REPORT TO: CABINET – 11th February 2008

AGENDA ITEM: 10

SUBJECT: Housing Special Purpose Vehicle

LEAD OFFICER: Director of Housing

CABINET MEMBER: Councillor Dudley Mead, Cabinet Member for Housing and Deputy Leader (Finance and Major Projects)

WARDS: All

CORPORATE PRIORITY/POLICY CONTEXT: The setting up of a Housing Special Purpose Vehicle will deliver new affordable housing for the Council. This supports the achievement of the following corporate priorities of retaining Croydon’s character and providing a better environment.

FINANCIAL SUMMARY: Expenditure on consultant, legal and other project management related costs are likely to be incurred in the next financial year, 2008/9.

A capital budget of £100k has been allocated in the Housing capital programme for 2008/9.

FORWARD PLAN KEY DECISION REFERENCE NO.: 747 This is a Key Decision as defined in the Council’s Constitution. The decision may be implemented from 1300 hours on the 5th working day after it is made, unless the decision is referred to the Scrutiny & Overview Committee by the requisite number of Councillors.

For General Release

1. RECOMMENDATIONS

The Cabinet is recommended to:

1.1 Agree the joint vehicle structure as the preferred option for the setting up of a Housing Special Purpose Vehicle to deliver new affordable housing for the Council.

2. EXECUTIVE SUMMARY

2.1 Tribal Consulting were appointed in October 2007 to provide advice on the funding options and potential vehicles which might be considered for the purposes of undertaking new affordable housing development in Croydon.

2.2 The Council is currently building 32 family houses funded by supported capital borrowing from the Greater London Authority (GLA) and borrowing within the
Housing Revenue Account (HRA). It seems unlikely that further funding will be made available through this route in the near future. In order to continue this programme of building an alternative funding mechanism needed to be identified.

2.3 A portfolio of potential sites is currently being drawn up with the aim of being able to deliver a three year programme.

2.4 Four main options were identified by Tribal and assessed using a number of key criteria. The options were:

- Local authority prudential borrowing
- Using the Council’s Urban Regeneration Vehicle
- Working with a Registered Social Landlord (RSL) partner
- A joint vehicle (a borrowing vehicle and an operating vehicle)

2.5 For reasons detailed in this report it is recommended that the best option is to progress the setting up of a joint vehicle.

3. DETAIL

3.1 The Council is in the process of building 32 family houses on four sites across the borough. Construction on the first site, Sumner Gardens will be starting in April 2008 with the other sites following later in the year. The Council was successful in securing £3.2 m from the GLA for these schemes but it is unlikely that any further funding opportunities will be on offer in the near future.

3.2 In order to continue with a building programme Tribal Consulting were appointed to produce a report advising on the various funding options and potential vehicles available to the Council.

3.3 The key criteria when reviewing the options were:
- that any chosen option must enable the Council to be able to bid to the Housing Corporation for social housing grant;
- the likely cost and availability of finance;
- being off balance sheet for the Council and not having to rely on prudential borrowing;
- reduction of risk particularly where cross-subsidy is required;
- the capture of future value increase in the assets;
- tax and financially efficient and flexible enough to adapt to future development opportunities; and
- control of the programme by the Council.

3.4 The above recognises that even with ‘free’ land, and the possibility of grant, financial viability in many schemes is likely to depend on cross-subsidy through either home ownership initiatives or outright sale. On larger schemes the ability to have diverse tenures could be the key for unlocking future additional grant funding.

