

SOUTH HOLLAND DISTRICT COUNCIL

Report of: Portfolio Holder for Housing and Executive Director - Commercialisation (S151)

To: Cabinet Tuesday, 23 July 2019

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Subject Welland Homes Business Plan Update incorporating Bentley Court

Purpose: To present to the Council, as sole shareholder for Welland Homes Ltd, an updated Welland Homes Business Plan and a proposal from the company to purchase five houses for the purposes of market rental investment at Bentley Court, Spalding. To put in place the necessary arrangements to enable the company to move into contract on the proposed acquisition, subject to the necessary shareholder approvals.

Recommendation(s) to Cabinet:

- 1) To approve the business case for the acquisition by Welland Homes Ltd of five houses at Bentley Court, Spalding, for the purposes of a market rental investment.
- 2) That subject to the refreshed business plan and the budget being approved, that delegated authority be granted to the Executive Director - Commercialisation (the S151 Officer), to approve the terms of any loan agreements required and the value of any periodic cash flow payments to be made to the company, as required to support the company in the acquisition of the proposed investment properties.

Recommendation(s) to Council:

- 3) That the updated Welland Homes Business Plan be approved, and included as an amendment in the SHDC quarterly finance report to members for quarter 1 2019/20. The original Capital Program was, included as Appendix E to the Budget, Medium Term Plan and Capital Strategy Report to Council on 27th February 2019, as Item 11 on the agenda.
- 4) To reaffirm the delegated authority, granted by Council on 25th March 2015, to the Executive Director – Commercialisation (the S151 Officer), to approve the final mix of use of reserves and borrowing in line with the business plan and Council Treasury Management Strategy.

1.0 BACKGROUND

1.1 Welland Homes was established by SHDC in 2015. The principal objectives for setting up the company were to increase housing supply to address demand; to boost the local economy; to improve the quality of rented sector accommodation; to set standards for good housing design; and to generate income for the Council.

1.2 The Council is the sole shareholder of the company and the company's business plan can only be amended with the approval of the shareholder. However, the company has five nominated directors who oversee the activity of the company. The current adopted business plan is predicated on the company owning 60 homes by 2022/23.

1.3 The company now owns 30 market rented homes across 3 sites:

Scheme name	Number of dwellings	Handover date	Development type
Walters Close, Spalding	15	2017/18	Acquisition of completed dwellings from developer, with discount on OMV
Tennants Close, Long Sutton	5	2018/19	Acquisition of completed dwellings from developer, with discount on OMV
Pankhurst Close, Spalding	10	2019/20	Welland Homes design and build contract.

1.4 Capital funding for new schemes is financed through a mixture of loans (at commercial rates) and equity provided to the company by the Council. Given the current Bank of England base rate, the authority earns a margin on the interest charged to the company. Additionally, the authority earns a return on the equity invested.

1.5 In return, the company receives the rental income and pays interest on the loan and can distribute dividends.

1.6 The company incurs core business (operating) costs such as insurance, accountancy services, legal expenses and reimbursement of SHDC staff time for administering board meetings.

1.7 Properties owned by Welland Homes are currently managed by Ark Property Services; a private letting agent with experience of operating in the market rented sector within the district.

1.8 The Welland Homes business plan was most recently updated in March 2018 when the Council approved funding for the Pankhurst Close scheme of ten market rented dwellings, which has since completed.

2.0 **NEW BUSINESS OPPORTUNITY – BENTLEY COURT**

2.1 Welland Homes is continuing to pursue further investment activity for the purposes of market rent to comply with its business plan. This business plan assumes a further scheme of 10 dwellings will be secured by April 2020.

2.2 The SHDC Housing Development Programme Manager has been seeking new development opportunities. This has involved liaison with agents, property developers and housing associations that are delivering mixed-tenure schemes within the district.

2.3 During February 2019, the SHDC Housing Development Programme Manager was approached by Seagate Homes, through the current property management provider, Ark Property Services, to offer Welland Homes the opportunity to acquire five properties at Bentley Court, Spalding.

