

SOUTH HOLLAND DISTRICT COUNCIL

Report of: Christine Marshall, Executive Director – Commercialisation (the S151 Officer)

To: Cabinet - 27th April 2021
Council - May 2021

Author: Katie Nicol, Housing Development Programme Manager and David Mackinder, Finance Business Partner

Subject Welland Homes Business Plan Update incorporating Holbeach Road, Spalding

Purpose: To present a business case to Cabinet and to present to Council, as sole shareholder for Welland Homes Ltd, a proposal from the Company to purchase six houses for the purposes of market rental investment and an updated Welland Homes Business Plan.

Recommendation(s) to Cabinet:

- 1) To approve the business case for the acquisition by Welland Homes Ltd of six houses, for the purposes of a market rental investment.
- 2) That, subject to the refreshed business plan and budget being approved by the Council in accordance with recommendation 3 below, delegated authority be granted to the Executive Director - Commercialisation (the S151 Officer), to (i) approve the terms of any loan agreements required; (ii) approve the value and the profile 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 next SHDC Quarterly report to members.
- 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 six 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 39 market rented homes across 5 sites as shown in the table below. All properties are let and the low void rates indicate that the properties are in demand.

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.
Bentley Court	5	2019/20	Acquisition of completed dwellings from developer, with discount on OMV
Northons Lane, Holbeach	4	2020/21	Acquisition of completed dwellings from developer, with discount on OMV

- 1.4 The original Capital Program was included as Appendix E to the Budget, Medium Term Plan and Capital Strategy Report to Council on 3rd March 2021, as Item 11 on the agenda.
- 1.5 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 Council earns a margin on the interest charged to the Company. Additionally, the council earns a return on the equity invested.
- 1.6 In return, the Company receives the rental income and pays interest on the loan.
- 1.7 By March 2021, the Company made sufficient profit to pay charitable donations to local charities which would have previously been paid by SHDC General Fund.
- 1.8 The current portfolio of 39 homes is appreciating in value and the current asset value is significantly greater than the total investment required to deliver those homes.
- 1.9 The Company incurs Core Business (operating) costs such as insurance, accountancy services, legal expenses and reimbursement of SHDC staff time for administering board meetings, managing the property management contract and identifying new business opportunities.
- 1.10 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.
- 1.11 The Welland Homes Business Plan was most recently updated in March 2021 when the Council approved funding for the acquisition of four completed dwellings at Northons Lane, Holbeach.

- 1.12 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 that the Company will have 60 homes in its ownership by October 2022. There have been some delays to the delivery of new homes due to the impact on the construction sector, SHDC and the Company, of the Covid-19 pandemic.
- 1.13 The SHDC Housing Development Team recommenced seeking new development and acquisition opportunities in Summer 2020.

2.0 **NEW BUSINESS SCHEME**

- 2.1 This section provides scheme information. It should be noted that if this scheme is supported, officers will undertake contract negotiations and detailed due diligence. However, at this time, ahead of formal approval, negotiations are at initial stages.
- 2.2 This opportunity originated from an officer led lead via the advertising sales agent. It relates to the acquisition of 6 new-build 2-bedroom semi-detached houses in Spalding. The construction of the homes is likely to be completed by August 2021.
- 2.3 The proposal is for Welland Homes to purchase completed dwellings from a small construction company. As this is an off the shelf purchase, Welland Homes will only be required to purchase the homes if they are delivered in accordance with the contract and subject to completion of satisfactory due diligence.
- 2.4 Ark Property Centre has indicated that there is demand for this property type in this location.
- 2.5 A heads of terms document was drawn up which included all relevant information relating to the scheme that was known at that time. This was reviewed by the Welland Homes Board who agreed to make an offer for this scheme. Following negotiation between the company and developer's agent, a price was negotiated and agreed 'subject to contract, formal approval, formal valuation and due diligence' between both parties.
- 2.6 The business case for this acquisition was unanimously approved by Welland Homes Directors on 6th April 2021. The Company directors considered the business case relating to the proposed acquisition and the impact on the Company's Business Plan. The business case indicated that the target date for acquisition of the dwellings was August 2021 and built in a delay to assumed occupation dates to mitigate against any delay to the programme, or in letting the units.
- 2.7 The business case identified that the scheme was likely to support the Company's principal objectives. The key considerations included:
- 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 good demand for private rented accommodation.
 - The size of the scheme is appropriate.
 - The Board is satisfied, based on the current understanding of the rental market and advice from Ark Property Centre that the properties will be in demand for private rented accommodation.
 - The scheme will provide good quality accommodation close to the town centre.
- 2.8 The board also considered the scheme costs identified in the business case, details of which can be found in confidential Appendix 1.

