Report No.

London Borough of Bromley

PART 1 - PUBLIC

Decision Maker:	**EXECUTIVE** **COUNCIL** **FOR PRE DECISION SCRUTINY AT THE RENEWAL, RECREATION AND HOUSING POLICY DEVELOPMENT AND SCRUTINY COMMITTEE**
Date:	**Tuesday 2nd February 2021** **Wednesday 10th February 2021**
Decision Type:	Non-Urgent Executive/Council Key
Title:	**PROPERTY ACQUISITION SCHEME PROPOSAL**
Contact Officer:	Sara Bowrey, Director Housing Planning and Regeneration E-mail: sara.bowrey@bromley.gov.uk
Chief Officer:	Sara Bowrey, Director of Housing, Planning, Property and Regeneration
Ward:	(All Wards);

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1. Reason for report

This report advises on the option to acquire approximately 242 properties under a funding arrangement with Orchard and Shipman for use as accommodation to help reduce the current pressures in relation to homelessness and temporary accommodation.

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2. RECOMMENDATION(S)

2.1 That Members of the Renewal, Recreation and Housing Policy Development and Scrutiny Committee, review the content of this report and provide their comments to the Executive.

That Members of the Executive are asked to:

2.2 Agree to enter into the limited liability partnership (LLP) arrangement described in this report with Orchard and Shipman for the acquisition of approximately 242 residential properties (dependent upon final purchase price).

2.3 Agree that the acquired properties will be leased by the LLP to Orchard and Shipman Homes for a 50-year period on an FRI basis.

2.4 Recommend that Council agrees the loan of £20m to the LLP for a period of 50 years with annual repayments starting from year 3 of 1.6% (£320k) per annum and increasing annually by CPI (collared at 0-4%), funded from the Housing Invest to Save Fund (£14m) and uncommitted Investment Fund (£6m) earmarked reserves.

2.5 Agree to enter into (i) the Members' Agreement for the LLP (between the Council, Orchard and Shipman, and the LLP), (ii) a guarantee agreement with the Funder (see part 2 report) to guarantee the loan facility of £60-£65m to the LLP and undertake to meet the liabilities of the LLP in respect of the loan facility in the event of loan repayment default, (iii) a loan facility agreement between the Council and the LLP for the loan made by the Council, and (iv) a Nomination Agreement with Orchard and Shipman Homes to secure nomination rights to the acquired properties (v) and all other ancillary documents in connection with the scheme.

2.6 Agree to delegate authority to the Director of Housing, Planning and Regeneration in consultation with the Director of Housing, Director of Corporate Services and the Portfolio Holder Renewal, Recreation and Housing to carry out due diligence in connection with the scheme, agree the details of each agreement and enter into all relevant agreements in connection with this scheme.

2.7 Agree to appoint Sara Bowrey, Director of Housing, Planning and Regeneration and James Mullender, Head of Finance, Adults Health & Housing as the Council's nominees to the board of the LLP, with authority to act on behalf of the Council in relation to all matters not reserved to the Council under the Members' Agreement; such nominees to be indemnified by the Council and on the basis that the LLP will arrange suitable insurance for its Board members. To delegate to The Chief Executive, as Head of Paid service, to make a replacement appointment of suitable seniority with the agreement of the person nominated if the final structure requires a different skill set or if a vacancy arises.

2.8 Note that subject to the approval of the above the scheme will provide full year savings of £1.5m per annum.

2.9 Note that should there be any material change to the scheme from the details set out in this report then a further report will be presented to the Executive to inform members of such change.

Council is requested to:

2.10 Agree the loan of £20m to the LLP for a period of 50 years with annual repayments starting from year 3 of 1.6% (£320k) per annum and increasing annually by CPI (collared at 0-4%), funded from the Housing Invest to Save Fund (£14m) and uncommitted Investment Fund (£6m) earmarked reserves.

2.11 Agree to enter into a guarantee agreement with the Funder to guarantee the loan facility of £60-£65m to the LLP and undertake to meet the liabilities of the LLP in respect of the loan facility in the event of loan repayment default.

