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| **REPORT TO:** | **Councillor Tony Newman, the Leader of the Council**<br>**2nd May 2017** |
| **AGENDA ITEM:** | **n/a** |
| **SUBJECT:** | **Lease Options for Concord, Sycamore and Windsor houses** |
| **LEAD OFFICER:** | **Mark Meehan Director of Housing Need**<br>**Barbara Peacock, Executive Director People** |
| **CABINET MEMBER:** | **Councillor Alison Butler Cabinet Member for Homes, Regeneration and Planning**<br>**and**<br>**Councillor Simon Hall Cabinet Member for Finance and Treasury** |
| **WARDS:** | ***ALL*** |

**CORPORATE PRIORITY/POLICY CONTEXT**

The Council has a range of statutory duties in relation to homelessness including a duty to secure accommodation for eligible homeless households. Within that range of statutory duties is the requirement to ensure that any temporary accommodation (TA) provided for homeless households is suitable, and that certain types of emergency shared accommodation (EA) are only provided for a maximum of six weeks for households with dependent children or where a household member is pregnant. A key priority is to meet housing need. Our priority is to increase the supply of private rented sector (PRS) accommodation available to discharge our duties, however the Council also needs a portfolio of TA to reduce its dependence on expensive emergency accommodation (usually provided via nightly bed and breakfast).

**AMBITIOUS FOR CROYDON & WHY ARE WE DOING THIS**

The Council already holds 10-year lease agreements on the three properties that form the basis for this report (Concord, Sycamore and Windsor houses). These arrangements enable Croydon to better meet its statutory duties to homeless families by providing 338 units of good quality temporary accommodation (TA). This reduces the Council's reliance on expensive and unsuitable emergency accommodation which ultimately saves money. The options in this report consider a range of proposals that would allow the Council to further reduce the cost of leasing these properties in return for a longer-term commitment (and some transfer of risk and responsibility for the buildings themselves).

This will address the following Ambitious for Croydon aims and objectives:

Croydon's Community Strategy 2016-21 seeks to tackle the lack of affordable housing, overcrowding and rising homelessness by reducing the costs we currently pay in providing suitable temporary accommodation.

The Council's Ambitious for Croydon outcomes, as set out in the Corporate Plan 2015-18, include providing a choice of home for people at all stages of life and enabling homeless households to access suitable accommodation.

The Ambitious for Croydon performance framework sets targets for reducing the use of emergency accommodation with the aim of reducing costs. Each of the options proposed considers how this might be achieved for the three properties in question.

**FINANCIAL IMPACT**

In 2015, the council entered into a 10-year lease agreement for three tower blocks (Concord, Sycamore and Windsor Houses). The blocks were recently acquired by Cheyne Capital who have offered improved lease terms, overall, if the council is willing to commit to a longer-term arrangement and accept full a transfer of risk in terms of responsibility for the repair and maintenance of the assets.

A range of options are presented and considered in this report (see Section 3). The preferred option is to enter into three new leases (40 years for Concord and Sycamore, 21 years for Windsor) which would commence afresh from 2017/18. This option is estimated to save the Council somewhere in the range of **£4.23-5.10m** over the remaining 8 years of the existing leases (depending on the level of uplift that is applied to the current lease when the annual cost is scheduled to be realigned to market rent after the first 5 years). It will also continue to provide a more cost-effective temporary accommodation solution than is otherwise expected to be available for the remaining 32 years (Concord and Sycamore) and 13 years (Windsor) respectively.

An annual revenue budget of £450k is set aside to cover the net cost of leasing Concord, Sycamore and Windsor houses. It is recognised that this budget is unlikely to be sufficient once the current lease cost has been uplifted at the end of year 5. However, the reduction in cost provided by the preferred option in this report means that the annual cost of the lease could be fully recovered by housing benefit income from tenants for the first two years. This would allow a £450k budget saving to be made over these two financial years, and would require a much lower budget provision in the years thereafter (which will increase in line with CPI annually).

Furthermore, the proposal to take on a 40-year finance lease for Concord and Sycamore houses means that the assets will transfer to the Council at the end of the lease. Although difficult to estimate, it is fair to assume that some residual value will remain in the assets at the end of the lease (even if the buildings are exhausted and only the land value remains). A 40-year finance lease is not considered viable for Windsor House given the presence of a number of commercial units (subject to separate leasing arrangements). A shorter, 21-year operating lease is therefore proposed for Windsor House.

