of 41 affordable rent and 11 shared ownership. The remainder is made up of 40 Private Rented Sector (PRS) homes and 71 homes for open market sale. The Council recognised that the affordable housing would be funded through a range of different sources, including HCA housing grant that would otherwise be returned to central government if not committed by March 2018.

5. At the time UC/HAB were selected they proposed that Bristol and Bath Regional Capital was a possible funder for the PRS. PRS tenure was not specified by the council. It was proposed by UC/HAB as part of their bid. At the time 57 PRS homes

were proposed. This report deals with the issue of providing a rental guarantee for the PRS element. It is being considered under the 'special urgency' arrangements because the scheme is due to start on site in June, and failure to agree financial underwriting will hold up the development of much needed homes on a long vacant site; United Communities is in the process of changing its governance structure (changing the current informal partnership between Bristol Community Housing Foundation and United housing association into a formally merged new association, registered as one body), which also involves them in restructuring all their debts and other financial arrangements. The rent guarantee needs to be in place before this can happen; the need for the financial underwriting has only emerged recently.

6. Since selection as developer UC/HAB have
   - undertaken site investigations
   - secured planning consent subject to a section 106 agreement.
   - carried out consultation on their proposals with councillors, stakeholders and public.

Affordable Housing Provision

7. The original proposal was to secure 30% affordable housing through the s106 agreement with nil subsidy (on the basis of 77% social rent and 23% shared ownership). The successful developer had the opportunity to deliver additional 10% affordable homes.
8. As a negotiated tender United Communities secured the Council's agreement to provide only 15.75% affordable housing through the planning system so that they could improve the overall viability of the scheme which would allow the housing association to maximise the available grants for affordable rent and shared ownership from the HCA.

9. The current affordable housing mix that was agreed as part of the land sale agreement last year is as follows:

S106 Units	Affordable Rent	26
Grant Funded	Affordable Rent	15
	Shared Ownership	11
Total		52

10. United Communities are prepared to consider a further 10 additional shared ownership but will not consider any further affordable rent and will not agree to go beyond 40% AH provision.

Private Rent Sector Provision

11. The original bid proposed that Bristol and Bath Regional Capital (BBRC) was a possible funder of any PRS element of the scheme.

12. BBRC is a community interest company that seeks to attract and retain investment into the Bristol and Bath region, BBRC is a not-for-profit organisation and BCC is a founding shareholder, holding a $1/7^{th}$ share of BBRC. The objectives of BBRC are to invest in projects that provide a commercially viable return to their investors and deliver public benefit to the Bristol and Bath region focused on four initial local priorities: Homes & Communities, Community Asset Development, Low Carbon Economy, and Employability and Enterprise. All surpluses are recycled to further its goals.

13. BBRC is seeking to acquire the 40 PRS units, 14 one bed and 26 two bed, backed by funding by way of a finance lease provided by a new type of social investment fund operated by Cheyne Capital. The 40 units would then be made available as PRS under an ethical rental scheme managed by United Communities. The mix of the 40 units are 20 to be let at market rent and 20 at 90% of market rent where annual rental increases for all 40 units would increase annually at CPI plus an agreed percentage but no more than 1.0%.

Financial Appraisal

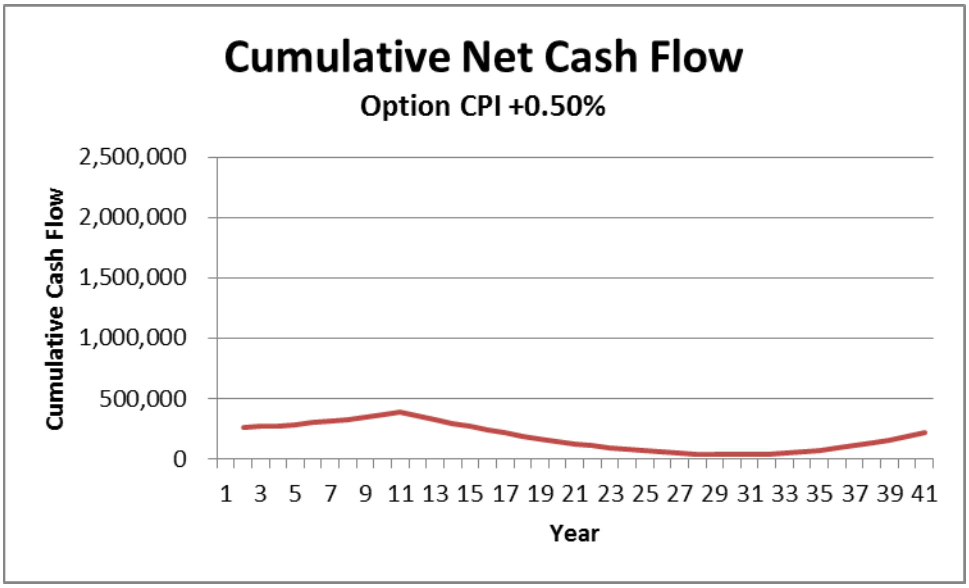
14. To complete the financial appraisal of the delivery of 40 PRS two options have been considered by the Council, with option 1 having two variants and a base case, these are:
   a) BBRC deliver 40 PRS units
   Base Case - rentals are increased annually by CPI +0.50% or
      i. Rentals are increased annually by CPI +0.75% or
      ii. Rentals are increased annually by CPI +1.00%
      (All rent levels are reset to market value or 90% of market value as and when a tenancy changes)
   b) United Communities deliver the units on the basis of 24 Rent to buy and dispose of 16 on the open market i.e. no PRS units.