2.4 The proposal was initially appraised by officers to consider whether it complied with the objectives of Welland Homes and whether, subject to an agreed price, the acquisition would provide an appropriate return for Welland Homes and the shareholder.

- 2.5 On 5th March 2019, at a Welland Homes board meeting, the company directors considered a new business report relating to the proposed acquisition. The report indicated that the dwellings were likely to complete in September/October 2019. However, Seagate Homes has more recently confirmed that the homes are likely to complete earlier in August 2019.
- 2.6 Following extensive consideration of the business case associated with the acquisition, the board identified that the scheme met their objectives:
- The scheme will make an appropriate return to Welland Homes to enable the debt to be serviced.
 - The scheme is in Spalding which is a location with high demand for private rented accommodation.
 - The size of the scheme is appropriate. Whilst the business plan had anticipated that 'scheme number 4' would provide ten dwellings, this proposal will add value to Welland Homes' property portfolio.
 - Whilst the acquisition of solely 3 bedroom houses is more expensive than a scheme including a mixture of different property types, officers are confident, based on the current understanding of the rental market that the properties will be in high demand for private rented accommodation.
 - The scheme will provide good quality accommodation.
- 2.7 The board also considered the scheme costs identified in the business case (financial evaluation), details of which can be found in confidential Appendix 1.
- 2.8 Having regard for the business case, Welland Homes board identified that the scheme met their objectives in terms of size, location and property type and return on investment. The board resolved to agree the following:

“...that the Company would submit a ‘subject to’ offer to Seagate Homes to purchase the units at Bentley Court (previously known as Banbury Close) Spalding and negotiate with the developer in order to secure the best price. [...] Any offer would be subject to due diligence, contract, valuation and formal approval by SHDC (as sole shareholder) and the Board. “

- 2.9 Following this board resolution of 5th March 2019, a number of offers were submitted to the Vendor for the five properties, subject to contract, due diligence, formal valuation and full approval and a price was agreed on the 15th April 2019.

3 **Financial Evaluation**

- 3.1 On 21st May 2019, Welland Homes board met to assess the impact of this scheme on a refreshed business plan. Directors commented that whilst they would prefer to be in a position to deliver 10 new homes by April 2020, they are satisfied that this scheme meets their objectives and they agreed:
- That the opportunity progress to being considered at Cabinet and Council;
 - That, subject to the approval of the sole shareholder, and the relevant legal due diligence and appropriate professional review, Welland Homes Ltd purchase 5 units at Bentley Court, Spalding, to be let as market rent properties, as per the refreshed business plan assumptions;

- That, subject to the approval of the sole shareholder, and the relevant legal due diligence and appropriate professional review, Welland Homes Ltd approve the amended Business Plan including the purchase of 5 units at Bentley Court, Spalding, to be let as market rent properties, as per the business plan assumptions.

3.2 A further meeting of the board occurred on the 11th June 2019 to consider additional information in relation to the Management Company cost estimate confirmed by the Developer during the intervening period. The detailed Management Company costs were factored into the appraisal model and the results reviewed and discussed.

3.3 The board noted the revised return generated, utilising a prudent level of rental income assumed and agreed unanimously to proceed with the acquisition and for the business plan to be proposed to Cabinet and Council

3.4 In order to enable Welland Homes to proceed with this project, the company is seeking approval from the shareholder to put into place all of the necessary arrangements to enable the company to complete the proposed investment.

3.5 These arrangements include Cabinet approving the business case for the acquisition and recommending to Council that a loan be made available to Welland Homes to acquire the units.

3.6 Approval will then be sought from Council to approve the changes to the Company's business plan (in its capacity as sole shareholder), and to make available all necessary finance to enable the company to acquire the units.

3.7 A 'Proforma B' has been prepared to enable the authority to cover the costs associated with necessary due diligence. This includes the appointment of a solicitor to prepare a Report on Title to ensure the units have good and marketable title. These costs will transfer to Welland Homes as part of the Total Commitment in the Loan agreement in the event that the scheme is approved by the shareholder.