- 2.9 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 that, subject to the approval of the sole shareholder, and the relevant legal due diligence and appropriate professional review, Welland Homes Ltd purchase 6 units at Holbeach Road, Spalding, to be let as market rent properties, as per the Business Plan assumptions.
- 2.10 A discount has been achieved on individual marketing prices of the units despite a strong sales market, where sector intelligence suggests that developers are seeking near-to-asking price offers. This is enhanced by the 'race' to benefit from the pause on stamp duty until 30th June 2021.
- 2.11 The Board noted that parking is limited in the vicinity but the properties have been provided with 1 in-line car parking space each. Should parking restrictions such as double yellow lines outside of the development be required, then this could be requested via a traffic regulation order. However, in order to be favourably received by LCC, it would be required to evidence that parking is or will be an issue.
- 2.12 The Board also considered the implications of the dwellings not being covered by NHBC warranty. However, it was noted that the developer will be providing a professional consultant's certificate by CMLC of Spalding. This alternative approach has been reviewed and deemed as sufficient, subject to the strength of the underwriting insurance company. Further checks will form part of the due diligence process prior to completion.
- 2.13 The developer is utilising SHDC Building Control for inspections. This provides an additional level of oversight on the quality of the dwellings. SHDC Building Control have been attending the site and inspecting progress with the construction. SHDC Building Control have also confirmed inspection has taken place to the piled foundations. Formal verification of the Building Control application has been delayed due to Building Control requiring further information. SHDC Building Control have confirmed that this is not unusual and officers will monitor to seek to ensure that this process is completed as part of the due diligence.
- 2.14 The surface water drainage from the scheme including the parking, will discharge into a combined on-site connection which will discharge to the maintained sewer under the highway (maintained by Anglian Water). No soakaways are contained within the development.
- 2.15 The refuse collection from the properties will be via roadside collection by SHDC, with bags to be presented on the relevant collection days.

3.0 **Financial Evaluation**

- 3.1 Welland Homes Board reviewed the business case for this scheme and assessed the impact of this scheme on a refreshed Business Plan. Directors acknowledged the impact on the current Business Plan and the positive return generated and the potential for the capital asset to appreciate over time. They were satisfied that this scheme meets their objectives and they agreed:
- That the scheme be presented to the Council, as Shareholder;
 - That, subject to the approval of the sole shareholder, and the relevant legal due diligence and appropriate professional review, Welland Homes Ltd purchase 6 units at Holbeach Road Spalding, to be let as market rent properties, as per the Business Plan assumptions.

- 3.2 The financial evaluation of the scheme is summarised in confidential Appendix 1.
- 3.3 The projected impact of this scheme on the overall Welland Homes Business Plan is set out in confidential Appendix 3.
- 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 subject to Shareholder approval, that a loan and equity investment be made available to Welland Homes to acquire the units.
- 3.6 Approval is being sought from Council to approve the changes to the Company's Business Plan (in its capacity as sole shareholder), and allocate the necessary finance to this project to enable the Company to acquire the units.
- 3.7 The offer accepted is subject to legal due diligence. Welland Homes Board have approved this scheme and a solicitor has been appointed to prepare a Report on Title to ensure the units have good and marketable title in advance of the scheme being fully approved by the Shareholder. As set out in the Service Level Agreement between SHDC and Welland Homes, these costs will be borne by Welland Homes as part of the total commitment in the Loan agreement. In the event that the scheme is not supported by the Shareholder, these costs will be met as revenue costs by the Company.
- 3.8 A formal valuation has been completed to verify the assumptions made within the appraisal of the opportunity. This has been carried out by a Royal Institute of Chartered Surveyors registered firm, to confirm the purchase achieves good value for money and that the rental level assumed for the units, is achievable. This was reviewed by the Board prior to the Board approving the scheme.