3.5 The main options identified were:
a. **Local authority prudential borrowing** – this is the cheapest and simplest option however, any borrowing in the HRA means that at the present time any resulting dwellings would be included within the HRA Subsidy calculation. Due to the way the HRA subsidy system works there would be minimal or no funds to service the additional debt. This option would only be practical if there was a change in housing finance regulations that would allow the ring fencing of such schemes so that the net rental income could be used to service the debt on new dwellings. The Housing Green Paper issued in July 2007 suggested that such a change was being considered but even if the Government does make the amendment the earliest date it might be in force would be April 2009. Another consideration is that it would be difficult to capture future asset value and carry out diverse tenure, while with pressure on government borrowing the availability of Public Works Loan Board (PWLB) loans for this purpose could be restricted in the future.

b. **Utilising the Council’s existing urban regeneration vehicle (URV)** – the partnership arrangements might not be appropriate for delivering affordable housing. The URV is a commercial vehicle and not really suitable for a specialist housing role.

c. **A partner Registered Social Landlord (RSL)** – under such an arrangement the RSL would take control of the land identified for housing development and raise the finance for it. The RSL would then lease to, or enter into a management agreement with, an operating vehicle which could be set up by the Council. Although cheaper financing for the Council, the RSLs may want arrangement fees and may be unwilling to have the kind of tight control that could be imposed on other potential vehicles, making it more difficult to capture future value increases in the assets. A major difficulty would be that RSLs have their own objectives and are not dedicated to a single local authority. Their willingness to do other forms of development and take risk would be their decision rather than the Council’s and may not provide the platform for a future social housing grant bid.

d. **A joint vehicle** – this consists of a borrowing vehicle supported by a financial institution which does the development and a charitable operating vehicle (operating vehicle) which takes the properties on a long lease from the borrowing vehicle as a subsidiary of the Council. This is a variation of the model being considered by some Arms Length Management Organisations (ALMOs) for their social housing grant bids and effectively transfers land at nil value to the financial institution for the length of the mortgage and the operating vehicle leases the property from the borrowing vehicle with a ground rent equal to the interest payment. The leases allow for future asset value to be captured, but avoids financing through a Council controlled vehicle. Such a joint vehicle would be complex to set up but if scoped appropriately would have a wider range of uses and able to finance the grant aided programme. The operating vehicle could be registered with the Housing Corporation which would enable it to bid for social housing grant.
3.6 Although set-up costs of any of the above options and financing costs have to be major considerations, the control and flexibility of the options should be given equal weighting. On some land, the development may have to be of direct benefits to local residents to offset their concerns and debt may need to be restructured later for major repairs. It would be useful to have the ability to finance new home ownership initiatives and the capacity to finance future joint ventures or bring in equity investors. When taking into account these considerations, the joint vehicle where the major priority is financial viability and security with an operating vehicle under the control of the Council but outside the tax regime, has significant benefits.

3.7 Tribal Consulting also looked at the practical issues and potential benefits of transferring existing HRA dwellings into the new operating vehicle and concludes that there could be some potential in doing so but regulations are likely to make this very restrictive. The real possibility is to use the flexibility of the joint vehicle as a way of financing the temporary to permanent schemes.

3.8 Their recommendation is that the joint vehicle consisting of a separate borrowing and operating vehicle would provide the most benefit to the Council in achieving its objectives. It is considered likely that other local authorities will come to the same conclusion although structures could differ, depending on the availability of land, legal and financial advice as well as changes in regulation if government is keen to encourage this approach.

The joint vehicle (Housing Special Purpose Vehicle - SPV)

3.9 A borrowing vehicle could be set up with all or the majority shareholding owned by a financial institution and any minority shareholding held by the Council sufficient for it not to be a controlled vehicle. There would be built into the constitution an arrangement so that the principal objective and business of the vehicle could not be altered without the consent of the Council. The board could also have a minority representation from the Council or its nominees.

3.10 The land for housing development would pass to the borrowing vehicle for development with finance provided by the majority shareholder. The land would be subject to restrictive covenants, to secure that it only be used for affordable housing (including building for sale to cross subsidise the affordable housing). When construction was completed, either a lease or a long term management agreement would be entered into with the operating vehicle. The lease would be for a ground rent equal to the net rent required to service the interest payments on the debt. Any grant received by the operating vehicle would be paid to the borrowing vehicle probably as a lease premium and used to pay off the working capital element of the debt. It is likely that the operating vehicle could be registered with the Housing Corporation.