3.8 Funding was also sought to appoint a formal valuation as part of the due diligence. This has been carried out by local firm Longstaff who are a Royal Institute of Chartered Surveyor (RICS) registered firm.

3.9 The valuation has confirmed that the agreed purchase price of the five units is below open market value, and that the scheme achieves value for money as a prudent discount is being achieved. The valuation is attached at Appendix 3.

4.0 RISK

4.1 Acquisition and development activity has within it inherent risks. Officers strive to identify and manage risk at each stage of the process of project consideration, and at regular points as opportunities progress through the governance process.

4.2 The risks associated with Bentley Court have been reviewed and discussed by the board at each board meeting and this project has been added into the risk register for the company.

4.3 The key risks for the company associated with this acquisition are identified below:

- **Developer does not deliver project, as agreed.** This is being mitigated by entering into a Contract negotiated between Welland Home's Solicitor and the Vendors legal team. In addition to the legal framework entered in to Welland Homes will ensure clear

lines of communication with the Developer and regular visits to site to ensure that the scheme is progressing and at a decent standard, are being carried out.

- **Contract negotiations are unsuccessful.** Key terms have been agreed. Early review of draft documentation has been carried out and Welland Homes have been open from an early stage regarding the governance required in order to proceed.
- **Difficulties in letting the properties.** A professional marketing agent is in place to manage and market the dwellings early. Discussions are underway with the Developer to propose early advertising in advance of contract due to timescales. Financial modelling does include prudent assumptions around void rates and rental income in order to safeguard the return expected.
- **Quality is not as expected.** Financial modelling includes an allowance for a clerk of works to carry out a purchasers snag prior to completion to ensure that units are handed over with a good standard of workmanship. Insurance documentation will be in place and units will be covered for 2 years by the developer.
- **Cost of Management Company Costs relating to the scheme increases at a faster rate than rental inflation.** Welland Homes will seek to have a representative on the Management Company Board. Should the costs significantly compromise the investment long term, the asset benefits from having a greater degree of liquidity than other asset classes (e.g. commercial units) and so other exit strategies could be considered.

4.4 The key risks for the Authority as sole shareholder are as follows:

- **Financial.** This risk is mitigated by the efficient running of the Company and the delivery of the Business Plan. The Council are prudent lenders and oversee their investment by regular involvement at Board Meetings and by the checks and balances required to progress Welland Homes investment activity.
- **Reputational.** As above, this risk is mitigated by efficient running of the company. Professional advice and due diligence is sought at every stage of the process and effective governance processes are in place to review and monitor all activity. Officer's review Welland Homes activity with the Shareholders interests in mind, as well as that of the Company.

5.0 IMPACT OF BENTLEY COURT ON THE BUSINESS PLAN

5.1 The current total investment required to deliver 60 properties across six schemes is set out in the refreshed Business Plan in confidential Appendix 2. The key changes to the Business Plan since it was last approved in March 2018 are summarised below:

- a) The proposed purchase of 5 units at Bentley Court Spalding in 2019/20 which replaces notional 'Scheme 4' of the original business plan which was proposed to be for 10 units.
- b) The Bentley Court units are anticipated to bring in some rental income by December 2019 which is earlier than anticipated from 'Scheme 4' of the previous version of the business plan.
- c) The outstanding 5 units from 'Scheme 4' have been forecast to carry over into notional 'Scheme 5' which is due to be delivered in 2020/21.
- d) The capital costs for scheme 5 and 6 reflect the costs built into the original business plan and have not been reforecast. However, it should be noted that the costs associated with Scheme 4 (Bentley Court) are higher than the costs originally forecast for schemes 4, 5 and 6. This indicates that the environment for business is changing and accordingly, it is possible that capital costs associated with schemes 5 and 6 could also increase once identified opportunities are modelled.

