APPENDIX 1

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New Homes Housing Investment Plan

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Contents

1. Executive Summary

This report builds on the July 2013 Savills report on the Housing and Finance Stock Options Appraisal. That report focussed largely on the financial position of the existing stock and concluded that although choices needed to be made between timing and levels of investment in the short term, in the longer term the Council could plan for an investment programme for existing stock beyond the current Warm, Dry, Safe programme where this represents a sustainable long term solution that meets residents expectations. It recommended further work was done to consider the financial performance of the Council's housing assets in order to inform investment decisions, and that the Council considers its appetite to lead regeneration and new build, which did not necessarily need to be constrained by the limits on borrowing within the Housing Revenue Account (HRA).

Since that report the Council has announced an ambition to expand its current new build programme of 1,000 units by an additional 10,000 units of social rented accommodation. This second stage report develops a 30 year housing investment plan which reflects this ambition as well as maintaining and investing in the existing stock base. The key stages of the Savills' review are as follows:

- The development of a high level 30 year investment plan
- Analysis of local opportunities through existing assets and land capacity
- Advice on steps required to build a development strategy to support delivery at this scale

1.1. New housing investment plan

The starting point for this report is a review of the HRA business plan, incorporating changes (including government consultation on social housing rent policy) and emerging risks since July 2013 to provide a robust baseline position.

The updated business plan illustrates that while the HRA is forecast to have sufficient resources to meet the needs of the current stock over the next 30 years, it is prudent to maintain current borrowing headroom below the debt cap in order to deal with potential liabilities in the medium term. As such it would not be prudent to rely on additional resources from the HRA to provide funding for new build development.

The report then goes on to explore alternative funding and potential delivery mechanisms that could be explored to deliver an expanded programme of new build.

The current 1,000 new homes programme is developed on the basis that they are funded from contributions from the Council's Affordable Housing Fund made up of in lieu payments from developers and Right to Buy receipts.

If this approach were taken to the funding of an additional 10,000 new homes at social rent, it is estimated that there would be a total funding requirement of £2.4bn including the impact of inflation over a 30 year period.

Any programme of new social rented homes would form part of a wider development of mixed communities new build for sale and shared ownership. Using the mix of tenures that form part of 1,000 new homes programme, this would mean an additional 2,900 market sale properties as well as additional shared ownership properties. The cross subsidy from this would reduce the net funding requirement from £2.4bn to £1.5bn over 30 years. The overall balance of market and social housing across the borough would be in line with Council housing policy, recognising that a proportion of the market element of future homes will be developed by others.

The new social rented housing will generate rental income. After allowing for costs of management, maintenance and future capital investment the balance could be available to support the cost of providing the new housing. Any financing provided through this route would reduce the subsidy requirement. However in view of the overall scale of funding required, it is unlikely that the entire debt requirement could be met through Council borrowing so an element of additional subsidy is likely to be required to be met from the Affordable Housing Fund and/or reserve balances.

It is important to consider how financing can be accessed in a way that does not impact on the HRA capital finance requirement and at a scale that can be contained within the Council's overall prudential limits.

These projections are very sensitive to changes in assumptions over time. Key risks to be managed on the programme will include build costs and land availability. Where build costs exceed current estimates, and if existing Council land supply needs to be supplemented by acquiring land from third parties, the financing requirement will increase significantly.

The report illustrates this sensitivity and considers the extent to which actions could be taken to manage these risks, including changes in tenure mix, introducing new models such as rent to buy and continuing to review the value of financing via S106 contributions compared with the value of on site provision.

The investment plan and sensitivities provide an initial indication of the funding requirement to deliver new homes and the range of routes available to meet this requirement. In exploring the range of potential delivery mechanisms available the report has therefore considered the extent to which each mechanism could offer the greatest ability to use available subsidy to maximum impact, thereby minimising the Council's exposure to additional financing requirement.

1.2. Potential Delivery Mechanisms

As well as considering the funding requirement for the additional 10,000 new social rented homes, the report has also considered the available land supply. Savills has reviewed work carried out to date to assess development potential across the borough including the 2009 Strategic Housing Land Availability Assessment (SHLAA) and 2010 Development Capacity Assessment (DCA).

Both these documents are relatively recent and show a clear and transparent projection of capacity that has been used to inform Savills' assessments of land supply required to deliver the Council's ambitions using a range of different potential delivery mechanisms.

While this shows that there is no absolute physical constraint on land supply to deliver the Council's objectives, not all of this land is in Council ownership. A key factor will be the actions required by the Council to access each of the opportunities identified. The Council will need to employ a range of proactive actions to take advantages of opportunities available to it as major landowner, and ensure it makes best use of its powers as local housing and planning authority to prepare a new housing strategy and Local Plan. This might include, for example, taking action at an early stage to acquire non Council owned land where advantageous to do so. Given the clear and comprehensive evidence of land supply, Savills considers the Council's ability to set proactive plans to access these opportunities to be the critical factor in land availability to deliver the Council's ambitions. The Mayor's Housing Covenant – 2015-18 Programme published in December 2013 expresses the Mayor's wish to work with boroughs, through their strategic planning and enabling roles and also keenness to encourage boroughs not only to develop affordable homes in their own right but strongly encourages boroughs to work in consortia with others to maximise efficiency in programme delivery. Whilst the Mayor's Covenant inevitably presents some challenges, there is a great degree of synergy with the direction which this report sets out.

There are a variety of different potential delivery mechanisms available which will need to be explored to deliver the scale of development required. Different mechanisms will suit different opportunities.

Potential delivery mechanisms identified include

- Extending the 1,000 new homes programme across existing Council housing estate
- Working in partnership with RPs to deliver new Council housing
- Council retention of S106 affordable housing
- Joint ventures
- Reconsideration of land use and intensification

There are also smaller scale opportunities available through buy backs of existing leasehold homes and bringing empty homes back into use which will continue in line with current Council actions. Buy back activity could include buybacks to increase the long term rented stock holding, or in order to facilitate estate regeneration.

Each potential delivery mechanism has been considered at a high level to explore the extent to which it meets key criteria of maximising supply and value, looking at the following aspects:

- Indicative dwelling output
- Skills and systems required by the Council in order to bring forward opportunities
- Management of construction costs
- Exposure to sales risk
- Product control
- Financial impact on the Council

- Opportunities
- Limitations
- Further action required to progress the opportunity

As part of the development of this report Savills has also analysed the proposals put forward by the Futures Steering Board in July 2013 and used this review to inform the proposals in this report. The FSB will continue to be a key stakeholder to be included in consultation about the programme as delivery plans are developed.

1.3. Alternative structures to facilitate the funding of new Council Housing

In the past, a number of financial, legal and regulatory issues have resulted in Registered Providers ("RPs") taking the lead in delivering new social housing, even on council owned land. On estate regeneration projects an RP would typically acquire the new affordable housing, and councils would often sell off or hand over land for an RP to build new social housing.

The main reason for this approach was that through the HRA subsidy system, councils were not able to retain the net rental income from council housing. So they could not afford to borrow to build or buy any new council housing. On the other hand RPs were able to borrow to fund the acquisition of new housing, because they retained the net rental income from new housing as well as their existing asset base. In addition, RPs had access to HCA grant and had built up development skills.

Today, the position has changed. Due to a combination of changes in the Localism Act, HRA reform, HCA grant reduction, and interest from institutional investors, councils are in a similar (or arguably stronger) position than RPs to deliver new social housing. As a result, many are looking at taking a direct involvement in the delivery and ownership of new social housing.

Ownership of the new housing within the HRA is often the preferred option for a council, but this may not be possible at scale due to Government caps on HRA borrowing. Whilst the rationale for the cap was largely to restrict borrowing against existing council housing, it applies to all debt in the HRA even for new housing. The government announced in the Autumn Statement 2013 the potential for Councils to bid competitively for a small relaxation in the HRA debt cap, to enable new build, linked to Council contributions of free land, and receipts from asset sales, and delivered in partnership with RPs. While this is welcomed, the amount of money is small when considered on a national basis and only available over a two year basis. As a result, many councils are looking to own new housing outside the HRA where there is no restriction on borrowing, beyond normal prudential borrowing principles.

Whilst ownership of new housing in the general fund may be possible, there are legal risks with this approach and no clear precedents for councils looking to deliver and hold new housing in the general fund. For these reasons many councils are using the option of establishing a council owned vehicle as a simple step to support the delivery of new council housing.

There are legal and financial implications to be considered, as well as options for the governance and operation of the Council Vehicle, and these issues are set out in the report.

Management models for new housing, whether funding is structured in a Council vehicle or directly in the HRA, can be developed in line with Council proposals to develop management models for its existing stock and actions to promote increased tenant management.

1.4. Building development capacity

The report sets out the actions required by the Council in order to access the development opportunities in the borough to enable a significant increase in delivery capacity from 1,000 to 11,000 new homes. In reality delivery capacity will need to be even larger, in order to ensure mixed communities, and to provide a level of cross subsidy from market sales.

Systems will need to be in place to ensure a step change in delivery capacity (separate from land supply) which may mean more than building up existing structures and operations, given the level of increase required.

The report proposes a governance framework with a single co-ordinating role with responsibility for budget and programme management, as well as comprehensive management of risk.

It proposes an operational framework supported by a procurement strategy that establishes frameworks for the supply of professional advice across the range of disciplines required including legal, design, cost, value, land use/planning consultancy, project management, programme management, and funding, ensuring individual project managers can access the support required in a timely manner at a competitive cost.