Impact on Vulnerable Adults and Children

1. Summary of Impact: The accommodation provided ensures that the Council is able to meet its statutory responsibilities in respect of housing

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Corporate Policy

1. Policy Status: Existing Policy: Further Details
2. BBB Priority: Supporting Independence: Further Details

Financial

1. Cost of proposal: Estimated Cost: £20m loan contribution to purchase of the properties
2. Ongoing costs: Estimated net savings of £1.5m per annum
3. Budget head/performance centre: Operational Housing
4. Total current budget for this head: £7.7m
5. Source of funding: Housing Invest to Save Fund (£14m) and uncommitted Investment Fund (£6m) earmarked reserves

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Personnel

1. Number of staff (current and additional): N/A
2. If from existing staff resources, number of staff hours: N/A

Legal

1. Legal Requirement: Statutory Requirement: Further Details
2. Call-in: Applicable: Further Details

Procurement

1. Summary of Procurement Implications: Not Applicable

Customer Impact

1. Estimated number of users/beneficiaries (current and projected): There are approximately 1800 households currently placed in temporary accommodation of which almost 1100 are in forms of insecure costly nightly paid accommodation. This scheme would provide around 242 good quality cost effective affordable housing units to fulfil the Council's statutory rehousing duties and reduce the current reliance on nightly paid accommodation.

Ward Councillor Views

1. Have Ward Councillors been asked for comments? Not Applicable
2. Summary of Ward Councillors comments:

3. COMMENTARY

3.1. For Bromley, like most London boroughs one of the most significant long-term cost pressures is the impact of homelessness and provision of temporary accommodation.

3.2. There are currently approximately 1,800 households in Temporary Accommodation (TA), of which approximately 1,100 are in costly forms of nightly paid TA, putting a continued strain on the Council's revenue budget

3.3. The Council therefore continues to seek all opportunities to increase the supply of affordable housing and reduce the costs in providing temporary accommodation to meet statutory rehousing duties and in particular the reliance on costly forms of nightly paid accommodation.

3.4 Orchard and Shipman are an established (and therefore regulated) registered provider with more than 30 years' experience in successfully acquiring and managing a range of affordable housing schemes on behalf of local authorities, developers, housing associations and government departments. Orchard and Shipman have worked in partnership with the Council for around 11 years sourcing and managing a portfolio of temporary accommodation including private sector leased accommodation and the council owned multi-facility units and a small number of street properties.

3.5 Whilst Orchard and Shipman continue to source properties for the Council under the private lease scheme, the supply is not sufficient to meet current levels of housing need, in the main due to fact that the rental and benefit levels applicable to such schemes is insufficient to complete with rental levels that can be commanded in the open market. This situation is being experienced across all private sector leasing providers.

3.5 Orchard and Shipman have approached the Council with a proposal for the funding, purchase, refurbishment and management of approximately 242 properties for use as affordable rented accommodation to assist in meeting the Council's statutory rehousing duties and reduce the current reliance on and associated cost of nightly paid accommodation. The final number of properties will be dependent upon the purchase prices secured.

3.6 Under the proposal, the Council and Orchard and Shipman will set up a limited liability partnership (LLP) with Orchard and Shipman and raise a funding facility of approximately £60-65m (see paragraph 6.10 below). The Council will provide an additional £20m loan from earmarked reserves. This funding would secure the purchase and refurbishment of the portfolio of units within a 12-14 month period for use as affordable rented accommodation. The structure and operating model are set out in appendix 1 of this report.

3.7 The purpose of the LLP is to enable the purchase and management of the affordable housing units.

3.8 The members' agreement for the LLP will govern the process for the LLP to identify properties to acquire for affordable housing against certain property standards, locations, types and size mix. Orchard and Shipman will arrange the acquisition of properties into the LLP based on these parameters, and the properties will then be leased by the LLP to Orchard and Shipman Homes which is a registered provider. Orchard and Shipman Homes will then be the landlord for the properties and subject to a nominations agreement with the Council. The locations would be a mix within and outside of the borough but not further than a 60-minute travel time. All properties would be approved by the Council to ensure they meet requirements under the Nominations Agreement before proceeding to purchase.

