

# Housing Finance and Customer Services Policy and Scrutiny Committee

<b>Date:</b>	14 <sup>th</sup> January 2019
<b>Classification:</b>	General Release
<b>Title:</b>	Update on Wholly Owned Housing Company
<b>Report of:</b>	Councillor Robert Rigby, Chair of Westminster Housing Investments Ltd
<b>Cabinet Member Portfolio:</b>	Cabinet Member for Finance, Property and Regeneration
<b>Wards Affected:</b>	All
<b>Policy Context</b>	City for All

## 1. Introduction

- 1.1 On 4<sup>th</sup> December 2017, Cabinet considered a report to establish a wholly owned housing company (WOC) to help deliver the Council's ambition to increase the supply of housing affordable to those living and/or working in Westminster and approved the formation of two companies to help ensure tax efficient operations. Following that approval, Westminster Housing Investments Limited (WHIL) was formed as a profit making company wholly owned by the Council, together with its subsidiary, Westminster Housing Developments Limited (WHDL). WHDL will undertake construction/development, and WHIL will hold intermediate and market homes for letting to achieve a rental return. In this report, except where otherwise stated, WHIL will be used to represent both companies.
- 1.2 This report updates Policy and Scrutiny Committee on progress.

## 2. Key Matters for the Committee's Consideration

- 2.1 The Committee is asked to:
- 1) Note progress so far in relation to the establishment of WHIL and WHDL as set out in this report,
  - 2) Consider any issues/topics for further review,
  - 3) Comment on the format and content of future Scrutiny reports.

### **3. Purpose and Aims of WHIL**

#### **Council Ambitions and Constraints**

- 3.1 The lack of sufficient housing across the City, that is affordable by Westminster residents, is one of the Council's principle concerns. The key mitigation is to increase housing delivery through Council-led projects and the Council has made a commitment to provide at least 1,850 affordable homes by 2023. In addition Westminster has set a target of 1,495 homes per year in its recently launched City Plan. The Council is clear that from the most vulnerable and low income households to those middle income households, all should have access to the type and quality of accommodation to meet their needs and remain living in the Borough.
- 3.2 Although the recent government announcement regarding lifting of the HRA borrowing cap will assist in extending HRA activity, the HRA is limited in the tenures and rent levels it can offer. Moreover, social housing requires significant subsidy and the Affordable Housing Fund is projected to be fully utilised by the existing pipeline of development schemes. The Council must look to other delivery vehicles which can access alternative funding sources and deliver more and varied new housing provision. The WOC has been set up to help deliver these Council ambitions.

#### **Aims and Objectives of WHIL**

- 3.3 The overall aim of WHIL is to extend the resources of the Council by working with the Council (where the Council's view is that other delivery partners are neither available nor appropriate) to deliver the regeneration, and new build or acquisition opportunities being identified by the Council. It will develop and/or acquire housing, and the assets, unlike with other housing partners, rental housing not retained by the HRA (that is Intermediate and market and sub market rental housing – see Appendix 1 for definitions) will be retained within the Company (and, as this is a subsidiary of the Council, in effect, within the Council). Should the Company be wound up the assets will revert to the Council. This would not be the case with other organisations including Westminster Community Homes.
- 3.4 Specific business objectives are:
- 1) to provide more affordable - Intermediate (see Appendix 1 for definition) and market housing in the city,
  - 2) to offer new tenures and, in particular, sub market tenures (see Appendix 1 for definitions) to extend the range of provision available for those living and working in Westminster,
  - 3) to increase housing delivery at a scale, pace and quality set by the Council and with control and ownership of the assets retained by the Council,
  - 4) to offer a flexible partner for the Council in delivering housing.
- 3.5 WHIL will not preclude the Council from working with other providers: it is there to step in when the market cannot deliver or where an options appraisal shows this to be best delivery route for a particular development opportunity.

This might be, for example, because a range of tenures and rents beyond those which the HRA can offer are required and these are not readily available or need to be pump primed in the market.