1.5. Conclusions

As a result of the initial work on the stock options appraisal, and the work since the summer to develop the housing investment plan it is reasonable to conclude that the Council's ambitions are realistic and deliverable. Key conclusions would include:

- The HRA business plan is constructed to manage emerging risk factors associated with the existing stock but is unlikely to be able to have sufficient resources to subsidise additional new build development.

- The investment plan for new homes would need to rely on funding supported by the future rental income stream of the new homes and additional subsidy from market sales, intermediate homes and additional capital subsidy (e.g. Affordable Housing Fund)

- Recent capacity studies show a clear and transparent projection of land supply. However a key factor will be the actions required by the Council to access each of the opportunities identified including sites not in Council ownership.

- There are a variety of different potential delivery mechanisms available that will need to be explored to deliver the scale of development required.

- The funding of new homes is constrained within the HRA due to limits on the debt cap, but other structures exist which many other Councils are using to structure and finance new development in a Council owned vehicle.

- Management models for new housing can be developed in line with Council proposals for the existing stock.

- A delivery framework including governance, operations, risk management, skills audit and procurement strategy will need to be established, led and managed to enable the Council to take a proactive and co-ordinated approach to increasing development delivery capacity, including the co-ordination of multiple project streams.

1.6. Next Steps

Finally the report summarises the range of actions to be taken over the next 6 – 12 months to build up development capacity including

- The development of a single consolidated financial model including site specific modelling to test funding and viability

- Various actions to take forward opportunities under different potential delivery mechanisms, including in particular engagement with registered providers and developers/house builders and the GLA to ensure access to third party expertise and capacity where these can support the Council's objectives for new Council housing.

- The development of a framework for the evaluation of existing HRA assets and the agreement of an active asset management strategy to take forward opportunities in consultation with residents

- Appraisal of alternative options to structure funding for new build homes in a way that allows expansion of the programme without breaching the HRA debt cap including further exploration of the establishment of a Council Vehicle

- The development of a detailed business plan involving site specific proposals as these are identified and agreed and an appraisal of funding options.

- The establishment of delivery framework including, governance, operations, risk management framework, skills audit, procurement strategy and how this will be led and managed

- An analysis of the wider impacts of a large Council housing building programme, including the management and monitoring of impacts on the Council, the environment, the housing mix in the borough, demographics and the housing market.

- The Council will continue to evaluate new and emerging models of delivery which may assist in meeting its objectives for housing investment and new build provision.

2. Introduction

2.1. Background

In July 2013 Savills reported on the Housing Stock Options appraisal. That review focussed on the financial position of the Council's Housing Revenue Account(HRA). It concluded that although choices needed to be made between timing and levels of investment in the short term, in the longer term the Council could plan for an investment programme for existing stock beyond the current Warm, Dry, Safe programme where this represents a sustainable long term solution that meets residents expectations. The recommendations from the stock options appraisal included

- A detailed evaluation of the financial performance of the Council's housing assets, alongside an assessment of the extent to which assets meet the Council's overall social housing objectives

- Exploration of the Council's appetite to lead regeneration and renewal and the development of funding strategies to deliver these within the existing HRA debt cap or through alternative financing arrangements

In addition the Council has made a commitment to increase its current new build programme of 1,000 units by an additional 10,000. Savills has been commissioned to develop a 30 year housing investment plan which reflects this ambition.

2.2. Review scope and methodology

The key stages of Savills' review are as follows:

- Develop a high level 30 year investment plan

- Analyse local opportunities through existing assets and land capacity

- Advise on steps required to build a development strategy to support delivery at this scale

The starting point for this report is a review of the HRA business plan, incorporating changes and emerging risks since July 2013 to provide a robust baseline position, in order to understand the extent to which the existing HRA has capacity to fund new homes.

The report then goes on to explore alternative funding and potential delivery mechanisms to deliver an expanded programme of new build. The report concludes with an outline development strategy with an action plan for activities over the next 6 – 12 months to test viability locally and refine the programme on a site specific basis.

3. Housing investment plan

3.1. Update of baseline HRA

Savills has revisited the HRA business plan assumptions used in their first phase report in order to incorporate the impact of emerging risk factors, including government changes to rent policy, and to confirm a realistic and prudent projection of financial capacity within the HRA. As part of this process Savills has tested and refined assumptions with the Council in the following areas

- The impact of proposed government changes in rent policy which depress future rental income by ending of the ability to converge rents to target beyond 2014/15 and the linking of future rent increases to CPI rather than RPI.
- Refining assumptions about the future capital programme, including additional amounts for fire safety, cyclical decorations and other improvements
- Testing assumptions about future capital receipts and void disposals, in the context of the requirement of land for new build.

The impact of these various factors is illustrated below.

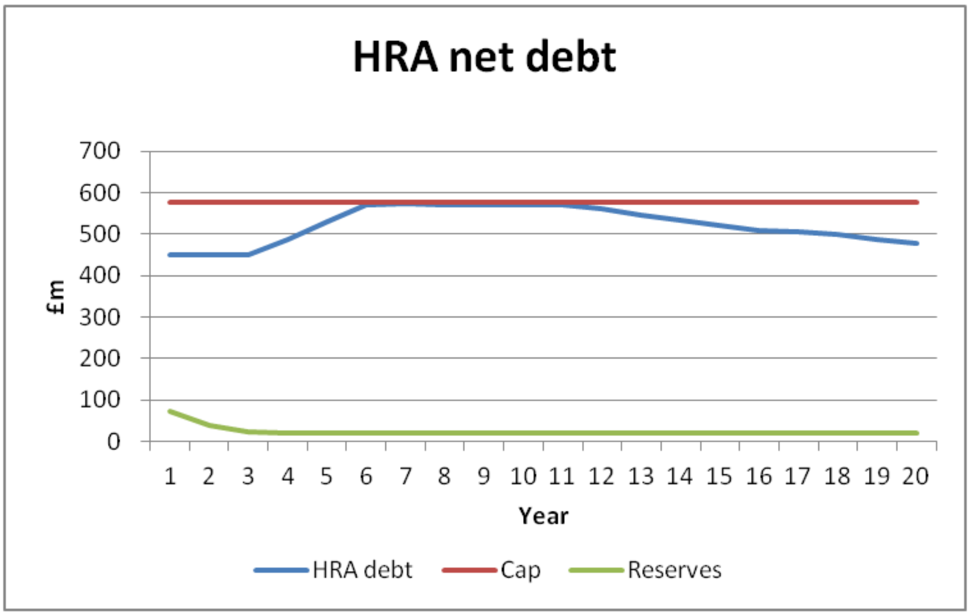

Fig 1: Baseline HRA business plan

The red line represents the cap on borrowing capacity within the HRA, set by government at £577m following the introduction of self financing in April 2012. The blue lines shows a ***potential*** requirement to increase HRA debt up to the cap in the medium term in order to finance requirements for investment in existing homes which may be required if identified risks materialise (e.g. additional fire risk works). The green line shows the HRA maintaining a minimum balance of reserves in order to manage risk.

This illustrates that while the HRA is forecast to have sufficient resources to meet the needs of the current stock over the next 30 years, it is prudent to maintain current headroom below the debt cap in order to deal with potential liabilities in the medium term. As such it would not be prudent to rely on additional resources from the HRA to provide funding for new build development.

The assumptions for the HRA assume that existing regeneration schemes such as Aylesbury are effectively self funding with costs incurred in the short term which are recovered from the project over time.

3.2. Financial plan for new homes

3.2.1. Baseline assumptions

The current 1,000 new homes programme projects a tenure split of 70% social rent and 30% social home buy, with an additional 200 homes to be built for market sale.

This is largely funded by contributions from the Council’s Affordable Housing Fund, generated through the receipt of in lieu payments for affordable housing as well as Right to Buy receipts.

Build costs were originally estimated by Grant Thornton of between £131m and £153m. Both Grant Thornton and Davis Langdon estimated costs of £160,000 per unit on phase 1. Experience from phase 1, and the nature of sites in phase 2 has meant costs are currently estimated at £170,000 per unit based on cost reports prepared by Davis Langdon.

The starting position for an additional 10,000 homes is that they are let at social (target) rents. Clearly a programme of this size would include additional units of other tenures (both market and intermediate or shared ownership) to produce a mix in line with Southwark’s planning policies and housing demand.

Savills’ modelling seeks to explore the subsidy required to deliver 10,000 social rented units as well as the options available to provide cross subsidy from an expanded programme that would include a range of tenure mixes.

Build cost estimates are based on a review of current market rates, assuming no significant site abnormalities and a volume building programme. This provides for an average build cost of £150,000 per unit rising in line with inflation over time. This includes an allowance for on costs, S106, CIL contributions etc. Savills are confident this is deliverable as an average across the programme, subject to effective and efficient procurement and cost control.

It is assumed the expanded 10,000 programme starts in 2015/16 and builds up over time, to continue beyond the life of the current 1,000 home programme completing in 2045/46. An illustrative profile which shows the programme building up over time is set out below.