**KEY DECISION REFERENCE: 1217LR -** This is a Key Decision as defined in the Council's Constitution. The decision may be implemented from 1300 hours on the expiry of 5 working days after it is made, unless the decision is referred to the Scrutiny & Overview Committee by the requisite number of Councillors.

## 1. RECOMMENDATIONS

1.1 The Leader of the Council is recommended to approve that the Council enters into the following revised lease agreements:

a) Concord and Sycamore Houses – 40-year finance leases

b) Windsor House – 21-year Full Repairing and Insuring (FRI) operating lease

This will secure on-going supply of 338 units of temporary accommodation at an improved cost.

1.2 It is also recommended that Leader of the Council agrees that the Executive Director for Resources (s151 Officer) be given delegated authority, in consultation with the Cabinet Member for Homes, Regeneration and Planning and Cabinet Member for Finance and Treasury, to make any amendments to the terms of the acquisition for the three proposed leases that might be considered necessary after the decision has been made.

## 2. EXECUTIVE SUMMARY

2.1. Background

A key element of the Council's housing strategy has been to boost the supply of temporary accommodation (TA) as a means of reducing reliance on expensive emergency accommodation (EA) commonly provided via nightly bed and breakfast arrangements. An increase in the volume of households presenting as homeless has put considerable pressure on the Council's budget, with a £2.32m overspend forecast for EA in 2016/17. Furthermore, the Council has agreed to fund £2.77m of growth within the 2017/18 budget to cope with the growing cost of EA provision.

Demand for EA and TA currently utilises an average of 2,500 units per week in Croydon across a range of supply types (from nightly bed and breakfast through to use of HRA stock).

In 2015, permission was sought to enter into 10-year lease arrangements for three properties that would boost TA supply by a total of 338 units. The three properties, located in close proximity to one another, are:

- Concord House (454-458 London Road) – 126 residential units
- Sycamore House (799 London Road) – 63 residential units
- Windsor House – 149 residential units

2.2. Securing a better deal for Croydon

The leases on these properties provide an affordable supply of good quality TA units for the medium-term. The scheme has also allowed the Council to reduce its reliance on expensive nightly EA. Each unit of EA has an average net cost to the Council of £3,800 per annum, which equates to an equivalent annual cost of £1.28m for the 338 units provided at Concorde, Sycamore and Windsor Houses (which currently cost less than £450k per annum). Based on current projections, this is expected to save the Council in excess of £5m (in terms of cost avoidance) over the full 10 year lease term.

The Council is now proposing to convert the lease on Concord and Sycamore Houses to a 40 year finance lease, and extend the operating lease on Windsor

House to 21 years. This proposal will:

- allow the Council to secure a guaranteed supply of good quality TA for the long-term;
- reduce the annual cost of the leases further to make the units even more affordable;
- increase the size of the saving made by reducing reliance on EA; and
- transfer ownership of two of the buildings to the Council at the end of the lease term meaning that the cost of operating the scheme will generate an asset with residual value for LB Croydon.

Concord, Sycamore and Windsor houses will also continue to provide the best value TA supply available to the Council. This means that whatever happens to homelessness demand over the next 40 years, the 338 units secured under these proposals will form the bedrock of the overall supply mix. If demand were to fall, other more expensive sources of supply could be reduced first to allow the Council to flexibly manage demand.

2.3. Existing Lease Arrangements

The structure of the existing arrangements involves a fixed annual cost for the first 5 years of the lease, after which this is increased to 90.3% of the market rate as it stands at the end of year 5 (on average across the 3 sites). A break clause is included after 5 years on the leases for Windsor and Sycamore House. No break clause exists on the existing arrangement for Concord House (this lease is fixed for 10 years unless the landlord accepts a renegotiation).

The combined lease cost across all three properties is currently £3.50m per annum. Some additional costs for utilities and internal repairs are also passed onto the Council, making the gross annual cost £3.88m. Under the current arrangements, the cost of maintaining and insuring the buildings rests with the landlord.