3.9 The total cost of purchase including all associated fees and any required refurbishment will be met from the funds raised by the LLP.

3.10 As noted above, once acquired the purchased properties will immediately be leased to Orchard and Shipman Homes Ltd on a 50-year full repairing and insuring lease basis. Orchard and Shipman will enter into a nominations agreement with the Council (on an exclusive basis) enabling the properties to be let to tenants nominated by the Council. The leasing arrangements will set out full requirements in terms of management and maintenance processes and standards.

3.11 The members' agreement for the LLP will also set out the arrangements for distribution of surplus rental income materially weighted to the Council. Further details are included in paragraph 6.9.

3.12 Orchard & Shipman Homes will pay a fixed rent to the LLP from the day of completion for each property, irrespective of rent receivable from any occupational underlettings.

3.13 Repayment of the loan facility will not start until year 3, providing time for all properties to be purchased and let and for funds from the rental stream to build up to ensure the facility payments can be serviced.

3.14 Rental levels will be set at the local housing allowance level. The rental income received on the portfolio will then be used to cover the ongoing management and maintenance costs together with the funding facility repayments.

3.15 At the end of the 50 year period, the funding facility and security will be released and the Council will have the right to dissolve the LLP for a nominal payment and the assets of the LLP will belong to the Council.

3.16 The properties would be used to provide affordable housing in discharge of the Council's statutory rehousing duty. In terms of discharge of duty compared to temporary accommodation, in addition to of course being a better outcome for the tenants, the rental income is significantly higher. The proposed structure will also enable flexible use of the units as settled affordable homes or private rented dependent upon prevailing need during the term. This provides flexibility to deal with any future reduction in homelessness (which appears unlikely) and also provides the ability to generate higher income from private rents, where necessary i.e. this helps provide alternative income in the event of any freezes in local housing allowance which have a detrimental impact on the overall financial model.

3.17 Due diligence has been undertaken to ensure that the financial and acquisition model is robust and mitigates against potential risks of delay in the acquisition programme, changes in the market, level of demand for such units. A summary of identified risks and mitigation can be found in appendix 2 of this report.

4. IMPACT ON VULNERABLE ADULTS AND CHILDREN

4.1 The recommendations support children and vulnerable people through the provision of good quality cost effective housing supply.

5. POLICY IMPLICATIONS

5.1 The Council has a published Homelessness Strategy which sets out the approved strategic policy in terms of homelessness. This includes temporary accommodation provision and reducing the reliance on nightly paid accommodation. The Council already works with a number of providers from the provision and management of temporary accommodation.

5.2 Officers will consider the Council's statutory obligations under the Equalities Act 2010 as the scheme progresses and take appropriate action.

6. FINANCIAL IMPLICATIONS

6.1 The proposed scheme would produce full year savings to the Council of around £1.5m per annum on temporary accommodation costs based on 242 properties being acquired. After 50 years the leasehold or freehold titles will be transferred to the Council for £1 with no outstanding debt payable.

6.2 There is a potential option to subsequently expand this scheme further with a corresponding increase in financial benefits as well as helping address homelessness need – to illustrate this if the number of properties increased by 25% savings would increase by a further £0.38m. which would increase the savings to up to £3m. Any proposal to significantly increase the number of properties to be acquired would be subject to further due diligence and a subsequent report to Members.

6.3 The proposal is that the scheme will be financed by a £60m loan from the Funder, repaid at 2.8% per annum (£1,679k) and a £20m loan from the Council, repaid at 1.6% per annum (£320k), both for a term of 50 years. The loan from the Council effectively secures equity in the properties whilst generating an income from the loan. Annual repayments for both loans increase annually by Consumer Price Index (CPI) (collared at 0-4%). It is proposed that the Council loan is funded from the Housing Invest to Save Fund (£14m) and uncommitted Investment Fund (£6m) earmarked reserves.

6.4 Details of the lease income from Orchard & Shipman are provided in the part 2 report.. Any shortfall in rent income compared to the loan repayments would be guaranteed by the Council.