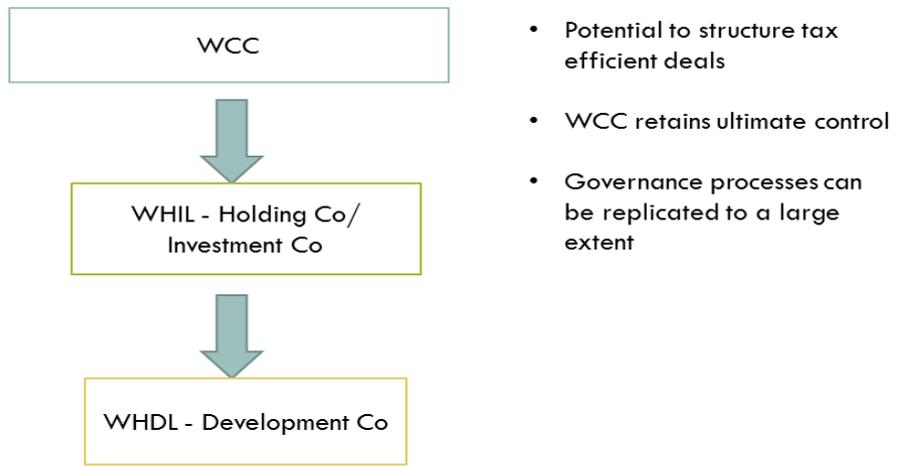
3.6 Equally, however, the scheme might simply be one which the Council would like to deliver itself. WHIL is not intended to duplicate the work of Westminster Community Homes (WCH), the Council's housing charity and Registered (housing) Provider (RP). WHIL will be a regeneration partner delivering a mix of tenures, as set out in Appendix 1, and although some lower cost Intermediate rental housing will be provided (which could be provided by WCH), this will be part of providing a mix of rental and sale housing at a range of price points within a ladder of housing provision determined by the Company (see Appendix 1) without the need to comply with either charity or RP regulations. In short, WHIL will offer a flexible yet commercially focused approach.

#### 4. Structure of the WOC, Governance and Operational Arrangements

4.1 WHIL and WHDL are companies limited by shares with the ability to deliver a profit and return back to the council. The Council holds 100% of the shares in WHIL and, in turn, WHIL owns 100% of WHDL. The intention behind the structure is that WHIL will hold properties as investments for Intermediate and market renting and WHDL will undertake construction/development. The Articles of Association are substantially the same for both companies.

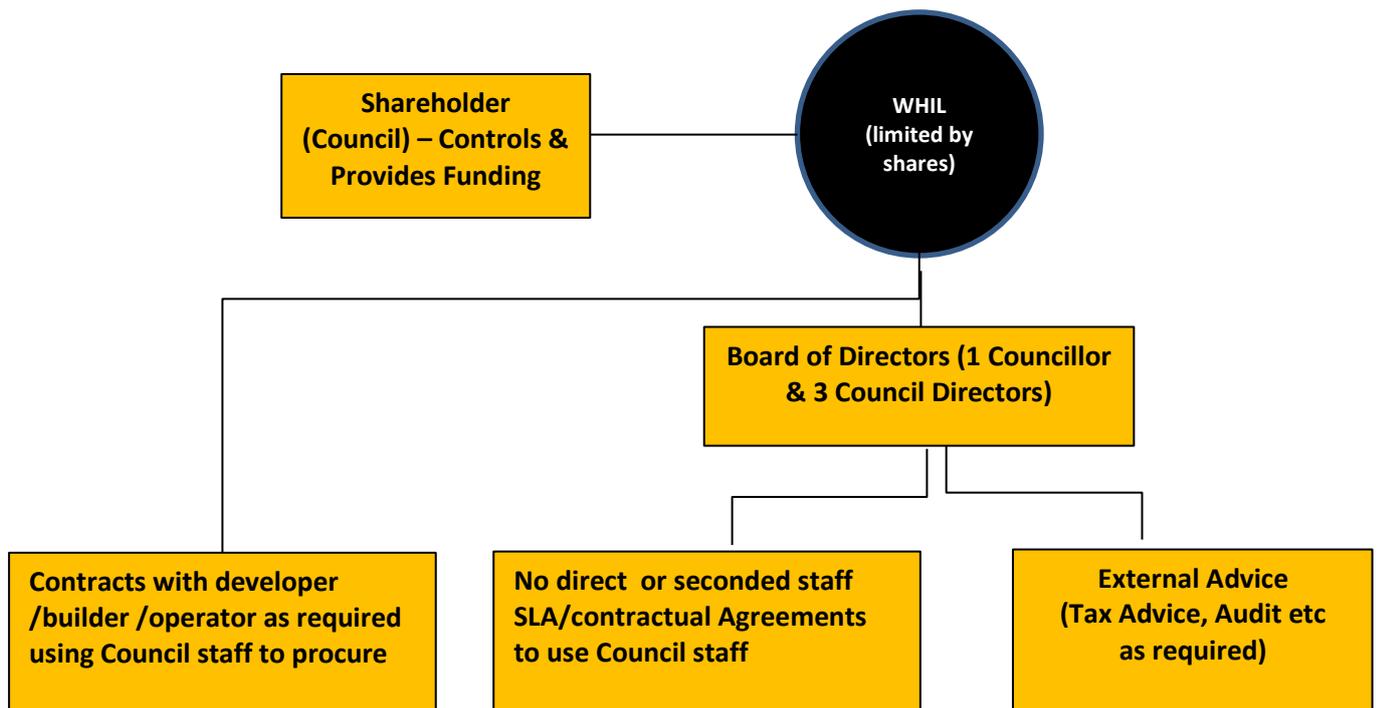
4.2 Structures/processes are in place to ensure the activities of the Company are adequately controlled. These have included approval of the Articles of Association by the Council as shareholder. The Council's nominated representative shareholder is currently the Cabinet Member for Finance, Property and Regeneration. In addition, as set out below, all funding will be provided through, and following approval by, the Council and individual schemes will also require Council approval.