The Council is able to charge rent to tenants in line with Local Housing Allowance (LHA) rates which guide the level of housing benefit that can be claimed by each household. The net cost of the lease is therefore much lower, and an annual revenue budget of £450k has been allocated to fund the cost of providing temporary accommodation at Concorde, Sycamore and Windsor Houses.

2.4. Cheyne Capital

The previous landlord placed the three properties on the market at the end of 2016. They were subsequently purchased by Cheyne Capital on 29th December 2016. Cheyne Capital is a London-based alternative asset management company. Cheyne's Social Property Impact team acquire or build properties with a view to leasing the properties to public sector organisations at affordable rates, and partner with local government departments delivering services such as social housing, elderly extra care, temporary accommodation, adult social care and supported living.

Cheyne have approached the Council with a view to securing a longer term lease arrangement to guarantee future cash flows. They have proposed two new lease arrangements:

- A 21-year Full Repairs and Insurance (FRI) operating lease
- A 40-year finance lease (which ultimately transfers the assets to the Council)

Both proposals offer a lower annual lease price but with a greater transfer of risk and responsibilities to the Council. All available options are reviewed in detail below.

## 3. OPTIONS APPRAISAL

3.1. **Option 1** - Do nothing (maintain existing 10-year leases)

The Council could opt to see out the existing 10-year lease arrangement on each of the properties. Two years have already been served on the existing leases leaving 8 years to run, which would allow it to maintain the supply of 338 units of temporary accommodation to 2025.

Based on the information shown in section 2.2 (see above), the key variable in assessing the cost of the existing agreement is the level of uplift that will be applied to the annual lease cost after five years. At this point the cost is scheduled to increase to 90.3% of market rent (as it stands at that point in time). This requires an estimate to take into account the likely increase in market rents over that five year period.

For the purposes of the financial modelling undertaken in conjunction with this report, the increase has been estimated to be within a range of 10-15% (based on input from the Asset Management team). The following cost estimates have therefore been generated based on an increase of 10%, 12.5% and 15% respectively:

**Table 1:** Estimated net cost of remaining 8 years on existing leases based on 10%, 12.5% and 15% uplift after Year 5 (£000s)

| | **8-Year Cost @ 10% uplift** (£000s) | **8-Year Cost @ 12.5% uplift** (£000s) | **8-Year Cost @ 15% uplift** (£000s) |
|---|---:|---:|---:|
| Estimated Net Cost | 4,788 | 5,226 | 5,664 |
| Budget | 3,600 | 3,600 | 3,600 |
| Additional Cost | 1,188 | 1,626 | 2,064 |

These figures show the anticipated net cost to the Council over the remaining 8 years of the existing leases (with 3 years at the current fixed rate and 5 at the uplifted rate). These estimates essentially provide the baseline comparison for the equivalent 8-year net cost of all the other options (see Section 4).

What this demonstrates is that although the existing budget of £450k is sufficient to cover the annual cost to the council across the first half of the lease term, it is not enough to cover costs once the increase has been reflected from Year 5 (even at the lowest end of the estimate range).

As a consequence, the “Do Nothing” option is not considered to be viable given that the Council would need to fund budget growth in order to make the existing lease arrangement sustainable. Given the wider financial pressures facing the Council and the availability of more cost effective options (see below), it is recommended that an alternative lease arrangement is sought.

3.2. **Option 2 -** Terminate existing leases at 5-year break clause

The other option available to the Council on the existing lease would be to exercise the break clause that is available after five years on Sycamore and Windsor (i.e. before the annual lease cost is uplifted to 90.3% of market rent). This would remove 212 units of TA, with the lease for the 126 units at Concord House fixed at 10 years with no break clause, meaning that there would be no change to the existing cost of this supply.

The first five years of the lease are expected to be affordable within the current budget provision. This option therefore allows the Council to mitigate against the impact of the lease increase at the end of Year 5 which is expected to make it unaffordable within the current budget (see 3.1 above).

However, there are operational factors that make terminating the existing lease early unsustainable. Firstly, a shortage of temporary accommodation supply is already identified as a significant problem for the Council and a significant driver of overspends on emergency accommodation (bed and breakfast). Releasing 212 units of supply would exacerbate this problem, and most likely leave the Council more reliant on emergency bed and breakfast accommodation.