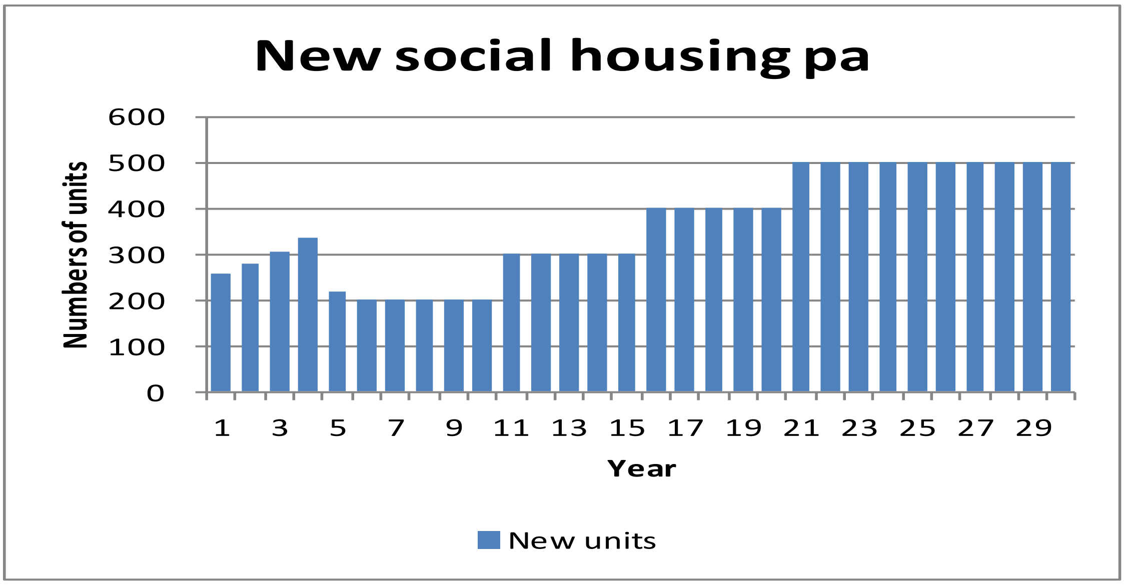

Fig 1: Projected new build numbers 11,000 homes

Where market or shared ownership housing is included in addition to the 10,000 social rented units the financial modelling is based on sales values from a market review by Savills which shows the following sales history between quarter 2 2012 to Q1 2013

All Sales: Q2 2012 to Q1 2013	North SE1 SE16 SE17	Central SE5 SE15 SE24	South SE22 SE21	Southwark
Detached	£403,600	£771,833	£1,089,098	£931,101
Semi-Detached	£387,556	£699,419	£750,286	£669,135
Terraced	£443,957	£515,393	£562,309	£512,736
Flat	£431,171	£255,738	£280,328	£357,703

Table 1: Market sales report Savills

A full market report on which these assumptions is based is included at Appendix A.

Moving prices on to a 2015/16 price base, a starting assumption of an average sales value of £378,000 is used for modelling purposes.

3.2.2. Illustrative funding requirement

Total build costs to deliver 10,000 social rented homes are estimated at £2.4bn. The annual cost increases to reflect the build up of the programme over time. At this stage the profile of build is estimated to start at 100 social rented units in 2015/16, building up over time to reach 500 social rented units and 100 market sales per annum by 2035. This profile is in addition to the 1,000 unit programme which will increase the numbers of units delivered in the early years. The profile is provided for modelling purposes and reflects the time required to access larger scale development opportunities. It would need to be tested with more detailed site feasibility studies in the next stage of the development of the plan.

The projected base line build cost requirement for the 10,000 additional social rented over 30 years is illustrated below.

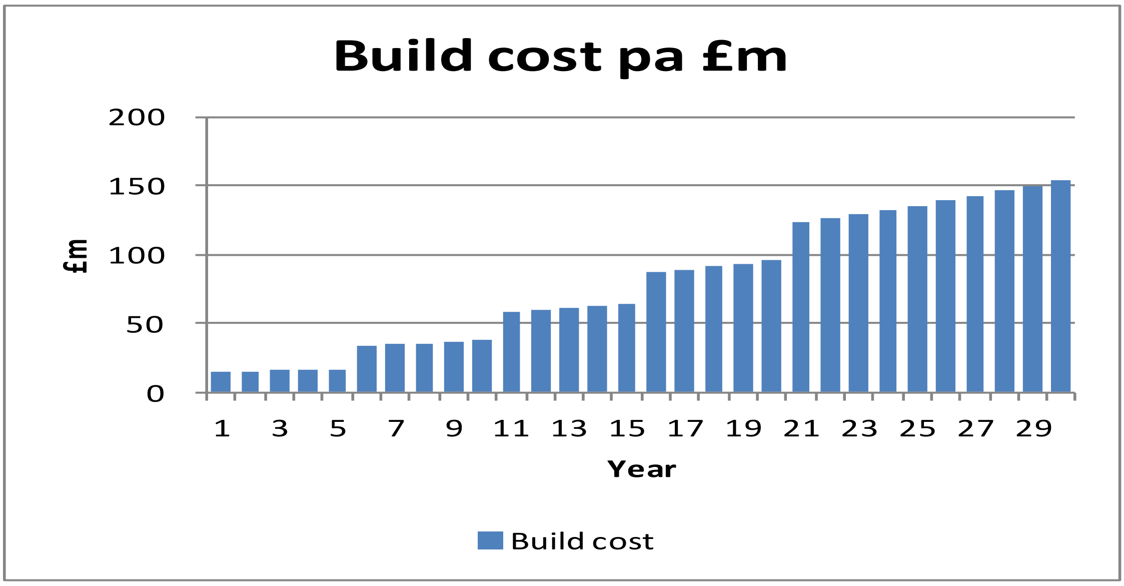

Fig 2: Projected cost requirement for 10,000 additional social rented units

Direct delivery is relatively capital hungry. If the programme were funded entirely by the Council in the way in which the 1,000 new homes programme is funded, there would a capital funding requirement of £250m in the first 10 years, rising to a total of £2.4bn over 30 years

3.2.3. Cross subsidy from market sales and shared ownership

Using a similar ratio to the 1,000 homes programme, there would be some 2,900 market sales delivered alongside the 10,000 social housing, Additional units built for intermediate tenures such as shared ownership will also generate a level of receipts which would act as cross subsidy, potentially reducing the funding requirement further. This recognises that Southwark's contribution to new Council homes on mixed sites across the borough will not be out of kilter with planning policy targets for mixed development across the borough, but a proportion of the market element of future homes will be developed by others.

The cross subsidy from profits on these sales is forecast to reduce the scale of funding requirement to £165m over 10 years and £1.5bn over 30 years.

3.2.4. Funding secured against future rental income

In addition to the cross subsidy delivered through market and shared ownership housing, the new social rent housing will generate rental income. After allowing for costs of management, maintenance and future capital investment the balance could be available to support the cost of providing the new housing. Any financing provided through this route would reduce the subsidy requirement.

Based on a social rent level, it is estimated that the new housing would have a value of some £80,000 per property (in 2015) – i.e. additional debt of £80,000 per property could be serviced and repaid from the net rental income that it generates. Financing could come through a variety of routes including Council borrowing via PWLB, bond finance or institutional investment, for example through a sale and leaseback type structure. Access to partner investment is also explored in section 4. The chart below shows the impact of both the cross subsidy from market sale and shared ownership, as well as the additional debt that could be raised against the social housing.

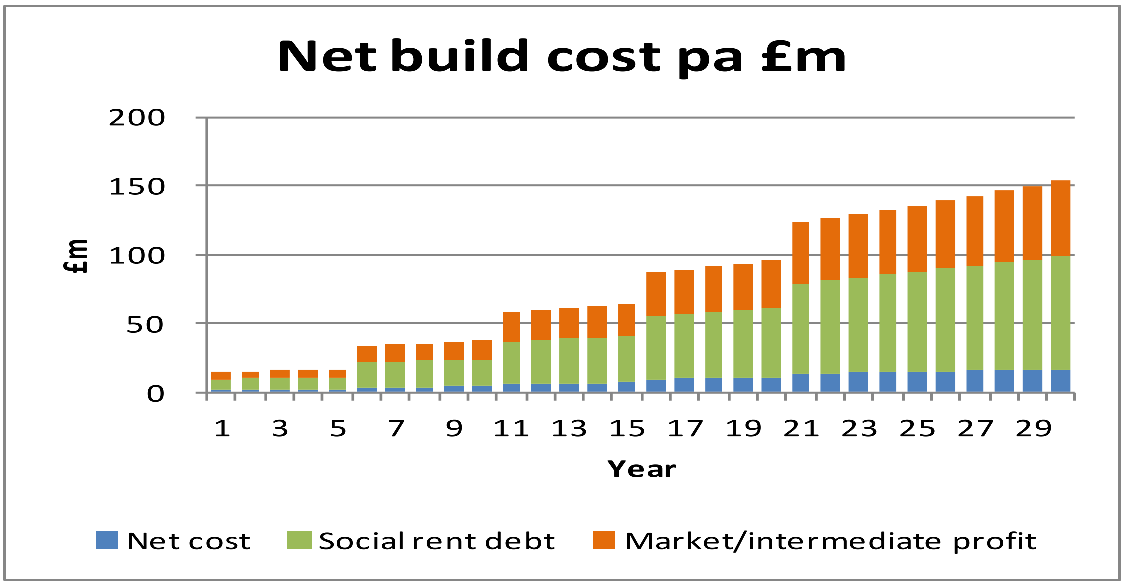

Fig 3: Projected net build cost requirement for 10,000 additional social rented units

Including the debt that could be supported by the social housing, the net cost of delivering the social rented housing reduces to £28m over 10 years and £262m over 30 years. This represents the subsidy that would be required (in addition to market sale profits and social housing debt), to deliver the 10,000 properties.