#### WHIL and WHDL Consolidated Structure and Ownership





4.3 Within the above overall structure the operational structure is as follows.



4.4 As can be seen from the above, it is not proposed that WHIL will employ staff directly. The Board currently comprises:

- Cllr Robert Rigby – Council Member representation on the Board and Chair
- Tom McGregor – Director of Housing, WCC
- Steve Muldoon – Assistant City Treasurer, Commercial & Financial Management, WCC
- James Green – Development Director, WCC.

The Board currently meets on a monthly basis with the first Board meeting having taken place in June 2018.

4.5 Below Board level, the Company will operate using Council staff under Service Level Agreements (SLA)/contractual arrangements (to provide, inter alia, consistent quality standards) and, as required, external advisers and developers/builders.

4.6 WHDL has the same structure but its shareholder is WHIL.

## 5. Current Progress, Business Plan and Funding

### Types of Scheme

5.1 In order to meet the objectives set for the Company, work has been underway to translate the aims and objectives into specific proposals. At this stage, and in line with the December 2017 Cabinet report, work has focused on schemes within Westminster only and scheme types as follows have been the starting point.

<b>Scheme Type</b>
<b>Mixed Tenure schemes on HRA land</b> involving market, Intermediate and social housing which could be delivered by the Company or delivered in partnership between the Council and the Company. These may include some of the HRA's potential pipeline schemes.
<b>Schemes on the Council's General Fund (GF)</b> or other public sector land
<b>Acquisitions from Developers</b> of both S.106 housing and market housing within Westminster to provide Intermediate, sub-market and market rental housing.

### **Tenures to be offered**

- 5.2 WHIL will offer assured shorthold tenancies, as this is the general form of tenancy agreement in the private sector. Rents will be set to meet housing need and ensure viability of WHIL and where the housing is part of a scheme's S.106 planning obligations then rents must meet those obligations. For housing which is market rent/sale in planning terms WHIL will seek to provide on sub-market rental terms where viability permits. Work is also progressing on the development of a sub-market sale product which will enable tenants of WHIL to become home owners. Also, WHIL will be able to register under the government's Help to Buy scheme.
- 5.3 WHIL is not a Registered Provider and therefore will not be able to access government grants but could receive subsidy from the Affordable Housing Fund. As it is not a Registered Provider, the controls on Registered Providers with regard to the Right to Acquire and Local Authority influence would not apply.

### **Business Plan Proposals**

- 5.4 WHIL has prepared its Business Plan which has been approved by the Council as shareholder. This has been based on provision of a mix of housing in scheme types as set out above. Initial proposals include two mixed tenure schemes on HRA land and a partial redevelopment of an existing but under-used school site to provide much needed teacher accommodation as well as intermediate rental housing and market housing to subsidise the scheme. In addition the Plan allows for acquiring c 75 units from developers to be let at Intermediate rents.
- 5.5 The Council's development team is currently assessing feasibility of these schemes through the Council's normal CRG process. When a scheme reaches OBC stage a final decision is made regarding the delivery route, including whether it should be progressed as a WHIL/WHDL scheme. It is expected that all the proposals in the current WHIL Business Plan will come forward for approval as WHIL/WHDL schemes in FY 2019/20, providing homes as follows by FY 2023/24.

<b>Units</b>	<b>Tenure</b>
139	Market sale
134	Social rent (HRA)
35	Market rent
74	Sub-market rent / sale
82	Intermediate rent (S.106)
<b>464</b>	<b>Total</b>

5.6 Appendix 2 shows current progress for these schemes against the Council's CRG approval process and indicates the review stages by the WHIL Board.