Secondly, even if alternative TA supply options could be found over the next three years, decanting 212 households from their existing accommodation within Sycamore and Windsor houses would require significant capacity to manage the service disruption. This option is, therefore, also considered unviable.

3.3. **Option 3 -** Extend leases on all properties to 21-year FRI lease

The first option proposed by Cheyne Capital, as the new landlord, would allow the Council to switch to a new 21-year Full Repairing and Insuring (FRI) operating lease. This would essentially extend the commitment on the three properties by 13 years (as 2 years of the existing 10-year lease have already passed).

Under this arrangement, the annual cost of the lease would decrease but all cost, and therefore risk, associated with maintaining the properties would also transfer to LBC. Based on their assessment of the recent survey, the Council’s Asset Management team estimate that the average annual cost of this transfer would be £831k. It is important to note that the Council bears the risk in the event that this turns out to be higher.

The annual lease cost would also be indexed at CPI annually. The cost comparison shown in Section 4 demonstrates a marginal level of financial benefit versus the existing arrangement. However, given the substantial increase in both the level of risk and the length of financial commitment, the level of benefit provided by this option is not sufficient to make it attractive.

3.4. **Option 4** - Extend leases on all properties to 40-year finance leases

The second option proposed by Cheyne Capital is the switch to a 40-year finance lease. This would extend the commitment on the three properties by a further 32 years (as 2 years of the existing 10-year lease have already passed).

This arrangement would largely operate in the same way as the 21-year FRI lease proposal in terms of the level of risk transfer (i.e. full responsibility for repair and maintenance will move to the Council). The key difference, other than the length of the commitment, is the fact that the properties will transfer to the Council at the end of the 40 years. The assets would therefore transfer to the Council's balance sheet over the life of the lease. This means that any value retained by the buildings and the land at the end of the lease also transfers to the Council.

This option is significantly more cost effective than the existing lease arrangement (see Section 4). However, it has been noted that one of the properties (Windsor House) contains a number of commercial units on the ground floor and these are let under the terms of long leases (one of which is for 999 years). Future potential for redevelopment or alternative uses for this site would therefore be difficult and significantly reduce any financial benefits in terms of residual value from this property at the end of the 40 years. It is therefore advisable not to take up the finance lease arrangement for this property.

3.5. **Option 5** - Exercise 40-year option for Concord/Sycamore Houses and 21-year option for Windsor House

As a result of the advice above with regard to Windsor House, the Council has made a counter offer to take up the 40 year finance lease on Concorde and Sycamore Houses alongside a 21 year FRI lease on Windsor House. This option provides the best value for money given the obstacles identified above.

Under this proposal, the responsibility for repair and maintenance transfers to the Council in the same way as it does for Options 3 and 4 (with both lease options considered to have the same implications in terms of risk transfer).

This option is not as cost effective as Option 4, but provides the best value in terms of the options that are deemed viable (which Option 4 is not given the complications with the commercial units). As a result, this is recommended to be the preferred option.

## 4. FINANCIAL AND RISK ASSESSMENT CONSIDERATIONS

4.1. The best basis for comparing the various options available to the Council is their cost over the first 8 years, this being the time remaining on the existing lease arrangements. Given that the uplift after five years on the current leases was modelled at 10%, 12.5% and 15% above, these estimates are also shown below for comparative purposes (the other options are all indexed at CPI annually which is why there is no difference across the three scenarios).

**Table 2:** Estimated net cost (£000s) to the council over the next 8 years

| | **8-Year Cost @ 10% uplift** (£000s) | **8-Year Cost @ 12.5% uplift** (£000s) | **8-Year Cost @ 15% uplift** (£000s) |
|---|---|---|---|
| **Option 1**: Do Nothing | 4,788 | 5,226 | 5,664 |
| **Option 2**: Exercise 5-Year Break Clause* | 6,646 | 6,646 | 6,646 |
| **Option 3**: 21-year FRI Lease | 2,186 | 2,186 | 2,186 |
| **Option 4**: 40-year Finance Lease | (786) | (786) | (786) |
| **Option 5**: 40-40-21 Combination | 563 | 563 | 563 |