The total additional debt shown here is some £1.3bn over 30 years – equivalent to £130,000 per unit (including inflation). However, there would be an element of recycling of debt, as the housing acquired in earlier years generates rental income and reduces the need for debt to support new housing in later years. Taking account of this, the maximum additional debt requirement would reduce to £1.0bn.

In considering the financing requirement to be met by the Council it is important to consider how financing can be accessed in a way that does not impact on HRA capital finance requirement and at a scale that can be contained within the Council's overall prudential limits.

In view of the overall scale of funding required, it is unlikely that the entire debt requirement could be met through Council borrowing. To reduce the funding requirement, additional subsidy or external funding would be required.

3.2.5. Sensitivity and risk

These projections are very sensitive to changes in assumptions over time. Key risks to be managed on the programme will include build costs and land availability. As an example sensitivity Savills has modelled the impact of an increase in build costs of 10% and a requirement to purchase land for 25% of the new homes in the later years of the programme.

The impact of this on the subsidy required to deliver the social housing is an increase from £28m to £76m over 10 years or from £262m to £1.2bn over 30 years

Risk management actions to restore the financial position could include

- Revised tenure mix
    - Introduction of affordable rents for smaller units where this fits with affordability limits established by the Council in separate studies
    - Rent to buy and intermediate rents
    - Increased sales
- Additional subsidy from the Council through increased void disposals and land sales or other corporate receipts.
- Use of future HRA surpluses where these are not required for investment in existing stock
- Bringing forward sales
- Third party involvement

As an example, Savills has modelled the potential impact of a rent to buy product being used for 10% of the social housing. This would reduce the subsidy requirement by £14m in the first 10 years (down to £62m), and over 30 years would reduce the subsidy requirement by £0.1bn down to £1.1bn.

While a tenure mix provides opportunities for additional cross subsidy, it will also address the Council's planning policies to support mixed communities. Intermediate and rent to buy models will also address the housing needs of those in Southwark unable to access home ownership or social housing.

3.2.6. Evaluation of financing via S106 contributions

Another option that the Council can consider to increase the capital funding available to support new build is the evaluation of S106 contributions from developers against the provision of new Council housing via this route. It should be noted that at least in the early years, this money is already earmarked for the 1,000 new homes programme.

Affordable Housing on site is currently delivered by Registered Providers; however an alternative model would be for these properties to be acquired by the Council, to contribute to the 10,000 homes target. This option is identified in the next section of this report on potential delivery mechanisms.

The existing Direct Housing Delivery Programme is mainly funded from in lieu payments from signed s106 agreements. The council's adopted Affordable Housing SPD 2008 (Section 3.6) together with the Draft Affordable Housing SPD 2011 (section 6.3) clarifies the Southwark Plan and Core Strategy policy framework and sets out the approach in relation to securing the maximum level of affordable housing from developments. Specifically, it sets out the sequential tests relating to the delivery of affordable housing, firstly relating to securing on site provision, secondly off site provision and thirdly an in lieu payment.

The NPPF, London Plan and local policies all set out that in exceptional circumstances (the local policy refers to "very exceptional" circumstances) a commuted sum may be acceptable in lieu of on-site or off-site affordable housing. The adopted Affordable Housing SPD (2008) sets out three 'value areas' in the borough, for the purposes of negotiating commuted sums. Applications in band 1 close to the river are evaluated on a case by case basis, band 3 to the south of the borough require a payment of £80,000 per habitable room and band 2, in between, £100,000 per habitable room.

Developers of private housing are required to submit a viability assessment which is evaluated by the Council to determine the level of affordable housing required on site, or where a greater proportion be available off site or where a payment in lieu could be demonstrated to deliver a higher number of affordable homes.

BNP Paribas in their March 2011 report assessed 29 schemes identified as part of the Development Capacity Assessment.

The evaluation of the cost benefit of on site provision over payments in lieu requires assessment on a scheme by scheme basis determined by viability assessment. The BNP Recommendations were as follows[1]:

- "The Council should set a relatively high level of payment in lieu to 'test' the reaction of the market. Six of the twenty-nine viable schemes could yield a payment in lieu at these levels;
- The level of payment in lieu should be kept under review and adjusted if the response is inadequate or results in too much demand, to the detriment of on-site affordable housing delivery;
- The results of BNP appraisals indicate that there is no correlation between size of scheme and the level of payment in lieu that can be secured.
- Consequently, the Council could set any size threshold that it deems appropriate.
- The Council will need to decide how to balance revenue maximisation by either securing a higher rate of payment per unit from a smaller number of schemes; or securing a lower rate per unit from a larger number of schemes. The latter approach would result in the provision of less on-site affordable housing units.

[1] Source BNP Paribas

- Careful consideration will need to be given to the timing of payments in lieu, as this will have an impact on cash-flow and viability.

- Finally, BNP views a mixed approach, whereby developers can 'split' their affordable housing obligations between on-site provision and payment in lieu, as an optimum route to achieving a balance between revenue maximisation and delivery of new affordable housing units."

As part of developing its plans for the financing of 10,000 additional homes, this evaluation would need to be updated in the light of 2013 sales values and projections on a site specific basis. A process would also need to be established to regularly update and review the evaluation over the life of the programme.

The investment plan and sensitivities shown above provide an initial indication of the funding requirement to deliver new homes and the range of routes available to meet this requirement. In exploring the range of potential delivery mechanisms available Savills has therefore considered the extent to which each mechanism can offer the greatest ability to use available subsidy to maximum impact, thereby minimising the Council's exposure to additional financing requirement.

4. Potential delivery mechanisms

4.1. Analysing local opportunities through existing assets and land capacity

As well as considering the funding requirement for the additional 10,000 new social rented homes, Savills has also considered the available land supply. Savills has reviewed work carried out to date to assess development potential across the borough including the 2009 Strategic Housing Land Availability Assessment (SHLAA) and 2010 Development Capacity Assessment (DCA).

The Core Strategy sets a housing target of 24,450 net new homes in Southwark between 2011 and 2026, which equates to 1,630 homes per year. The London Plan 2011 introduces a higher target of 20,050 net new homes between 2011 and 2021, which equates to 2,005 homes per year. The Mayor’s draft housing strategy Homes for London, published November 2013 highlights increasing concern over how to house London’s growing population which has led to a top down review of the current housing targets and implementation strategy. The ongoing housing shortage is invariably pushing up house prices and rents and as a result a challenging quota of 42,000 homes per annum has been suggested over the next ten years across London as a whole. Southwark's planning policies are supportive of growth and highlight the need for new homes, particularly affordable homes all across the borough. Southwark regularly reviews housing capacity and monitors housing completions in order to inform these targets as there is some debate about whether the higher figure is achievable. Therefore the addition of the Direct Delivery programme and the commitment to building 11,000 homes over a 30 year period will help the Council to meet its targets. In this context Savills believes there is sufficient land capacity available to deliver an additional 10,000 homes over 30 years. It does not require a change in the Council’s planning policies to accommodate this level of growth, although the Council may want to reflect the programme in its emerging New Southwark Plan.

These documents are relatively recent and show a clear and transparent projection of capacity and that the Council has been targeting housing growth in the borough in a way that means although its plans are ambitious, they are realistic. These documents have been used to inform Savills’ assessments of land supply required to deliver the Council’s ambitions using a range of different potential delivery mechanisms set out in section 4.2.

The report sets out below an extract from the introduction to the DCA in Southwark. While it reflects a standard methodology is does give some view of the land which is available, should market conditions prevail to deliver these sites.

“The Development Capacity Assessment (DCA) is a tool used to estimate potential future housing capacity that may come forward across a number of sites in the Borough. It was developed following on from the Strategic Housing Land Availability Assessment 2009 (SHLAA) produced by the Greater London Authority (GLA). The DCA looks in more detail at the potential housing sites over 0.25 Hectares identified through Southwark's input into the SHLAA alongside smaller sites. The SHLAA helped the GLA in developing a 10 year housing target for each Borough which was set out in the London Plan 2011.

The DCA considers the sites proposed as potential development sites in the 2009 SHLAA and determined whether they are all suitable as potential housing sites in the future and the timescale in which they realistically may come forward. It has assessed sites already proposed as allocated sites in the Southwark Plan UDP 2007, as well as sites that currently have valid planning permission, those that are on land owned by the council, those that are proposed through the Council's Area Action Plans and other sites above and below 0.25 Hectares that have the potential to accommodate housing in the future.

These assessments are not based on discussions with owners, rather, they are an assessment of potential sites that may help the Council to deliver on its housing targets over the time period of the Core Strategy. As such, it is important to stress that the Development Capacity Assessment is a forward capacity estimate only which assists Southwark Council in developing its housing trajectory. It is not to be used as a definitive list of sites that will come forward in the future, or with the number and breakdown of housing units that are outlined within it."[2]

While this shows that there is no absolute physical constraint on land supply to deliver the Council's objectives, not all of this land is in Council ownership. A key factor will be the actions required by the Council to access each of the opportunities identified. The Council will need to employ a range of proactive actions to take advantages of opportunities available to it as major landowner, and ensure it makes best use of its powers as local housing and planning authority to prepare a new housing strategy and Local Plan. Given the clear and comprehensive evidence of land supply, Savills considers the Council's ability to access these opportunities to be the critical factor in land availability to deliver the Council's ambitions. This might include, for example, taking action at an early stage to acquire non Council owned land where advantageous to do so. In order to ensure the Council can take maximum advantage of the range of potential delivery mechanisms set out below, it will need to set proactive plans to access these opportunities and drive value. The report sets out examples of these requirements below.