3.11 The transfer of the land and the leases would have 'mortgagee in possession' clauses sufficient to enhance the security value of the properties and hence reduce the borrowing risk in case of a default. The arrangements would allow any increase in the values of the property to provide additional security in the future to support further debt. Any profits would arise in the operating vehicle.
and be available to support further affordable housing development.

3.12 This borrowing vehicle is likely to have a higher debt cost than the Council borrowing, with additional set up and monitoring costs. However, the ability to be flexible and finance other types of development would be available because it is outside the local authority controlled borrowing regulations and, where appropriate, risk could be ring fenced within the borrowing vehicle. The constitutional arrangements could be set up so that the purposes of the borrowing vehicle were set and any future funding had to be used for social and affordable housing in the borough. Such a borrowing vehicle would also allow financing for other parties such as RSLs, developers and charitable trusts without regulatory restraint but where the Council directed and the lender was willing to fund.

3.13 The operating vehicle could contract with the Council for it to provide Housing Management etc services, so that it need not employ any staff of its own. However, the Council would be obliged to charge VAT on the fees charged for its services, which would be irrecoverable unless the vehicle was in a group structure with the Council, which could be possible.

3.14 The operating vehicle could be used by the Council to take leases on other housing projects not necessarily financed through the borrowing vehicle. A structure diagram showing how the vehicles might operate is shown below:

NB: Lease ground rents = mortgage servicing
3.15 It will be necessary to undertake a formal process to select a financial institution for the borrowing vehicle. Although this process does not fall within the European tendering regulations, it is considered good practice and from the previous experience of Tribal has proved beneficial in terms of fees and margins. The structure of the borrowing vehicle should allow for more than one lender either individually or as a consortium. Debt will probably be structured as a working capital facility dropping into a long term mortgage loan. Any interested financial institution will want to see the basis of any viability appraisal and also the suggested board members for both vehicles. Assuming a successful bid for grant, or identified as non-grant schemes it is envisaged that the timetable from initial decision to being in a position to draw down funds would be approximately four months. Obviously drawdown of funds will depend on the first tranche of land being available as initial security and either commitment to pay grant or a viable project without grant.

3.16 Any funding is likely to attract an arrangement fee payable to the financial institution, legal costs and professional advice. Once the structure is set up, there should be some efficiencies in these costs for later borrowing tranches. It is recommended that any selected financial institution should be of a size and be willing to give a statement of intent for providing further finance.

3.17 The borrowing vehicle would need to enter into a project management arrangement directly with the Council or through the operating vehicle (as client of the borrowing vehicle). The development would be in the name of the borrowing vehicle who would obtain necessary planning permissions, tender for construction etc. However, it is not envisaged that the borrowing vehicle would have any directly employed staff.

3.18 Work is already under way to build up a portfolio of potential sites for the provision of new affordable housing. Various sites have been identified on HRA land which includes garage sites and other land surplus to requirements. Housing and Planning are working up options and an architect has been engaged to draw up outline schemes.

3.19 It is therefore proposed that the Council proceeds with the setting up of a Housing Special Purpose Vehicle based on the joint vehicle described above. If this is agreed then officers can proceed to develop the detailed structures of the SPV and progress the selection of a financial institution. There will then be a further report to Members seeking agreement to the structures and recommending the appointment of a financial institution as a result of the selection process.

4. CONSULTATION

4.1 This proposal has been discussed at the Place Making Sub-Board and the Members Regeneration Board.
5. FINANCIAL AND RISK ASSESSMENT CONSIDERATIONS

5.1 Capital consequences of report recommendations

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5.2 The effect of the decision

Expenditure on professional fees (consultant and legal) and other project management related fees are likely to be incurred in the next financial year, 2008/9.