- e) The Core Business (Operating) costs for Welland Homes from 2019/20 onwards are forecasts. They have been calculated based on the actual 2018/19 company costs, with an inflation figure added. Accordingly, the business plan is predicated on forecasts only. It is possible that the Core Business (Operating) Costs could increase further. Individual projects have little effect on the core business costs.
 - f) Gross Scheme Returns are based on accurate forecasts of likely rental income.
 - g) New projects may incur small losses in the first few months after completion. This is due to loans incurring interest immediately following completion, and also the likelihood that properties may not be fully occupied immediately. However, all projects will quickly make positive returns, contributing over £146K per annum after loan interest costs by 2022/23.
 - h) Gains of £626.5K (£507.5K after tax) arising from the revaluation of existing properties, up to 2018-19. Members should be mindful of the fact that property values could go up or down.
 - i) Welland Homes Ltd should be in the position to pay a dividend by 2021-22 and in future years. This is because the cumulative retained loss is cleared, accumulated profits retained within the company become a positive figure and cash in the bank is in excess of business needs.
 - j) Borrowing reaches £5.66M and the Council's equity investment is £3.20M by 2022/23, giving a total of £8,86M of SHDC invested in Welland Homes Ltd
- 5.2 The detailed projected financial impact of the refreshed Welland Homes Business Plan on the Council is set out in Appendix 5. It demonstrates that with the benefit of the Bentley Court scheme, there continues to be a beneficial financial return to the Council from Welland Homes activity. This is forecasted to be revenue savings of over £0.297m per year by 2022-23.
- 5.3 The Bentley Court scheme provides a lower 30 Year Return on Equity than the previous schemes in the Welland Homes Business Plan. This is attributed to the purchase price for these units being high compared to the previous schemes due to a number of factors:
- The other acquisition schemes; Green Lane and Tennants Close were agreed in 2016 and 2017 respectively. Since these were agreed property prices have continued to rise in the district, and the quantum of investment opportunities on the open market has decreased. This is evidenced by the significant increase in asset value of Welland Homes existing assets at Walters Close and Tennants Close since the original purchases were completed.
 - The scheme comprises all 3 bed properties rather than a mixture of 2 and 3 bed which would reduce the average cost per unit.
 - The scheme is only 5 units and so it doesn't benefit from the same economies of scale as at Pankhurst Close and Walters Close.
 - The scheme is located in a higher value part of Spalding compared with previous acquisitions at Walters Close.
 - Pankhurst Close was a development scheme as opposed to an acquisition. A development scheme balances higher risks (due the risks involved in constructing the properties as opposed to simply acquiring them) with potentially higher rewards, and therefore it is not directly comparable with an acquisition opportunity so needs to be considered separately.
- 5.4 The current modelling assumes that the Council's investment in Welland Homes will be funded through internal borrowing. While the Bank of England base rate is so low this will mean that the Council can achieve a higher rate of interest from Welland Homes than by investing elsewhere. However, it should be noted that, as this is a long term investment, there is a risk that if the base rate increases there may be an 'opportunity cost' to the authority.

- 5.5 In line with the delegated authority granted by Council on 25th March 2015 and re-affirmed within the recommendations within this report, the Executive Director - Commercialisation (the S151 Officer) will approve the final mix of reserves and borrowing in line with the business plan and Council Treasury Management Strategy.
- 5.6 The element of funding that comprises a loan or loans will be subject to a formal loan agreement or agreements which may be protected by way of a charge against the company's assets generally (a floating charge) or against specific assets. Delegation to the Section 151 Officer is sought to approve the terms of any such agreements.
- 5.7 Delegation to the Section 151 Officer is also sought to approve the process required for the Company to draw down periodic cash flow payments if required.

6.0 OPTIONS

Option 1 – To approve the business case for the acquisition by Welland Homes Ltd of five houses at Bentley Court, Spalding, for the purposes of a market rental investment.

Option 2 – Do nothing. Without the approval of the shareholder, Welland Homes would be unable to proceed with the proposed investment. This in turn would limit the delivery of housing from Welland Homes under the existing business plan and leave the company unable to deliver forecast returns.

7.0 REASONS FOR RECOMMENDATION(S)

- 7.1 To approve the business case for Welland Homes to acquire five homes at Bentley Court, Spalding in order to realise the expected benefits as detailed below.