6.5 The lease to Orchard & Shipman would be on a full repairing and insuring basis, so the risks of future repairs and maintenance costs would be Orchard & Shipman's risk, along with service charges, management, bad debts and void costs (unless the Council fails to nominate within timescales).

6.6 As the loan repayment amount includes principal repayments as well as interest, the Effective Interest Rate (EIR) is different to the rates in paragraph 6.3 above. Assuming annual CPI inflation of 1%, the total repayments on the £60m loan over 50 years is £108m, which equates to an EIR of 1.19%. In other words, £60m invested at 1.19% interest (accumulating), would be worth £108m in 50 years. The total loan repayments and EIR for CPI rates of 1, 2, 3 and 4% is set out below:

	£60m funder (2.8%)		£20m Council (1.6%)	
CPI	Total repayment £m	EIR	Total repayment £m	EIR
1%	108	1.19%	21	0.06%
2%	142	1.74%	27	0.61%
3%	189	2.33%	36	1.19%
4%	256	2.95%	49	1.80%

6.7 For the Council's loan, the EIR is likely to be less than the rate the Council might achieve through treasury management investments, so there may be a loss of treasury management income. The table below sets out the total net impact on treasury management over 50 years and average per annum for different combinations of CPI and treasury management rates:

Net gain/(loss) over 50 years (£'000)			
		CPI	
		1%	2%
Treasury management	1%	-4,537	2,869
	2%	-9,703	-1,328
Average gain/(loss) per annum (£'000)			
		CPI	
		1%	2%
Treasury management	1%	-91	57
	2%	-194	-27

6.8 As part of the funding agreement, there will be no repayments for the first two years which will eliminate the risk of a shortfall in rental income from tenants not being sufficient to cover loan repayments during that period.

6.9 This also means that any income from Orchard & Shipman during this period would generate a surplus within the LLP which could be used to purchase additional properties. This would effectively generate a return at the same rate as the lease to Orchard & Shipman. Alternatively, any surplus could be set aside, either in the LLP or transferred to a Council earmarked reserve to mitigate any future shortfalls as a result of LHA rate increases being lower than CPI, or to offset any loss of treasury management income as referred to in paragraph 6.7 above. To illustrate,

6.10 It is also worth noting that the rates available on the financial markets have generally reduced since the scheme and financing was originally proposed. It has been indicated that for the same annual repayment amount the loan could increase from £60m to around £65m which would also improve the financial performance of the scheme. However, as this could change again before the scheme is finalised, the figures in this report prudently reflect the original funding proposal.

6.11 To illustrate the potential additional benefit, if the final loan amount is £65m then the repayments of the Council loan could be increased from 1.6% (£320k) per annum to 2.2% (£440k). This would change the Effective Interest Rates in paragraph 6.6 to 0.72% for CPI of 1%, 1.27% for CPI of 2%, 1.86% for CPI of 3% or 2.48% for CPI of 4%.

6.12 A key part of the financial model is how the various cashflows change over time. The loan repayments increase by CPI (collared at 0-4%), and rent income from Orchard and Shipman will increase in line with Local Housing Allowance (LHA) levels, which are linked to 30th percentile rent level for the area.

6.13 Appendix 3 provides a summary of Net Present Value (NPV) scenario modelling carried out on the proposal. This shows the potential impact of LHA rent inflation being lower than CPI (assumed at 2%).

6.14 This shows that even if LHA rent inflation was at 1% compared to CPI assumed at 2% for the entire 50 years, the net deficit that the Council be guaranteeing would not exceed the savings on temporary accommodation at any point, with the scheme providing a total NPV benefit to the Council of £31m (£76m including the estimated asset value).

6.15 If LHA increased at the same rate as CPI, the NPV benefit would be £44m (£89m including estimated asset value).

6.16 A key risk to the Council is therefore if CPI increase on the loan repayments exceed the LHA increase on rent payments from Orchard and Shipman. If the LHA increase is lower than CPI

for a sustained period then the Council would have the option to mitigate this by letting the properties on alternative tenures including up to market rents. This would reduce the savings on temporary accommodation budgets, but would ensure the continued financial viability of the scheme overall.