4.2. Potential delivery mechanisms

In order to deliver a programme of the size required to fit with the Council's ambitions, all available potential delivery mechanisms will need to be considered.

Potential delivery mechanisms identified include

- Extending the 1,000 new homes programme across existing Council housing estate
- Working in partnership with RPs to deliver new Council housing
- Council retention of S106 affordable housing
- Joint ventures
- Reconsideration of land use and intensification

There are also smaller scale opportunities available through buy backs of existing leasehold homes and bringing empty homes back into use which this report assumes continue to be progressed in line with current Council actions. Buy back activity could include buybacks to increase the long term rented stock holding, or in order to facilitate estate regeneration. The

[2] Development Capacity Assessment august 2010

strategy proposed in the report assumes that these opportunities are progressed in line with current Council actions.

The various potential delivery mechanisms available need to be considered in combination rather than as a menu of options. Different mechanisms will suit different opportunities. In order to consider the merits of each of the potential delivery mechanisms that would provide access to a larger supply the report sets out an initial view of the following aspects, exploring the extent to which each potential mechanism meets key criteria of maximising supply and value:

- Indicative dwelling output
- Skills and systems required by the Council in order to take maximum advantage of the supply available
- Management of construction costs
- Exposure to sales risk
- Product control
- Financial impact on the Council
- Opportunities
- Limitations
- Further action required to progress the opportunity

4.2.1. Extending 1,000 Homes Programme.

Indicative Dwelling Output

The existing 1,000 new homes programme has drawn on opportunities for development of new homes through the identification of Council owned land. This has been identified by a variety of means; via local knowledge of the stock and redundant sites (e.g. garages). In addition there is potential to expand the Hidden Homes Programme potentially through adding floors onto suitable existing blocks in council ownership.

Supply through this route could be expanded via identification through stock condition survey work used to identify high capital investment estates and a framework for active management of HRA assets.

The current programme anticipates 1,000 new Council rent and shared ownership homes (plus 200 market sale) over a period to 2020. The current programme is limited by funding which is via cash in lieu payments and RTB receipts, and potentially funding from the GLA. There is sufficient land available, as illustrated by the 2009 SHLAA and 2010 DCA, to show there is potentially scope both to increase this programme and to extend it beyond 2020. Savills estimate that there is potential to increase supply through this route by up to another 1,000 dwellings. Supply is constrained through this route and any proposals would need to be taken forward in consultation with residents.

Skills and Systems

The Council has had to skill up to embark on the 1,000 homes programme and has had to adopt systems for procuring professional teams and construction partners. The programme is in its relatively early stages and there is an opportunity to review systems and practices to identify whether value and costs can be driven to provide greater efficiency.

Construction Costs

The council has sought advice from Davis Langdon on construction cost. In Savills' view the cost assumptions are at the upper end of what Savills would expect for valuation purposes. Construction is intended to be delivered via OJEU compliant procurement using existing frameworks, although other options are available including direct LBS procurement. There is the opportunity to review construction costs and tendering practices. Particularly key is the importance of supervision of design teams to ensure that design is focussed on delivering appropriate quality and that design drives value in open market sale products.

Exposure to Sales Risk

Savills understand that whilst 200 units will be provided for sale under the existing programme, there has been little appetite for the Council to take developers risk [or returns] at scale. The Council will need to evaluate its preferred approach which will depend on circumstances. One option is to seek to work with developers to deliver open market sale through joint ventures. Whilst this presents the opportunity to share or transfer risk, there is also the lost opportunity to take developer's profit, which could in turn be used to provide additional cross subsidy to fund Council rent and shared ownership housing. There is the opportunity to introduce skills and expertise into the development process to enable the Council to benefit from greater returns, whilst maintaining an appropriate level of risk assurance.

Product Control

The Council retains maximum control for the product and provided appropriate levels of design supervision are introduced, value and costs can be driven effectively.

Financial Impact

Direct provision utilising capital resources is relatively capacity hungry method to develop. However via factoring in revenue streams and sales receipts, along with potential capital grants from the GLA, the cashflow is capable of being managed to reduce debt call.

Opportunities

Opportunities to improve delivery through this mechanism include

- Identification of further estates through a detailed review of HRA assets
- Procurement review
- Development management review
- Approach to sales risk

Limitations

The limitations of this approach include

- Ultimately constrained supply of land where residents support further development

Possible Further Action

Possible further action to maximise delivery through this mechanism would include

- Review procurement
- Review development management
- Review programme appraisal methodology
- Evaluate approach to sales risk

4.2.2. Work in partnership with RPs to deliver new Council Housing

Indicative Dwelling Output

Registered Providers (RPs) have a long track record of delivery of homes in the borough. The current RP development pipeline is 2,234 new homes over the next 3 years[3]. RPs are well placed to secure debt on their existing assets and can lever in significant levels of debt, which they continue to invest in the borough. This is valuable capacity and this activity forms a significant element of the local new homes provision market.

There is potentially a risk that these RPs see the Council's strategy as a threat to their existing investment plans in Southwark. However these RPs are current investment partners where generally there is a good understanding and relationship with the Council.

In Savills' view, there is merit in seeking to work closely with existing RP partners and potentially new RPs and property companies to establish collaborative relationships with the aim of developing models of new homes delivery which seek to maximise the number of new homes produced whilst continuing to lever their assets.

In recent years RPs have responded to the changed funding regime, where grant rates are reduced, by diversifying into development of homes for sale and, increasingly, market rent. This is in addition to their existing shared ownership product range. Therefore there is an opportunity to work with RPs where the Council works in partnership, securing new social rent as council housing with RPs securing other housing products to meet their own needs. Savills propose that early discussions are held with RPs to discuss ways of joint working. These discussions would need to be held at Executive Director/Chief Executive level in addition to any ongoing liaison through Southwark Housing Association Group (SouHAG).

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[3] Source: Cabinet report 16 July 2013 Independent Housing Commission

Savills believe there is an ability to access opportunities to deliver an additional 1,500 – 2,500 social rented Council homes in this way.

Skills and Systems

Whilst there is some variance, there is a significant range of best practice in development skills and process which afford the Council with the ability, through joint working, of shared approaches and benefit from existing expertise.

Construction Costs

RPs have established OJEU procurement frameworks in place which provide the opportunity for the Council to secure competitive rates based on existing levels of capacity and volume. In section six the report recommends a review of current procurement frameworks and the extent to which alternatives may present better value for money and a more effective route to expertise in the local market.

Exposure to Sales Risk

Again there is the opportunity to share learning and best practice with RPs and potentially dependant upon the nature of a partnership to either share or transfer market sale risk.

Product Control

RPs have established programmes and are conversant with existing design expectations. However, where the Council has different requirements (e.g. lifts in low rise blocks and higher specification of fire safety) these can be incorporated through early engagement with an RP and the design of products.

Financial Impact

As noted above there is the ability, depending upon appetite to either share or transfer risk. For example if the Council purchases the completed social rented housing it bears the financing risk but none of the development risks associated with the project.

Opportunities

Savills believes there is scope to deliver new opportunities, either arising from Council land holdings or where third party land is acquired – in conjunction with RPs whose stock is adjacent to Southwark's.

Limitations

Whilst many RPs do wish to diversify, this route will not suit all current partners. Early discussions with individual RPs will be key to establishing a good understanding of mutual objectives.

Possible Further Action

Possible further action to maximise delivery through this mechanism would include

- One to ones with senior representatives from Council and RPs to explore opportunities.

4.2.3. Council Retains S106 affordable housing

Indicative Dwelling Output

Via the planning system the market will generate a pipeline of affordable housing. The current system means that these affordable homes are purchased by RPs. The level of affordable housing is determined by a blend of policy compliance which is subject to a toolkit viability assessment. Whilst the level of affordable housing which can be “afforded” by a particular project is subject to market conditions, it is anticipated that there would be a supply between 500 to 1,000 homes, which without Council intervention may have been sold to RPs to deliver as affordable rather than social rents.

Skills and Systems

The key issue is pricing of the social rented housing. Developers would normally seek prices through competitive tendering; therefore the “value” of the social rent in the viability is subject to market forces. However, the value could be established by formula and negotiation in conjunction with the Council as the Local Planning Authority (LPA). Savills have experience of this model operating in practice. The Council has considerable skills and expertise in this area which is deployed in its existing approach to negotiating section 106’s.

Construction Costs and Exposure to Sales Risk

This route relates entirely to the Council's use of planning powers and as such does not expose the Council to construction or sales risk.

Product Control

Potentially there is less control over product as the delivery of the Council rent and shared ownership will be ancillary to the developers’ objective to deliver at a low cost and to maximise value of the market product. Early involvement, which is possible through negotiations at the planning stage, can mitigate this risk.

Financial Impact

This will be subject to viability and management performance. It will need to be tested on site by site basis.

Opportunities and Limitations

Volume is largely determined by the market and the Council’s need to take “in lieu” payments to fund the 1,000 homes programme. Cost value can only be assessed on an individual scheme by scheme basis to evaluate where it is beneficial to take dwellings on site or via funding to the new homes programme.