### **Funding**

5.7 Funding for the above will be made available to WHIL by the Council in a mix of loan and equity investment. The loan will be at a commercial but competitive rate given the PWLB rates available the Council. WHDL will undertake construction/ development and dispose of newly developed housing either into the market or to the Council (for social rented housing held in the HRA) or to WHIL for market and Intermediate rental housing. The receipts generated will enable WHDL to return all funding to WHIL which in turn may repay the Council, subject to other pipeline schemes coming forward in need of investment. WHIL, the investment company, will retain the rental properties for letting and will use the net rental income after operational costs to service and repay the debt and make dividend payments.

5.8 Detailed estimates and modelling have been undertaken in relation to the above proposals. These show how payment of interest on, and repayment of, loan finance can be made from income earned from the Company's development and housing activities, either sales receipts or rental income. Dividends to the Council (on its equity investment) are then paid from profits earned after all other costs, including corporation tax, have been paid. Thus the Company can operate on a commercial basis like any private sector company and offer a return to the Council on its investment.

### **Approval of the Business Plan**

5.9 Following development and approval by the Board the Business Plan was presented to CRG in September 2018 and subsequently approved by the CM on behalf of the Council.

5.10 Funding will be allocated following the Council's normal budget setting approval process in February/March 2019. In addition, all schemes proposed will require specific approval at CRG and by the Cabinet Member for Finance, Property and Regeneration before any funding can be drawn down. Regular update reports to the Board will be provided on:

- scheme proposals and progress,
- performance against the overall Business Plan,

- forecast spending against budget.

These will follow the Council's normal reporting cycle and will enable overall monitoring of funding allocations to WHIL.

## 6. Risks and Success Factors

6.1 The key set up and organisational risks identified are set out in the table below together with the proposed mitigation for each and the residual risk rating assessment. Individual scheme related risks, for example, planning risks, site conditions and securing vacant possession, design and construction, utilities provision, will be addressed as part of the scheme governance process set by the Council.

### 6.2 Set Up & Organisational Risks

Risk	Mitigation	Risk rating
Political risk/Government intervention	It is important that the rationale for the Company is communicated continually and at every opportunity to ensure it is understood, not just currently, but in future. This will minimise the possibility and/or impact of any future political or government change at any level which could lead to a change in policy or intervention which could de-stabilise the proposals. Future government policies which might impact adversely on the Company will be kept under review and any change considered at that time.	High
Failure of the Company	A slim, low cost structure is proposed using Council expertise and skills. The Company could be wound up relatively easily if necessary.	High
Need to assure compliance with all legal and regulatory requirements, including state aid	Legal advice has been sought to ensure all requirements are met and was set out in detail in the Business Case approved by the Council's Cabinet in December 2017. The key issue mentioned is that all dealings between the Council and the Company are on a full commercial basis. This is to comply with state aid requirements. If subsidy is provided to meet Intermediate rent levels then there is a state aid exemption for affordable rental housing. Care will need to be taken to comply with the terms of this exemption – for example, ensuring no cross subsidy transfers to other parts of the business.	Medium
Suitable sites cannot be identified.	Three potential sites have been identified, together with developer acquisitions on two sites, and work is underway to identify more potential schemes	High

Risk	Mitigation	Risk rating
Business plan is not viable or scheme/ development risks are not well managed	This business plan is supported by detailed modelling and sensitivity analysis around key assumptions, which has been developed with external expertise and tested in-house. Scheme proposals within the business plan will be subject to further scrutiny through the Board as well as the Council's capital review and approval processes. Council staff and processes will be used to procure and manage external contractors.	
Homes prove difficult to rent or sell	Research is already underway within the Council to identify the demand for Intermediate rental housing and a robust marketing plan will be developed. Subject to S.106 requirements, tenure proposals will be kept under review.	
Minimising tax implications will not be possible	Expert advice will be procured to identify the potential leakage to tax and how best to minimise this risk.	
Setting up and running the Company will prove too costly to be met from estimated receipts and rental income.	Sensitivities around key assumptions have been undertaken and base assumptions are considered to be prudent (see below). These will be kept under regular review. A number of scheme development risks will be dealt with through the design and pre-contract process.	
Reputational risk – capacity and skills to engage in new activity,	The Company role as a developer of market and Intermediate housing will require consideration of an appropriate marketing strategy and branding and consideration of the skills required of its Directors to engage in commercial activities. Mitigation could involve recruitment of suitable advisers and service suppliers albeit at a cost.	

### Sensitivity Testing

6.3 In relation to the Business Plan, sensitivities have been undertaken to test the base case position. The critical factors impacting the success or otherwise of the base case financial plan are (in order of magnitude):

- development and acquisition cost increases,
- adverse outturn market sale values or demand, and
- long term rental income inflation falling below 3.00% per annum.