BBRC

15. The BBRC proposal is that a 40 year finance lease is entered into by BBRC with Cheyne Capital to acquire the 40 units with the rental income stream underwritten by BCC. It is a requirement of investors in the Cheyne Capital social investment fund that any funding approved of this type is underwritten by the public body, in this case BCC.

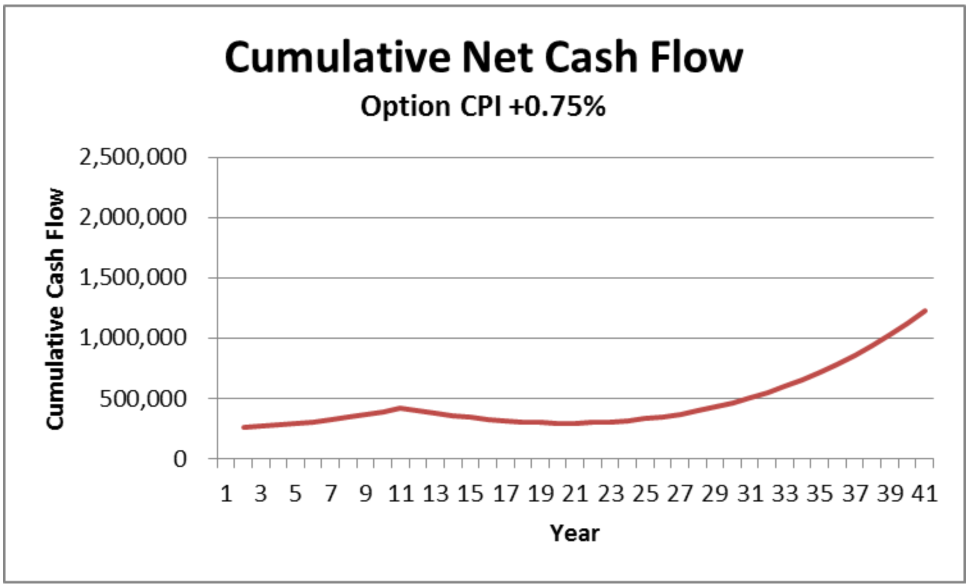
16. BBRC have worked with BCC on an open book basis and shared their financial modelling and assumptions associated with the Dunmail proposal to deliver PRS. As part of the due diligence the financial model assumptions have been tested for their reasonableness. The assumptions around management and maintenance, BBRC cost recovery service charges and level of reserve for major repairs all fall within an acceptable benchmark range.

17. The base 40 year financial model based on rental values increased by CPI +0.50% returns a marginal financial benefit over the life of the lease period where cumulative cash reserves associated with the project fall to below £40k in three separate years, see graph 1 below. Applying a sensitivity analysis to maintenance and management costs of +0.25% and +0.50% would both push the project in to a negative cumulative cash flow position and increase the risk around ability to service the lease payments. This arrangement would too risky for the Council to underwrite the rents.