*it is assumed that the equivalent of the 212 tenants in Sycamore and Windsor Houses would revert back to EA for the remaining 5 years (which is the worst case scenario)

4.2. This comparison shows Option 4 to represent the best value. However, given the issues noted with regard to a finance lease arrangement on Windsor House, Option 5 is recognised as the best value of the viable options. It has the lowest cost over the first eight years of the lease term and also results in two of the properties transferring to the Council at the end of their 40-year lease. Compared to the current lease arrangements, this proposal is estimated to deliver an overall cost reduction of **£4.23-5.10m** over the eight year period, depending on the level of uplift applied to the existing leases at the end of year 5.

4.3. **Future savings/efficiencies**

The added benefit of Option 5 being significantly cheaper than the existing lease arrangement is that it is also expected to deliver a further budget saving. The original decision to enter into 10-year lease agreements on the three properties was based on the delivery of a saving by diverting 338 homeless households from expensive EA provision (bed and breakfast). The proposed leases would allow the Council to maintain the supply of TA that supports that saving, whilst also delivering a reduction of the £450k annual revenue budget that was originally earmarked to cover the net cost of Concorde, Sycamore and Windsor.

Based on the financial modelling undertaken, Option 5 would fully recover cost over the first two years of the lease meaning that the whole budget could be offered as a saving in the short-term. This calculation is relatively secure given that LHA rates are frozen to 2020 which provides a high level of assurance over the likely income that could be generated (assuming that void rates are low).

A small budget would be required in 2019/20 (Year 3 of the new lease arrangement), rising by the CPI uplift on the lease cost to an estimated £175k by Year 8. This longer-term estimate is likely to be less accurate as it is subject to any changes that impact the level of income that can be recovered from tenants from 2020 onwards (for which very conservative estimates have been made).

4.4. **The effect of the decision**

The simple effect of switching the existing leases to the proposed combination of the 40-40-21 year leases offered by Cheyne is that the Council saves a significant sum of money in comparison to what it could expect to pay if it does nothing (£4.23-5.10m). Furthermore, it is also able to remove the need for the £450k annual revenue budget that covers the net cost of leasing the three properties for at least the next two years.

It is important to re-iterate that the new leases transfer a significant level of additional risk to the Council in terms of the on-going responsibility to maintain the physical fabric of the building. Estimates have been built into the calculations undertaken to reflect this, but the financial impact of any material change to these estimates (such as unforeseen major works to the structure) would be borne by the Council and could reduce the level of assumed financial benefit. A number of detailed surveys have been undertaken, including for the main concrete structure, in order to mitigate these risks as far as possible.

The other key impact of taking the 40-year lease option on Concorde and Sycamore houses is that these would become finance leases, meaning that the assets fully transfer to the Council at the end of the lease term. The financial benefit of this is difficult to quantify given the timescales involved, but it is fair to assume that at least some residual value would remain (even if this is only linked to the land component). The Council could therefore choose to sell the assets to generate a capital receipt or re-purpose them to support on-going service requirements at the end of the 40-year lease term. Windsor House would revert back to Cheyne Capital at the conclusion of the proposed 21-year lease.

Ultimately, the context for this decision is that the supply of self-contained accommodation is heavily constrained. Where it does exist, the Council are in strong competition with other London boroughs and the placement of homeless households in emergency bed and breakfast provision is both expensive and unsatisfactory as a housing solution. It also causes shortages in the availability of supply which puts upward pressure on pricing. The decision to extend the leases on these three properties provides the council with a reliable supply of good quality TA units for the foreseeable future which will insulate the general fund budget from the impact of expensive EA provision as homelessness demand continues to sty stubbornly high.

The ultimate aim is to continue to reduce the use of short-term EA accommodation solutions. This will be done by developing a portfolio of provision, combining these sites with a cost-effective mix of Council stock, private leasing, direct relationships with private landlords, privately financed provision.

4.5. **Risk**

4.5.1. Homelessness Demand

Extending the leases on these properties to 40-40-21 years respectively assumes that the demand for TA supply provided by the council will remain at a certain level for the duration of these lease terms. There is a risk that changes in legislation or other external factors could alter the level of demand, or alter the mix of TA accommodation required.