Possible Further Action

Possible further action to maximise delivery through this mechanism would include

- Discussion with developers / house builders
- Utilise new Southwark Plan to create supportive environment

4.2.4. Joint Ventures

Indicative Dwelling Output

There is sufficient land available, as illustrated by the 2009 SHLAA and 2010 DCA to potentially provide 2,000 to 3,000 dwellings over a thirty year period on large scale sites that would be suitable to a joint venture approach. However to unlock this potential will require significant gearing up and capacity building within the Council. This will mean taking a different approach to the risk and reward balance. Before embarking upon JV activity the Council will need to carefully consider its objectives for doing so. Potentially JVs offer the opportunity for the partners to pool strengths to mutual benefit. Here a key driver for the Council will be access to lower construction costs, development, construction and market sale expertise. Drivers for developers are access to opportunity and collaboration with the Council and access to its statutory powers.

Skills and Systems

It is proposed that consideration is given to establishing joint ventures as delivery vehicles to deliver either large standalone land opportunities, or as an extension of this to deliver clusters of development opportunities in a particular location. Southwark has one of the strongest track records of delivering housing regeneration through JV arrangements including at Peckham, Canada Water, Elephant and Castle, One Tower Bridge and Aylesbury. The issue for the Council in gearing up its skills and systems to expand this for the delivery of 10,000 new homes will be one of resources.

The premise of the proposed JV would be to bring together complementary skills and resources to create additional value and to create vehicles to deliver complex and challenging opportunities. In essence this means that the Council brings land, investment and statutory powers, i.e. planning and Compulsory Purchase. Developers / house builders bring effective supply chains, construction, sales and marketing expertise. Blending these complementary skills can, if effectively structured, drive costs down and values up.

Construction Costs

Developers and house builders have very effective supply chains based on volume procurement, standardisation and group procurement arrangements with suppliers. A developer's business model is to seek to maximise the efficiency of build and to maximise value created, through understanding the market and product. The Council entering into a JV with a developer allows these benefits to be acquired.

Exposure to Sales Risk

JV structures vary widely, however the principle is one of risk sharing not risk transfer. In order to maximise the returns to either party, both parties will share common objectives. In this case it would be structured so that the Council acquired social housing from the JV. There are examples of this working successfully elsewhere in the market. Savills is advising Oxford City Council (OCC) and Grosvenor in their Joint Venture to develop land at Barton, Oxfordshire to deliver 800 homes. Savills is advising the joint venture on affordable housing and land disposal to developers. Outputs are profits from the regeneration, OCC are re-investing these profits into creation of Council housing at affordable rents.

Product Control

By joining with a third party developer in a JV, absolute control of the product can be secured by establishing Council requirements at the establishment of the joint venture.

Financial Impact

The financial impact on the Council will depend on the structure of the JV. One example is for the Council to contribute land and to receive completed housing units in return. An additional route could be through the Council providing loan finance to the JV secured at low rates via the PWLB but on lent to the JV with a margin, providing a revenue return back to the Council. Alternatively a developer may be able to put its own investment either from a third party (unsecured cash) or (typically) – working capital. This would reduce the loan requirement at the Council, but also reduce the return the Council might achieve on the financing arrangement, as the developer's cost of funding is likely to be higher than the Council.

Opportunities

In general, the prior creation of a separate vehicle and/or legal structure could have some benefits when a public sector body has a significant pipeline of similar development projects, and a desire to contract with a single private sector partner to bring these forward. However, there can be significant time and complexity in the procurement and establishment of such a vehicle. Consequently Savills would suggest that this delivery mechanism is suited to larger estates and unlocking non residential sites.

Limitations

This mechanism provides for the future flexibility to bring in third party development expertise where this is seen as beneficial to the expansion of activity and increased requirement for funding. The Council would need to consider its appetite to share risk and reward, as well its ability to manage the relationship over time, ensuring value to the Council as originally envisaged.

Possible Further Action

Possible further action to maximise delivery through this mechanism would include

- Work to establish Council's preferred approach
- Soft market testing with developers

4.2.5. Reconsideration of land use and intensification

Indicative Dwelling Output

In order to unlock land to meet housing and employment needs better, a collaborative approach to master planning and regeneration is required using the levers available to the Council as landowner and planning authority to determine, influence and deliver (in partnership) change in localities. This would involve consideration of complex issues around different employment uses that are more modern and compatible with residential neighbours which could be considered as part of the development of the new Housing Strategy and Local Plan.

Potentially by deploying a joint venture model or series of JVs combining complementary skills and resources it is possible to negotiate transactions with existing land owners. This approach may lend itself to unlocking opportunities. These are more likely to be larger, longer term proposals which Savills believes could deliver in the region of 2,000 – 3,000 dwellings, in the later part of the 30 year period.

Skills and Systems

The skill requirements at the Council will be similar to the JV section above. In addition the Council will need to gear up internal resource to work on negotiation with land owners and developers and to co-ordinate with stakeholders and develop masterplans and business models.

This is a complex area and the Council will have a good knowledge of the opportunities which exist. In order to unlock these opportunities and for the Council to secure social rented housing it will be necessary for the Council to take an active role and to seek to work with developer partners over a long period of time. JVs offer the opportunity for the Council to share in the long term value of these opportunities and secure the social housing.

Construction Costs, Exposure to Sales Risk, Product Control, Financial Impact, Opportunities

These will all be as set out in the section above on Joint Ventures. In terms of financial impact it will be important for the Council to take proactive action as both a planning and housing authority to ensure value is captured by the Council from any redesignation and intensification of third party sites. Opportunities to acquire non council owned land at an early stage could be explored where advantageous to do so. The Council has an opportunity to bring the full weight of its powers as Local Planning Authority, CPO and enforcement to bear with early engagement of the market to drive value for the Council, providing it takes proactive action early.

The Government's Autumn Statement 2013 has announced an increase in funding in the form of loans or equity stakes for infrastructure to support and unlock large regeneration sites (defined as 1,500+ homes). There is likely to be an annual bidding round, with the HCA administering the scheme. The Government is keen to get Local Enterprise Partnerships (LEPs) involved, so £50m in 2015/16 is earmarked for LEP-supported schemes. There are nine schemes currently in the pipeline but longer term this fund may provide opportunities for Southwark bringing forward complex large sites. The development of strong links between the LEP growth strategy and the Council's plans for new homes would facilitate access to funds where available and required.

Limitations

The Council will need to consider the extent to which any redesignation may conflict with employment generation policies. It will also need to consider how any value uplift will increase its costs, for example where land needs to be acquired from third parties.

Possible Further Action

Savills understands that Grant Thornton has already advised the Council on the opportunities available through this route and this provides a useful starting point to set plans for proactive action. Savills would recommend that more work is done to assess how the Council can access the land capacity and opportunities that might be released through this route.

5. Alternative structures to facilitate funding of new Council housing

In the past, a number of financial, legal and regulatory issues have resulted in Registered Providers ("RPs") taking the lead in delivering new social housing, even on council owned land. On estate regeneration projects an RP would typically acquire the new social housing, and councils would often sell off or hand over land for an RP to build new social housing. The GLA's December 2013 Investment Prospectus prescribes conditions on rents which can be charged and furthermore nominations protocols, which may not provide the best fit with Southwark's ambitions. At this stage the financial model does not rely on receipt of grant but does require subsidy in some form (for example from the affordable housing fund and cross subsidy from market sales).

The main reason for this approach was that through the HRA subsidy system, councils were not able to retain the net rental income from council housing. So they could not afford to borrow to build or buy any new council housing. On the other hand RPs were able to borrow to fund the acquisition of new housing, because they retained the net rental income from new housing as well as their existing asset base. In addition, RPs had access to HCA grant and had built up development skills.

Today, the position has changed. Due to a combination of changes in the Localism Act, HRA reform, HCA grant reduction, and interest from institutional investors, councils are in a similar (or arguably stronger) position than RPs in the ability to deliver new social housing. In particular:

- Following the HRA self-financing reforms, councils now have control of a substantial asset base, with debt levels that are typically lower than an RP's. They can now retain net rent on existing and new housing, so have the financial ability to fund the build or acquisition of new housing.

- Councils have easy access to funding for capital investment from the Public Works Loan Board (PWLB) or from external funders, and they can typically secure funding at a better rate than most RPs[4].

- HCA grant levels are much lower and councils also have access.

As a result, many local authorities are looking at taking a direct involvement in the delivery of new social housing, and in owning the new housing themselves.

Ownership of the new housing within the HRA is often the preferred option for a council, but this may not be possible because Government has imposed a cap on the total level of debt that can

[4] To support capital investment, local authorities have access to funding from the Public Works Loan Board (PWLB). Variable rate loans are available for up to 10 years and fixed rate loans for up to 50 years. Fixed interest rates are determined by the UK Debt Management Office (DMO), by reference to gilt yields and published twice a day. The cost of borrowing for a local authority is some 0.8% above gilts (the cost of borrowing for Government), so is very competitive when compared to most private sector organisations. Today, the fixed rate for a 30 year loan is some 4.4%, and the short term variable rate 1.27%. Whilst RP funding costs are typically 0.5% to 1% higher than local authorities, some of the very largest are able to borrow at rates close to local authorities.

be held in the HRA. Whilst the rationale for the cap was largely to restrict borrowing against existing council housing, it applies to all debt in the HRA even for new housing. The government announced in the Autumn Statement 2013 the potential for councils to bid competitively for a small relaxation in the HRA debt cap, to enable new build, linked to council contributions of free land, and receipts from asset sales, and delivered in partnership with RPs. While this is welcomed, the amount of money is small when considered on a national basis and only available over a two year basis.   As a result, many councils are looking to own new housing outside the HRA where there is no restriction on borrowing, beyond normal prudential borrowing principles.