4.0 RISK

- 4.1 Acquisition and development activity has within it inherent risks. The risks are sought to be identified and managed 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 this project have been considered by the board and will be reviewed as the due diligence is undertaken. This project will be added into the risk register for the Company.
- 4.3 The key risks associated with this acquisition are identified below:
- **Contract negotiations are unsuccessful.** Whilst key terms have been agreed, draft documentation has yet to be reviewed. Officers are seeking to protect the best interests of the Company and shareholders at all times and external legal specialists are being appointed to act on the Company's behalf in these negotiations.
 - **Difficulties in letting the properties.** A professional marketing agent is in place to manage and market the dwellings early. As part of the contract negotiations officers will seek agreement from the developer to allow early advertising in advance of the acquisition. Financial modelling does include prudent assumptions around void rates. Additionally, advice on appropriate rental income has been provided by Ark Property Centre and verified by the formal valuation completed in order to safeguard the return expected. A delay has been built in to the cash-flow expected before rent is assumed to be generated.

- **Quality is not as expected.** Financial modelling includes an allowance for a Buyer's Representative to carry out a purchasers snag prior to completion to ensure that units are handed over with a good standard of workmanship. SHDC Building Control team have commenced inspections of the properties and will continue to monitor along with CLMC structural inspections. Insurance documentation and certification will be in place prior to completion.

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. Officers review Welland Homes' activity with the shareholder's interests in mind, as well as that of the Company.

5.0 IMPACT ON THE BUSINESS PLAN

5.1 The detailed projected financial impact on the Council is set out in Appendix 3.

5.2 It demonstrates that with the benefit of this scheme, there continues to be a beneficial financial return to the Council from Welland Homes activity. This is forecasted to be revenue return of over £0.316m per year by 2022-23 comprising equity dividends/donations, loan interest and staff recharges.

5.3 The key changes to the Welland Homes Business Plan since it was last approved in January 2021 are summarised below:

- The proposed purchase of 6 additional units by August 2021.
- Scheme 5A (Northons Lane) was purchased by Welland Homes on 31st March 2021, bringing the total number of homes in ownership to 39. This Business Plan assumed that the homes on scheme 5A would be occupied by August 2021 but it is likely that the Company will receive rental income on some or all of the properties by May 2021.
- This business case relates to notional scheme 5B which it was assumed in the current Business Plan would be for 6 homes and would generate rental income by 1st April 2022. By purchasing the six homes subject to this business case, the refreshed Business Plan provided at Appendix 2 assumes that rental income will be generated sooner, by 1st October 2021.
- Scheme 6 which comprises 15 homes will still be assumed to be in management by 1st October 2022, as per the current plan.

5.4 Welland Homes' overheads such as core costs and fees for audit, directors' insurance and legal services have increased since the original Business Plan which was prepared many years ago. The refreshed Business Plan provided at Appendix 2 includes the actual costs for 2019/20 and assumes an inflated level of overheads for future years.

5.5 It should be noted that the capital costs for Scheme 6 reflect current market costs and are considerably higher than those built into the original Business Plan which were based upon 2017 market prices.