6.17 As the Council has learned from the More Homes Bromley scheme, there are two main other risks that could have a significant financial impact; that purchases are not acquired in the expected timeframe, and that purchase prices exceed those in the financial model.

6.18 The first risk, of delayed acquisitions is mitigated by the fact that there are no loan repayments in the first two years. If the acquisitions still haven't been completed by this date, then the surplus built up in the first two years as set out in paragraph 6.9 above should further mitigate this risk.

6.19 There is no specific mitigation for the risk that purchase prices exceed the financial model; however Orchard & Shipman have carried out an analysis of data from Rightmove and assumed an average cost in the model that is above the lowest price range. A sample of this initial analysis was been reviewed by Housing officers for suitability with no significant concerns noted other than the location of some of the properties being too far away from Bromley. Orchard & Shipman are currently updating this work to reflect this as well as current market data. This will be subject to a further suitability/due diligence review prior to finalising the agreements.

6.20 In addition, there is a risk that the Council may have to provide top-ups where households may be affected by the benefit cap. These could potentially be funded from Discretionary Housing Payments, or from the operational housing homeless prevention budget which would reduce the savings on temporary accommodation. Officers will aim to ensure that this is minimised through the acquisition programme taking into consideration the number of bedrooms and relevant LHA levels for the area.

6.21 With regard to the scheme being one where the Council discharges its homeless duty compared to having to acquire temporary accommodation, in addition to being a better outcome for the tenants, the rental income can be significantly higher, as indicated by the table below (for Outer South East London, which covers the majority of Bromley):

	Affordable Housing	**Temporay Accommodation**
	Current LHA	**90% 2011 LHA**
	£	**£**
Self contained (1 bed)	10,740	7,310
Self contained (2 bed)	13,200	8,934
Self contained (3 bed)	15,600	10,776
Self contained (4 bed)	19,200	14,079

6.22 Without knowing the locations of the properties it is hard to quantify the overall impact, but a rough estimate suggests that if the scheme was temporary accommodation rather than discharge of duty then the rent income that O&S collect would reduce from around £3.4m to around £2.3m, which would have a significant detrimental impact on the financial viability of the scheme.

6.23 From an accounting perspective, the Council's Treasury Management advisors, Link Asset Services, have confirmed that the scheme should be accounted for as a Joint Venture. Under

this proposed accounting treatment, if the Council's share of net assets exceeds material levels (roughly over £5m), then the Council would have to prepare group accounts and include an Investment in Joint Ventures line on the Balance Sheet showing its share of the net assets, as well as its share of the profit or loss in the Comprehensive Income and Expenditure Statement. A liability may also have to be recognised for the guarantee. In accordance with Capital Financing Regulations, the loan from the Council will have to be treated as capital expenditure, with the repayment treated as a capital receipt, although interest will be treated as revenue income.

6.24 As the proposed structure is an LLP, it is not expected that there will be any Corporation Tax liabilities as may arise with a wholly-owned company structure (as LLP's are transparent for tax purposes); however expert advice is also being commissioned to confirm this along with any other tax implications such as VAT and SDLT.

6.25 Reflecting all the arrangements shown above there remain significant potential savings to the Council of around £1.5m per annum on temporary accommodation costs based on 242 properties being acquired. Based on current estimates, the profile of the savings, which have been assumed in the financial forecast, are shown below:

	£'000
2021/22	347
2022/23	1,110
Full year	1,525

6.26 There will be a further significant benefit from the broadly self-financing scheme as after 50 years the leasehold or freehold titles will be transferred to the Council for £1 with no outstanding debt payable.

7. LEGAL IMPLICATIONS

7.1 The proposal is for the Council and Orchard and Shipman (being for these purposes either its holding company or other current (and substantial) member of its group) to set up a limited liability partnership (LLP). LLPs are corporate bodies established under the Limited Liability Partnerships Act 2000, and have tax transparency (i.e. tax on profits is not applied to the LLP but to its members).