8.0 EXPECTED BENEFITS

- 8.1 The acquisition of 5 homes will support the delivery of the wider Welland Homes Business Plan, which will in turn support the delivery of savings targets set out in the Council's Medium Term Financial Plan.

9.0 IMPLICATIONS

9.1 Constitutional & Legal

- 9.1.1 Whilst operational matters in respect of the company are executive functions, the changes proposed to the business plan result in a need to change the budget. As a result, the final decision is reserved for Council.
- 9.1.2 An external solicitor will be appointed to ensure that Welland Homes will comply with the legal requirements relating to the acquisition. A review of the loan agreement, which drawn up by Eversheds on behalf of South Holland District Council, has been carried out by the Council's Solicitors previously and the same template agreement is proposed to be used for this acquisition.
- 9.1.3 The proposed revisions to the business plan are consistent with the agreed objectives of the company.

9.2 Contracts

9.2.1 In capitalising Welland Homes as a means to enable the company to deliver the project, the Council will utilise a loan and equity agreement, prepared by external legal advisors. This loan and equity agreement will act as a contract between the Council and Welland Homes in relation to the financing arrangement between the two parties.

9.3 **Corporate Priorities**

9.3.1 The recommendations contained within the report will make a notable contribution to the realisation of the Council's corporate priority around 'Your home'.

9.3.2 The opportunity supports the "delivery of new homes through [SHDC's] housing companies...Welland Homes" and also "delivery of housing solutions to meet local needs and aspirations."

9.3.3 The recommendations also support the Council's objective to "ensure that our residents are enabled to live in high quality housing no matter the tenure."

9.4 **Financial**

9.4.1 There is a detailed financial report with financial implications set out in the confidential appendices attached.

9.5 **Reputation**

9.5.1 In order to mitigate reputational risk, a robust risk management structure sits around the administration of Welland Homes as a company. Reputational risk is a key consideration within this structure, and is being proactively managed by the project team.

9.5.2 In order to manage reputational risk in terms of the timeframe around the acquisition and the required governance, the project team have met with the Developer to clearly articulate the caveats within the offer, and the process surrounding the opportunity, so all parties have clear expectations.

9.6 **Risk Management**

9.6.1 In order to mitigate risk, a robust risk management structure sits around the administration of Welland Homes as a company. This risk management structure has been created to manage the financial, legal, delivery, strategic and reputation risks associated with the activity of the company. A risk register for the company is reviewed by the board and a separate risk register, from the perspective of the Authority is reviewed at the internal project group meeting.

9.6.2 Risks around acquisition activity are sought to be mitigated through regular review and the appointment of professional expertise to provide legal due diligence, and accredited valuation advice to ensure value for money, in terms of the cost of the opportunity.

9.7 **Stakeholders / Constitution / Timescales**

9.7.1 Welland Homes has an ambition to purchase the homes in August 2019. The financial modelling of the opportunity has prudent assumptions around income generation and assumes the units are let from December 2019. This is in advance of the previous business plan expectations.

9.8 **Transformation Programme**

9.8.1 Detailed revenue savings arising from the Council's investment in Welland Homes are set out as part of Confidential Appendix 5. Forecast revenue savings of over £0.297m per year will be achieved by 2022-23 as a result of this investment and the wider business plan.

10.0 WARDS/COMMUNITIES AFFECTED

10.1 All

11.0 ACRONYMS

11.1 None

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Key Decision: Y

Exempt Decision: Partially exempt

This report refers to a Discretionary Service

Confidential Appendices attached to this report:

(Please note that the following appendices are not for publication by virtue of Paragraph 3 (Information relating to the financial or business affairs of any particular person (including the authority holding that information))

Confidential Appendix 1 – Bentley Court business case (financial evaluation)

Confidential Appendix 2 – Welland Homes Business Plan

Confidential Appendix 3 – Bentley Court Valuation

Confidential Appendix 4 - Financial Impact of the Welland Homes Business Plan on the Council