- 5.6 The scheme gross return on equity has been compared to the rest of the Welland Homes programme and a summary table is attached at confidential Appendix 4. The comparison summary provided at Appendix 4 identifies that this scheme provides a higher 30 Year Return on Equity than the Bentley Court and Northons Lane schemes, but lower than the earlier schemes in the Welland Homes Business Plan. This is 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 housing 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 since the original purchases were completed.
 - The scheme is 6 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 Spalding which is a popular residential location in the district and therefore prices are at a premium.
 - The post lockdown housing market saw unexpected growth and increased demand during 2020, meaning that some developers are achieving near-to-asking price offers.
 - 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 (financial return), and therefore it is not directly comparable with an acquisition opportunity so needs to be considered separately.
- 5.7 However, although this Scheme, 5B provides a lower 30 Year Return on Equity than the earlier schemes in the Welland Homes Business Plan it still provides a positive return and allows investment in a capital asset with scope for appreciation in value over time.
- 5.8 The Core Business (Operating) costs for Welland Homes for 2020/21 onwards are forecasts. They have been calculated based on the actual 2019/20 Company costs, but are slightly inflated to take account of rising costs. Accordingly, the Business Plan is predicated on forecasts only. It is possible that these forecasted Core Business (Operating) Costs could increase further. Gross Scheme Returns are based on accurate forecasts of likely rental income.
- 5.9 The total investment required to deliver 60 properties across six schemes is estimated at Appendix 3.
- 5.10 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.
- 5.11 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.
- 5.12 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.) Delegation to the Section 151 Officer is sought to approve the terms of any such agreements.

5.13 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.

5.14 The revised Business Plan was considered and agreed unanimously by the Welland Homes Directors, subject to approval by the shareholder.

6.0 OPTIONS

Option 1 – To approve the business case for the acquisition by Welland Homes Ltd of six houses, at Holbeach Road Spalding for the purposes of a market rental investment and to approve the amended Business Plan.

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 forecasted returns.

7.0 REASONS FOR RECOMMENDATION(S)

7.1 To approve the business case for Welland Homes to acquire six homes in Spalding in order to realise the expected benefits as detailed in Section 8 below.

8 EXPECTED BENEFITS

- 8.1 The acquisition of six homes and delivery of this scheme will provide a number of benefits:
- Supports 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
 - Increases housing supply to address demand;
 - Boosts to the local economy;
 - Improves the quality of rented sector accommodation; and
 - Generates income for the Council.

9 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 The legal requirements for the acquisition by Welland Homes will be met by an external solicitor appointed by Welland Homes. Review of the loan agreement, 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 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' and supports the following priorities in the Corporate Plan 2019-2023:

- Enable effective planning and delivery of housing solutions to meet local needs and aspirations to ensure that our residents have access to a range of housing options in the district;
- Deliver new homes for our residents and provide a dividend to Council through our Welland Homes housing company; and
- 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. This includes a financial evaluation of this Business Case; a revised Welland Homes Business Plan; an assessment of the financial impact of the revised Welland Homes Business Plan on the Council; and a comparison of the financial return anticipated to be achieved on this scheme alongside forecasts for other approved Welland Homes projects.

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 required governance, the project team have held discussions 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 2021. The financial modelling of the opportunity has prudent assumptions around income generation and assumes the units are let from October 2021.

9.8 Transformation Programme

9.8.1 Detailed revenue savings arising from the investment in Welland Homes are set out as part of Confidential Appendix 3. Forecast revenue return of over £0.308m per year comprising equity donations, loan interest and staff recharges will be achieved by 2022-23 as a result of this investment and the wider Business Plan. In addition, the Council will also receive indirect contributions through New Homes Bonus and as a result of an increased Council Tax base.

9.8.2 In March 2021, Welland Homes Limited provided charitable donations to local charities in lieu of contributions from the SHDC. The charitable donations removed a financial commitment from the SHDC General Fund of £111,000, during 2021/22.

10 WARDS/COMMUNITIES AFFECTED

10.1 All

11 ACRONYMS

11.1 None

Lead Contact Officer:

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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))

Appendix 1 –Financial Evaluation

Appendix 2 - Welland Homes Updated Business Plan

Appendix 3 – Financial Impact on Council

Appendix 4 – Comparison with approved Welland Homes Acquisition and Development Programme Returns.