In summary, the sensitivity analysis shows that the base case business plan is relatively robust in relation to a single sensitivity downside movement for most of the variables tested.

6.4 Mitigation will include:

- extensive due diligence to firm up costs,
- appropriate contingencies,
- transfer of risk wherever possible to a development contractor,
- external advice, benchmarking and prudence in relation to sales income and focus on relatively short development timescales,
- reviewing rent levels frequently and following void periods,
- flexibility re retention of sale assets and re selling rental assets.

## **Exit Strategies**

- 6.5 Should it become necessary, the lean structure of the Company, the retention of the assets within the ambit of Council control and the ability, subject to S.106 requirements, to be flexible around tenure, means that homes can be sold at any time. This could be into the market, to housing associations, existing residents or, possibly, simply returned to the Council. In extreme circumstances this would permit a relatively fast winding-down of the Company and a clean exit strategy.
- 6.6 A second exit strategy which could be considered would be to sell the Company; the Council would simply transfer its shares and the new owner would take over the operation of the Company and its assets and outstanding debt.
- 6.7 Furthermore, the decision to not recruit permanent staff into either of the new entities and instead to draw upon support from council staff in the development team and other functions means that there would be fewer complications in closing the entities down should this be required. Any decision to actively recruit staff into WHIL will need to be based on robust justification.

## **7. Progress to Date & Future Work Plan**

- 7.1 Work has been progressing to establish the first live schemes for the Company within a sound framework for project governance. Parameters set for this are first that, so far as possible, existing Council governance processes should be used so as not to duplicate effort and secondly, that the process should be timely yet robust.
- 7.2 Appendix 2 shows the current Council governance process and indicates how the WHIL project team and Board will interface with this to ensure schemes passing through WCC CRG process are, where they are proposed for development by WHDL, reviewed in that context. The Appendix indicates where current WHIL proposals are within the process.
- 7.3 In order to simplify identification of appropriate schemes, key project appraisal hurdles are under discussion with the Council. These include matters such as the minimum number of units and capital outlay, the tenure (to include a mix of tenures rather than all affordable which would duplicate either the capability of the HRA or Westminster Community Homes) and financial hurdles (in relation to equity returns, debt repayment etc).

- 7.4 The future work plan focusses on continuing to progress the current identified schemes, bringing forward new proposals and developing the operational arrangements.

## **8. Conclusion**

- 8.1 It is considered that good progress has been made in establishing WHIL and the Business Plan developed should provide a solid and robust basis for development activities to commence in FY 2019/20. These will support the Council's drive to provide more homes for working people on middle and lower incomes.
- 8.2 It is proposed that a further report is brought to Policy & Scrutiny Committee in a year's time.

**If you have any queries about this Report or wish to inspect any of the Background Papers please contact:**

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## **Appendix 1 – Company Tenures**

## **Appendix 2 - Scheme Progress**

## **Background Papers**

Cabinet Report 4<sup>th</sup> December 2017 – Establishment of a Wholly Owned Housing Company

**Company Tenures**

<p>Assured shorthold tenancies at Intermediate rents</p>	<p>The Company will offer assured shorthold tenancies, as this is the general form of tenancy agreement in the private sector.</p> <p>Intermediate rental housing will be provided at rent levels at a cost at least 20% below market rents under S.106 planning requirements for affordable housing as set out by WCC in its City Plan and confirmed within the planning approval for each scheme.</p> <p>The Company will not be a Registered Provider and therefore will not be able to access government grants but could receive subsidy from the Affordable Housing Fund.</p>
<p>Assured Shorthold tenancies at Market and Sub Market rents</p>	<p>In addition to Intermediate rental housing, assured shorthold tenancies can be offered by the Company at market and sub-market rents. This housing will not be S.106 planning constrained as, in planning terms, it is market housing. However, to help grow a more balanced mix of tenures and housing options in Westminster, the Company will seek to flex the rents for the market housing it provides and set them at any level from market rent downwards to meet housing need and ensure viability of the Company.</p>
<p>Sale housing with or without Help to Buy</p>	<p>The Company can build sale housing and sell it using the Help to Buy scheme in the same way as any other developer, provided it is able to register under the scheme and the properties are within the value limit (currently £600,000 in London).</p>
<p>Other tenures and products – as part of a “Ladder of Housing Opportunities”</p>	<p>Further work is being undertaken to assess new tenures that could be offered within the Council’s emerging policy to create a “ladder of housing opportunities” in Westminster. These include options for discounted sale housing and rent to buy.</p>