7.2 The funder (please see the part 2 report) would enter into a Loan Facility Agreement with the LLP to make £60 to £65 million available to the LLP for the purposes of the LLP acquiring and refurbishing properties. The Council will guarantee the liabilities of the LLP to the Funder under the Loan Facility Agreement, if and to the extent that the LLP is unable to meet the loan repayments. This approach has financial benefits in terms of the cost of the loan. The funder will take a floating charge over the assets of the LLP as security for the loan. Further, the Council will make a separate loan of £20 million to the LLP to acquire and refurbish properties.

7.3 Under the LLP arrangement, Orchard and Shipman as a member of the LLP will have responsibility for procuring properties and refurbishing the properties within the agreed budget per property. These obligations would be documented in an agreement between the LLP and Orchard and Shipman and/or via the Members' Agreement. Orchard and Shipman will be responsible for instructing relevant professionals such as surveyors, external lawyers and works contractors (the costs of which will ultimately fall to the LLP). When a property is ready to let the LLP will grant a 50 year lease to Orchard and Shipman Home (OSH) which is a registered provider. OSH will enter into a Nomination Agreement with the Council giving the Council the right to nominate tenants to OSH for the properties leased to it.

7.4 A number of legal documents will need to be entered into to set up the LLP and capture the obligations of each party. It is anticipated that the following key legal documents will be required:

- LLP Members' Agreement between the Council, Orchard and Shipman, and the LLP;
- Nomination Agreement with OSH;
- Funding Agreement between the Council and LLP;
- Loan Facility Guarantee Agreement between Council and the Funder.
- Other documents in support of the arrangement will include:
  - Form of appointment of LLP board nominees;
  - Possible loan security instruments (in favour of the Funder and the Council);
  - Template leases and tenancy agreements;
  - Template forms of property acquisition documentation;
  - Services agreements and contracts with relevant professionals (e.g. surveyors, lawyers and works contractors);
  - Collateral warranties in support of the above-mentioned appointments and contracts (enabling recourse by the Council in particular);
  - Services agreement between the LLP and Orchard and Shipman for the services provided by them to the LLP in relation to property acquisitions either stand-alone or as part of the Members' Agreement;

7.5 It is considered that the proposed transaction is not subject to the application of the Public Contracts Regulations 2015 as the dominant element of the transaction is the provision of finance to support acquisition of properties by the LLP which is exempt from public procurement rules. However, care will need to be taken in drafting the legal documentation to ensure the Council is complaint with the rules with regards to obligations Orchard and Shipman undertake in relation to property acquisition and any work carried for the LLP to bring them up to standard. Since 1 January 2021 EU rules on state aid no longer apply. However, state aid rules have been replaced with a subsidy control regime and the Council need to be mindful of these rules when drafting the documentation.

7.6 The Council may rely on its general power under the Localism Act 2011 (Section 1) as well as section 9 of the Housing Act 1985 to be a member of the LLP and enter into the proposed arrangements for acquisition of properties for housing. Under the Localism Act, anything done for a commercial purpose must be done via a company (and not an LLP). However, provided the dominant purpose of the arrangement is to meet housing needs, there is no commercial purpose here. This legal position is established by the case of Peters v London Borough of Haringey [2018] EWHC 192 (Admin) where it was confirmed that a Limited Liability Partnership (LLP) structure can legitimately be used to create joint ventures with the private sector to promote regeneration objectives (being for a non-commercial purpose). In this case the purpose is not regeneration, but (as noted) housing supply. It does not matter for these purposes that the LLP itself may generate profit; it is the dominant purpose of the Council in being a member of the LLP that matters. Under the Limited Liabilities Partnerships Act 2000, a LLP has to be formed for carrying on a business *"with a view to profit"*. However, merely

making a profit from activities or maximising return did not, in the Haringey case, mean that those activities were carried out with a commercial purpose.

7.7 The recommendations in this report seeks approval from members to delegate authority to the Director of Housing, Planning and Regeneration in consultation with the Director of Housing Director of Corporate Services and Portfolio Holder for Renewal, Recreation and Housing to agree the details of each agreement and enter into all relevant agreements in connection with this scheme. Should there be any significant change to the scheme from the details set out in this report, then a further report will be presented to the Executive to inform members of such change.

Non-Applicable Sections:	Personnel; Procurement
Background Documents: (Access via Contact Officer)	