Whilst this is not anticipated, if levels of demand were to reduce, the Council would be able to reduce some of its other types of TA supply first (which are more flexible but generally offer lower value for money).

The other key issues to consider is that cheaper alternatives for TA supply could emerge over the next 40 years which the council would be less able to exploit if it is tied to long-term leases on these buildings. The key mitigation for this risk will be to ensure that the use of Concord, Sycamore and Windsor is flexible enough to allow usage to be switched to an alternative form of housing provision, either for other statutory duties outside of the housing department or use for community needs (such as student accommodation or PRS for example). It should be noted that additional capital investment may be required to make any proposed change of use viable.

4.5.2. Voids and Unforeseen Costs

The financial modelling undertaken to assess the impact of the Cheyne Capital proposals includes a range of assumptions about key items such as void levels and maintenance costs. If actual void levels are higher, the level of tenant income will be lower which will increase the net cost to the Council. Current void levels are very low making the short-term risk minimal, but over a longer-term arrangement this might become more likely.

The largest risk to the Council is the transfer of responsibility for the repair and maintenance of the buildings. An annual contribution of £831k has been built into the cost calculations, but were something substantial to emerge, this provision may not be sufficient and the estimated financial benefits might not emerge.

Finally, it is difficult to estimate the level of income that will be available to the Council beyond 2020, at which point the freeze on LHA ends. Conservative estimates have been used to assess the level of income that could be generated by the 338 units of TA in question, but any major legislative change that affected the level of housing benefit available to homeless households would have a dramatic impact on this proposal (and indeed all forms of EA and TA supply).

4.5.3. Market Value of Properties

Under the terms of the 40-year finance leases for two of the properties, the value of the assets will transfer to the Council's balance sheet at the end of the lease term. The value of the properties at this point in time is unpredictable. It is possible that the buildings may be worth very little (having fully depreciated) and additional costs of demolition may be required in order to re-purpose the land. However, if the Council is able to maintain them effectively over the life of the lease, this may not be the case.

In addition, the market value of the land is expected to appreciate with less risk which would transfer financial benefits to the council (if it were sold) or provide a useful site for further development.

(Approved by: Lisa Taylor, Director of Finance, Investment and Risk and Deputy s151 Officer)

## 6. COMMENTS OF THE COUNCIL SOLICITOR AND MONITORING OFFICER

6.1 On behalf of the Director of Law and Monitoring Officer, it is commented that the powers of the Council to acquire land to assist it in carrying out its functions derives from section 120 of the Local Government Act 1972 and the recommendations set out in this report are in accordance with those powers.

(Approved by Sean Murphy, Principal Corporate Solicitor (Regeneration), on behalf of the Director of Law and Monitoring Officer).

## 7. HUMAN RESOURCES IMPACT

7.1 No Impact

## 8. **EQUALITIES IMPACT** if an equality analysis has been completed it should be listed as a background document and provided to me with the final report

8.1 An initial EqIA of this proposal has been undertaken. The evidence provided has not specifically identified any disadvantage to service users with protected characteristics. At this stage a full EqIA is not required.

## 9. ENVIRONMENTAL IMPACT

9.1 No specific adverse environmental impacts have been identified resulting from the proposals contained in this report.

## 10. CRIME AND DISORDER REDUCTION IMPACT

10.1 No specific adverse crime and disorder impacts have been identified resulting from the proposals contained in this report

## 11. REASONS FOR RECOMMENDATIONS/PROPOSED DECISION

11.1 Local authorities are required to provide accommodation to homeless households in accordance with the provisions of Part VII of the Housing Act 1996. In discharging this duty local authorities must ensure they comply with the requirements of Homelessness (Suitability of Accommodation) (England) Order 2003 (SI 2003/3326) and ensure that homeless households with dependent children or that include someone that is pregnant are only accommodated in bed and breakfast shared accommodation in an emergency and then for no longer than six weeks. The council is now compliant with this requirement due in part by securing this supply of temporary accommodation, to better manage its homelessness cases. Securing 2 assets at the end of the 40 year lease can also assist the HRA balance sheet.

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**BACKGROUND PAPERS - LOCAL GOVERNMENT ACT 1972: Equality Analysis**