The costs of setting up the borrowing and operating vehicle are estimated at £30k for consultancy fees and £40k for legal costs. Any arrangement fees for the setting up of the borrowing vehicle will be capitalised as part of the overall loan.

A budget of £100k has been allocated within the Housing capital programme to cover this expenditure.

5.3 Risks

There is a risk that the financial institution could foreclose or that there are changes to the legislation but these can be mitigated by borrowing in tranches. It is considered that there is a low risk of this happening.

5.4 Options

There is currently no other suitable funding option for the Council to deliver new affordable housing. There may be future alternative options if the Government makes changes in the legislation. If this option is not pursued the Council will be unable to continue with its new build programme.

5.5 Savings/future efficiencies

There are likely to be some efficiencies in costs for future borrowing tranches. Any profits arising in the operating vehicle would be available to support further affordable housing.

(Approved by Peter Brown, Divisional Director of Housing (Finance and Investment))

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

6.1 The Solicitor to the Council comments that it will be necessary to seek the Secretary of States consent under s.32 of the Housing Act 1985 and to
establish the structure of the vehicles forming the SPV such that they are not Council controlled. However, beyond that the principle of the Council establishing and SPV is supported by a variety of powers under the Housing and Local Government Acts.

6.2 As noted in body of the report the legal and financial structure of both vehicles will be complex and specialist external legal advice will be sought in this respect.

(Approved by: Gabriel MacGregor, Deputy Council Solicitor (Corporate) on behalf of the Council Secretary & Solicitor and Monitoring Officer)

7. HUMAN RESOURCES IMPACT

7.1 There are no staffing considerations arising from this report.

(Approved by: Robert Laban, Head of HR Consultancy, on behalf of the Divisional Director, Human Resources & Organisational Development)

8. CUSTOMER IMPACT

8.1 This vehicle will deliver new affordable housing for the Council which will help to address the acute housing need in the borough.

9. EQUALITIES IMPACT ASSESSMENT (EIA)

9.1 An equality impact assessment of Croydon’s Housing Strategy 2006-10 was undertaken and consulted upon in 2006. As a result, a programme of actions and schedule of equality targets have been established, a number of which relate specifically to the capital programme, for example in relation to the number of new-build homes suitable for people with disabilities, the number of new smaller homes suitable for a range of clients with support needs or who are vulnerable, and the number of larger homes suitable for larger families and which is likely to have a beneficial impact on people from black and ethnic minority communities.

9.2 This vehicle will help to meet these targets by delivering a range of new affordable housing in the borough.

10. ENVIRONMENTAL AND DESIGN IMPACT

10.1 The housing delivered through this vehicle will be built in accordance with the Lifetimes Homes Standards and the Housing Corporation’s Scheme Development Standards, with the intention of making properties easier to live in for older people, the disabled, and families with children.

10.2 The new houses and sites will be designed to achieve the Code for Sustainability level 4. Provision will be made for on-site renewable energy facilities, such as solar panels and mini-wind turbines and collectors for rainwater recycling. Standards of heat and sound insulation will also be high.
11. **CRIME AND DISORDER REDUCTION IMPACT**

11.1 The housing will be designed to achieve “Secure by Design” standards.

12. **HUMAN RIGHTS IMPACT**

12.1 There is no human rights impact arising from this report.

13. **FREEDOM OF INFORMATION/DATA PROTECTION CONSIDERATIONS**

13.1 There are no Data Protection considerations arising directly out of this report. Information requested under the Freedom of Information Act about the Special Purpose Vehicle and any associated agreements held internally or supplied by external organisations, will be accessible subject to legal advice as to its commercial confidentiality, or other applicable exemption, and whether or not it is in the public interest to do so.

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**Contact Officer:** Peter Brown, Divisional Director of Housing (Finance and Investment) Ext 65474

**Background Documents:** Report by Tribal on “New Development Vehicles” – November 2007