Whilst ownership of new housing in the general fund may be possible, there are legal risks with this approach and no clear precedents for councils looking to deliver and hold new housing in the general fund. For these reasons many councils are using the option of establishing a council owned vehicle as a simple step to support the delivery of new council housing.

5.1. New build through Council Vehicle

Under this option the Council establishes a separate wholly owned vehicle, using its General Powers of Competence, which becomes the owner of the new rented housing. The separation of ownership into a new vehicle provides transparency and accountability, and the flexibility to deliver new council housing through different routes.

The new tenancies let by the Council Vehicle would not be secure tenancies with the Right to Buy, but assured tenancies, similar to those that would be offered by an RP. However, the Council could impose full control over the terms of these tenancies, and choose to require the Council Vehicle to offer tenants a range of contractual rights, similar to those that they would have held by statute under a secure tenancy (e.g. Right to Buy).

The Council Vehicle could be funded through PWLB loans in the same way as the HRA, but the borrowing would not count towards the HRA debt cap. The only restriction on borrowing would be the normal prudential borrowing principles. Resources from the Affordable Housing Fund, or potentially other capital reserves, could also be made available to the Council Vehicle. However, there may be some limitations on the use of retained right to buy receipts through a Council Vehicle.

There are a range of issues relating to consents associated with both land transfer and financial support which are detailed below.

When appropriating land between the HRA and general fund there are no tax issues to be considered, but when transferring land to a separate legal entity the implications of stamp duty land tax (SDLT) need to be considered. The operation of the Council Vehicle could also open up VAT and corporation tax issues. There are options for managing and mitigating these liabilities through the legal structure of the Council Vehicle and the use of the Council's ability to recover VAT. Again, these will require more detailed advice.

The option of holding the housing in a Council Vehicle provides advantages to the Council in terms of flexibility of funding (in that the Council itself would not necessarily need to borrow) and in terms of flexibility of tenancy type and the ability to engage in a wide range of commercial activity. This route is a relatively tried and tested approach which has been adopted by an increasing number of Councils (estimated 40 councils) including, for example, at Woking, Ashford, Newcastle, Gateshead, Hounslow, Brent, Ealing and Greenwich. Examples of models in use at other authorities are included at Appendix B.

5.2. Governance and operation of the Council Vehicle

There is a range of options for the operational organisation of a vehicle to deliver a council's objectives, ranging from:

1. The establishment of a vehicle (effectively part of the Council) that is there purely as the legal owner and funder of the housing.
2. The development of a Council Vehicle into a separate organisation that undertakes a wide range of activities to deliver new housing.

The exact operational structure of a vehicle will vary from council to council depending on the requirements and preferences of each organisation. In order to progress with delivering housing outputs in a timely manner, the Council Vehcile can initially be set up as set out in 1, moving towards 2 if required.

As the Council Vehicle would be a wholly owned subsidiary, the Council would be able to exercise full control over its activities, in appointment and removal of directors, and if necessary winding up the vehicle.

5.3. Legal and financial implications

5.3.1. Council Vehicle formation

Formation of a new vehicle is a straightforward process. In terms of legal form, the new Council Vehicle could be a Company Limited by Guarantee (CLG) or a Company Limited by Shares (CLS). The preferred route due to flexibility for future changes and tax reasons is a CLS.

Transfer of property between different entities can give rise to a liability to pay Stamp Duty Land Tax (SDLT). However, there is relief from this liability where the two entities are part of the same group of companies. Formation of a CLS under the Council's ownership should allow the Council to take advantage of this relief.

5.3.2. Transfer of land or property from the Council to the Council Vehicle – possible need for consent

The Council Vehicle option can be used in any of the potential delivery mechanisms set out in section **4**. Completed housing could be acquired by the Council Vehicle from a developer, or alternatively the Council Vehicle could develop housing itself on Council land, or enter into partnership with third parties.

In the case of development by the Council Vehicle on Council land, consideration would need to be given to the timing of transfer of property by the Council, and any payment by the vehicle. There may be a need to seek consent from Government for the disposal of land, and possibly for the provision of financial assistance to the Council Vehicle (for example if the land were transferred below market value). State aid issues may also need to be addressed in respect of any market housing that the Council Vehicle develops but would not apply to social housing developed.

There are a number of general consents in place that deal with these circumstances – if these do not apply, the Council would need to apply for special consent. Consents would be needed to address both the disposal of land and any potential financial assistance, to use the same example as above, if land were transferred below market value. Whilst recent changes to the general consents on HRA land give councils flexibility to dispose of vacant HRA land at any value, the issue of financial assistance still needs to be considered. Different consents apply depending on whether the land is being transferred from the HRA or general fund.

In summary, whether or not there is a need to apply for special consent will depend on a number of issues, including:

- Is the land vacant or does it contain existing housing?
- Is the land being transferred from the HRA or General Fund?
- Is it being transferred at market value or an under-value?
- Is it being transferred for affordable housing?

In general, the transfer of vacant land at market value from the Council to the Council Vehicle is likely to be covered by general consents. Legal advice would be needed to consider the precise circumstances of any proposed transfer, and whether or not specific consent would be required.

5.3.3. Payment for transfer of land or property

At its inception, the Council Vehicle will have no financial resources, and would be financially reliant on the Council. As a result, payment by the Council Vehicle to the Council for the transfer of land would be either through the Council accepting deferred payment, or a loan from the Council to the Council Vehicle at a level equal to or above the transfer value.

In either case, the Council Vehicle would have a financial liability to the Council, and would need to be satisfied that it was capable of meeting this liability when it fell due. Similarly, the Council would need to be satisfied that its loan to the Council Vehicle complied with its internal risk and treasury policies.

As well as needing to satisfy the Council's internal risk and treasury policies, the Council may also need to be mindful of state aid issues in setting the terms of any lending to the Council Vehicle. Whilst there are some exemptions for affordable housing, it may be that lending would need to be at a market rate where state aid issues might arise in respect of funding for market housing options. This could be addressed by a rate that was linked to prevailing PWLB rates with an additional margin.

5.3.4. Financing of the Council Vehicle

As a part of the initial set up of the Council Vehicle, a comprehensive business plan would need to be developed that demonstrated its financial viability. This would need to cover the sourcing and terms of financing of the Council Vehicle and demonstrate that it had the ability to meet its financial liabilities.

In addition to the initial land transfer, the Council Vehicle would need to be satisfied that it would be able to secure sufficient financial resources to support subsequent activities, including development of housing on the land, and any other operating activities.

The simplest source of finance would be from the Council, through loans from existing financial resources or additional borrowing. In the case of new PWLB funding, as the Council would not be borrowing for capital expenditure on HRA assets, then any additional borrowing would have no impact on the HRA Capital Financing Requirement, which is restricted by the borrowing cap.

In developing its financing strategy, both the Council Vehicle and the Council may wish to explore alternatives to loan financing from the Council to the Council Vehicle, to ensure that there were no other options that were more appropriate or offered better value for money. For example, there is a precedent in Barking & Dagenham where their council owned housing entity secured external funding instead of using loans from the Council. Whilst there are a number of arguments for and against alternative financing options, there is now very strong interest by institutional investors in financing new Council housing investment.

5.4. Management models for new housing

Management models for new housing, whether funding is structured in a Council vehicle or directly in the HRA, can be developed in line with Council proposals to develop management models for its existing stock and actions to promote increased tenant management.

This could follow the local management model explored at options appraisal stage including

- The establishment of an overarching framework of governance to ensure the development of local decisions while managing the impact on the overall HRA of local management decisions.
- A policy framework for decisions on how a local management area is defined. These areas must make sense to residents on the ground, and must be of a scale and with a balance of properties which enable viable proposals to develop. Area based asset analysis work may be one way of ensuring that viable property portfolios are established, alongside appropriate levels of debt and funding to sustain long term improvement. This needs to sit alongside resident engagement to ensure these areas reflect existing communities and will enable the establishment of a clear local focus which balances the views of tenants and leaseholders.
- Resident engagement which allows each area to explore options for the management model that suit their appetite for involvement and partnership, drawing up local service standards to inform any contractual arrangements required.
- A programme of soft market testing, visits to other providers, and in the case of external partners, procurement with resident involvement.
- The establishment of a service structure, with local delivery alongside shared support services, enabling the financial strength of the HRA to be maintained, while devolving delivery to a local level.

There is clearly a significant role for the existing Council service in the ongoing management of any new social housing held by a Council owned vehicle. Legal advice would be required on whether this could be dealt with through a management agreement or require broader procurement processes as this will depend very much on decisions about how the vehicle is structured should a decision be established to proceed down this route.

6. Building development capacity

The report highlights the sorts of actions required by the Council in order access the development opportunities in the borough to enable a significant increase in delivery capacity from 1,000 to 11,000 new homes. In reality delivery capacity is likely to need to be even larger, in order to ensure mixed communities, and to provide a level of cross subsidy from market sales.

Systems will need to be in place to ensure a step change in delivery capacity (separate from land supply) which may mean more than building up existing structures and operations, given the level of increased capacity required.

This section sets out the headings and achievable workstreams for the next few months to provide a foundation for delivery.