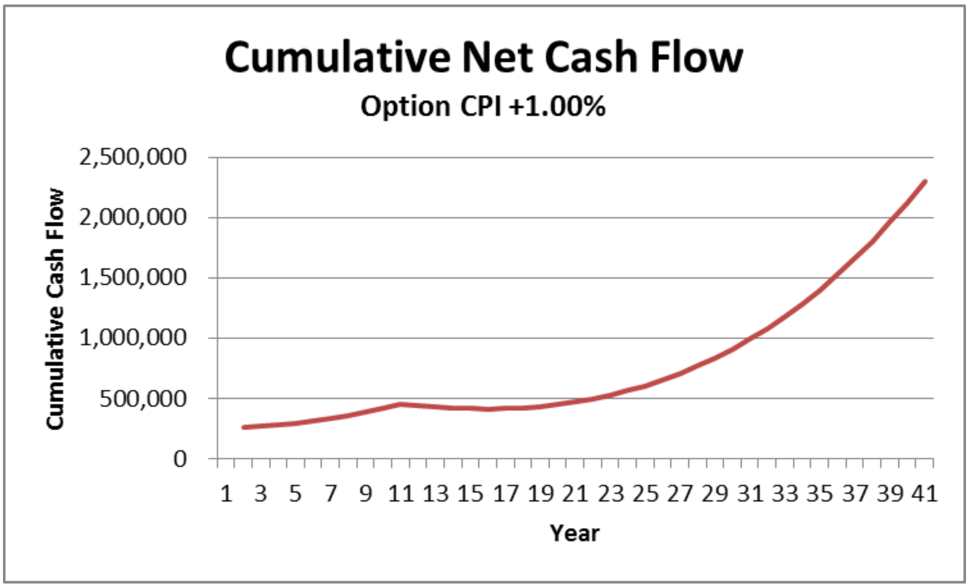
Graph 1

18. Variant 1 on the base model where annual rents are increased by CPI +0.75% increase returns over the base model and delivers a reasonable financial return over the life of the lease period where cumulative cash reserves associated with the project never fall below £298k except from the first two years of the lease period, see graph 2 below. The application of a sensitivity analysis to maintenance and management costs of +0.25% and +0.50% will have a minor impact on the cumulative cash flow of the project, as a result the risk to the ability to service lease payments is minimal. The level of cumulative cash reserves exceeds £500k only at year 30 of the lease term and quickly rises above £1m by the end of the lease. This option is recommended as the most financially viable method to deliver 40 PRS units with a low level of risk to the Council in guaranteeing the rent.



Graph 2

19. Variant 2 on the base model where annual rents are increased by CPI +1.00% increase returns over the base model and delivers a significant financial benefit over the life of the lease period where cumulative cash reserves associated with the project never fall below £415k except from the first two years of the lease period, see graph 3 below. The application of a sensitivity analysis to maintenance and management costs of +0.25% and +0.50% will have a minor impact on the cumulative cash flow of the project as a result the risk to the ability to service lease payments is negligible. The level of cumulative cash reserves built up under this option are significant so would not be the recommended course of action. In addition this would lead to the rents being somewhat less affordable than under variant 1.



Graph 3

20. The level of provision that would have to be set aside in the capital programme to reflect the risk of underwriting or acting as guarantor to the BBRC proposal will vary under the three options as follows:

Option	Option Description	Provision
Base case	CPI +0.50%	£1.5m
1	CPI +0.75%	£0.5m
2	CPI +1.00%	£0.0m

The provision has been calculated on the basis of 10% of the total lease value due to Cheyne Capital at commencement of the lease. The total lease payments to Cheyne Capital are c £15m. Option 1 assumes that cumulative cash flow margin is sufficient and risk reduced to be able to reduce the provision by 2/3rd. Option 2 the cash flow margin is sufficient large and risk largely removed to not require any provision.

The level of the provision would reduce annually as the balance of any outstanding lease reduces each year.

22. Recognising the level of risk that BCC is absorbing together with the provision that needs to be set aside some initial discussions have taken place with BBRC that would provide BCC with a level of return. The options being considered include a share of the rental income where the cumulative cash reserves exceed £500k and an agreed number of properties transferring to BCC as the end of the lease. These options will be developed should the proposal to support BBRC is approved.

23. In recognises the risks that will continue to exist over the life of the lease period, BCC and BBRC will work on an open book basis where annual updates on the financial position of the income and costs in scope will be provided by BBRC.

United Communities

24. An alternative option would be for United Communities acquire the 40 units and dispose of them as 24 Rent to Buy and 16 as open market sales. Clearly these would not be PRS units and the opportunity would be lost to develop 40 PRS units on the Dunmail site and would move the scheme away from the one already approved and significantly change the tenure mix from one which was intended to provide a greater diversity of tenures. From a BCC perspective the financial risk of the developing the 40 units would remain with United Communities and there would be no financial risk to BCC. Disposal in this way would have no impact on the site valuation already agreed with United Communities/HAB. However because of the fundamental changes to the agreed scheme that this would bring this alternative option is not recommended.

Land Sale Agreement

25. The basis of the sale is a Development Agreement and a Building Lease. After entering the Development Agreement the Building lease will only be granted after three conditions have been met:
    1. Full planning consent.
    2. Funding being available for the complete development.
    3. All requisite consent being secured.

26. The council will receive a land receipt of £1.8m. Due to the uncertain sales market in the area impacting on viability the council is to receive this receipt after the sales of the open market properties have reached an agreed level. The freehold transfer would take place upfront, in phases and subject to conditions. The council's receipt protected by a land charge against the title.

Conclusions/Recommendations

27. The proposal brought forward by BBRC opens up a new source of finance previously not available where a social investment fund managed by Cheyne Capital seeks ethical investments in return for low risk consistent returns. This type of model may be applicable to other housing developments and replicable to other projects that deliver social value. In summary the Council is recommended to agree to provide a rental guarantee of not more than £500k, based on a PRS scheme of 40 homes where rents are pegged to CPI +0.75%. This represents a low risk to the Council, secures this new form of investment, and leaves the mix of the agreed scheme intact. It also offers the potential for the Council to share in any uplift in value over time, thus producing a return on a guarantee, without having to directly make the investment itself.