6.1. Governance

The governance framework for the programme would benefit from a single co-ordinating role responsible for budget ownership, management and control mechanisms including:

- Investment decisions, which need to be timely to move in a dynamic market
- Spending
- Purchases
- Statutory Powers e.g. CPO
- Delegated authority
- Standing Orders and the need for any revision to deal with increased programme size

Workstream 1: Review existing governance systems.

6.2. Risk Mapping

Comprehensive risk maps with sensitivity analysis will also need to be developed to include key development risks:

- Planning
- Land assembly / leasehold interests
- Resident consultation
- House price variations
- Impact of rent policy
- Construction costs

Workstream 2: Review existing risk identification approach and propose a new approach for an expanded programme.

6.3. Operational Skills and Systems

The operational framework would need to include actions required to ensure systems are in place for delivery including a skills audit / gap analysis/ staff resource requirements and a review of project management systems, procedures and practices.

The skills available to the development function would need to include;

- Ability to appraise opportunities to identify the most suitable form of development
- Awareness of value creation and place making to maximise the development opportunity
- Strong planning skills to be able to present rationale for developing outside of existing plans
- Ability to persuade / influence local residents / members / officers on the opportunity being created and benefits to the local community
- Flexible approach to working within other teams within the Council to create new opportunities
- Strong financial ability to understand how the required level of return will be achieved from proposed development
- Project management skills to ensure programmes are delivered to time, cost and quality as this will create confidence both by Council and residents and enable future support
- Good market knowledge across all sectors

Workstream 3: Carry out skills audit and organisational restructure.

6.3.1. Housing for Sale and Non Residential

The types of skills needed would encompass all tenure types including housing for sale and potentially non residential uses. This is so that each opportunity is analysed in how it creates the most value, short, medium and long term. Product design and finish must respond to the specific market and specialist input into design is required to maximise value.

Workstream 4: Carry out review of design process and approach to housing for sale.

6.3.2. Programme Management

Managing the cashflows of the development process and clear consistent reporting is also a significant key task. This will assist in driving the performance of the programme. Acquiring or holding land costs money or has opportunity costs and the way in which these costs are supported, through investment income or other sources until such time the scheme is developed and generates receipts / revenues has to be critical to the overall success of the programme.

The Council may wish to consider establishing a single coordinating role, initially in order to provide the proactive momentum and co-ordination needed to establish the development function. Ideally this role would have both private and public sector development experience and be able to put together a team with the required skill mix and capacity, to include existing skilled individuals within the Council.

Workstream 5: Review project appraisal, cashflow and management systems and recommend potential systems suitable for an extended programme.

6.3.3. Procurement strategy

The programme will require a range of procured services including

- Construction
- Development partners
- Professional advisors
    - Legal
    - Design
    - Cost consultancy
    - Value added / agency consultancy
    - Land use/planning consultancy
    - Project management
    - Programme management
    - Funding

Workstream 6: Review framework arrangements for constructors, development partners and advisors.

6.4. Potential delivery mechanisms

The following actions are recommended for each of the potential delivery mechanisms:

Extending 1,000 new homes programme

Action: Review procurement

Action: Review development management

Action: Review programme appraisal methodology

Action: Establish approach to sales risk

Action: Establish a framework for evaluating the performance of existing assets

Work in partnership with RPs

Action: One to ones with senior representatives from Council and RPs to explore opportunities

Council retains S106 opportunities

Action: One to one discussions with developers/house builders

Joint ventures

Action: Development of Council's approach/consideration of alternative models

Action: Soft market testing with developers

Land redesignation and intensification

Action: Further work on land capacity and opportunities

Action: Proactive approach to planning and regulatory powers within strategic masterplanning framework

Workstream 7: Evaluation and development of potential delivery mechanisms

6.4.1. Alternative structures to facilitate funding of new Council housing

- Appraisal of alternative options as set out in this paper and a recommendation to structure funding in a way that allows expansion of the programme without breaching HRA debt cap
- A decision on the legal form of any Council Vehicle established and whether the council should be the sole shareholder, directors, key business activities and the principles of its operational relationship with the council
- Development of management model for new housing
- Development of outline business case setting out high level funding requirements and deliverables. A detailed business plan would then need to be developed involving site specific proposals as these are identified and agreed.
- Appraisal of funding options

Workstream 8: Funding strategy for new Council housing

7. Conclusion

This report builds on the first phase report on Housing Stock Options appraisal to focus on Council plans to develop 11,000 new homes.

Savills has revisited the HRA business plan assumptions used in the first phase report in order to incorporate the impact of emerging risk factors, including government changes to rent policy, in order to confirm a realistic and prudent projection of financial capacity within the HRA.

This illustrates that while the HRA is forecast to have sufficient resources to meet the needs of the current stock over the next 30 years, it is prudent to maintain current headroom below the debt cap in order to deal with potential liabilities in the medium term. As such it would not be prudent to rely on additional resources from the HRA to provide funding for new build development.

In developing a high level investment plan for an additional 10,000 new homes Savills has first looked at the financial plans relating to the initial 1,000 new homes programme. This is largely funded by contributions from the Council's Affordable Housing Fund, generated through the receipt of in lieu payments for affordable housing as well as Right to Buy receipts.

An expanded programme would entail estimated build costs of £2.4bn (taking into account inflation over the 30 year investment plan period). Direct delivery would be very capital hungry and the Council would need to take into account

- Cross subsidy from an expanded programme that includes market sales and intermediate homes
- Access to finance funded from future rental income.

Both of these factors could significantly reduce the capital funding required from other sources such as the Affordable Housing Fund.

In considering the financing requirement to be met by the Council it is important to consider how financing can be accessed in a way that does not impact on HRA capital finance requirement and at a scale that can be contained within the Council's overall prudential limits.

In view of the overall scale of funding required, it is unlikely that the entire debt requirement could be met through Council borrowing. To reduce the funding requirement, additional subsidy or external funding would be required.

As well as considering the funding requirement, the report has also considered the available land supply. Recent capacity studies show a clear and transparent projection of land supply. However a key factor will be the actions required by the Council to access each of the opportunities identified. This will be the critical factor in land availability to deliver the Council's ambitions.

The report sets out a variety of potential delivery mechanisms which will need to be explored in order to access the scale of opportunities required to deliver a programme of this scale. In order to ensure the Council can take maximum advantage of the range of potential delivery mechanisms, it will need to set proactive plans to access these opportunities and drive value.

Active management of the Council's existing HRA assets will also be required to maximise opportunities across the existing HRA portfolio.

The funding of new Council housing directly in the HRA is significantly constrained by the HRA debt cap. However there are alternative structures that exist, and which many councils are now developing, in order to facilitate the funding of new council housing. This involves the establishment of a Council Vehicle to hold the long term interest in the housing. The establishment of a Council Vehicle for new housing also holds other advantages in terms of commercial accountability and flexibility suitable to the development process. There are various legal and financial implications associated with the establishment of a Council Vehicle for the development of new housing that would need to be considered as part of the development of an outline business case for the proposals if adopted.

Management models for new housing, whether funding is structured in a Council Vehicle or directly in the HRA, can be developed in line with Council proposals to develop management models for its existing stock and actions to promote increased tenant management.

The report highlights the sorts of actions that may be required by the Council in order access the development opportunities in the borough and enable a significant increase in delivery capacity from 1,000 to 11,000 new homes. In reality delivery capacity is likely to need to be even larger, in order to ensure mixed communities, and to provide a level of cross subsidy from market sales.

Systems will need to be in place to ensure a step change in delivery capacity which may mean more than building up existing structures and operations, given the level of increased capacity required.

A delivery framework is proposed that provides for a single point of co-ordination of multiple project streams. Suggested next steps are set out to enable the Council to move forward in building the development strategy over the next 6 – 12 months.

The Council will continue to evaluate new and emerging models of delivery which may assist in meeting its objectives for housing investment and new build provision.

8. Appendix A: Housing Market Report

9. Appendix B: Examples of Council vehicles established for the purpose of housing development

Ealing

In the light of the HRA self-financing reforms, the London Borough of Ealing has identified that there are a number of alternative delivery options that can be considered to support the council's housing development and regeneration objectives. Following an analysis of legal and financial issues, the principle of establishing a council owned company has now been approved and the detailed business case is being developed for cabinet consideration. The intention is that the council company would initially support the Copley Close estate regeneration project, by developing new rented properties outside the HRA debt cap, and that it would then be available to use for subsequent projects.

Ashford

Earlier this year, Ashford Council approved the creation of two wholly owned Local Authority Companies – a Property Company and also a Building Consultancy Company. The creation of the property company is intended to support the development of new housing in the borough, using a variety of tenures, ranging from social rents, intermediate rents and market rents through to outright sale, where it might best suit that community and sale values will assist in providing funding to enable more development. Approval took account of detailed consideration of legal, governance and funding issues.

Thurrock

Earlier this year, Thurrock Council approved in principle a proposal to establish a wholly owned housing company to assist in the delivery of the council's housing development and regeneration objectives. It is expected that the company will help deliver the council's target of 1,000 new affordable homes and support the broader housing regeneration activity. A key factor in the decision to establish a separate council company is that it would enable council control of development outside the restrictions of the HRA debt cap.

Woking

Woking Borough Council owns and funds a group of companies, which were formed to assist the council in delivery of a number of key objectives, including decent and affordable housing and economic development. Thameswey Housing Limited provides affordable housing within the borough and Thameswey Developments Limited is a property developer, developing both commercial and residential schemes to further the Council's ambitions. Whilst the original council company was set up in 1999 to address energy and environmental objectives, it was broadened out in 2010 to address housing objectives