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OPTION APPRAISAL – TEMPORARY ACCOMMODATION DELIVERY MODEL

London Borough of Croydon

13th January 2023

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BACKGROUND

In 2013, the Council invested £29.4m into a property fund focussed on the provision of temporary accommodation. It was capitalised with a sum of £56m with the additional finance invested by Big Society Capital and London and Quadrant. The fund, Real Letting Property Fund 1 (RLPF1), is managed by Resonance, which specialises in the management of social impact investment funds. RLPF1 was established as a closed fund with a term of ten years and is due to mature in February 2023.

The fund acquired properties across London with the Council having nomination rights over 146, both inside and outside of the borough. These properties are let on a long-term lease to a number of housing providers who take on responsibility for day-to-day housing management issues including lettings and rent collection.

The rentals paid by the housing providers to RLPF1 are set at 81% of the local housing allowance for the area in which they reside. The Council uses its nomination rights over the units to supplement its accommodation for those people and families needing temporary accommodation. This stock will be lost to the council once the fund matures as the assets will need to be liquidated to repay the Council and other investors their investment capital.

Resonance is currently working on building a replacement fund which will largely replicate RLPF1 but with a bigger accommodation portfolio and a national rather than London focussed geography. The fund is referred to as National Housing Property Fund 2 (NHPF2) and is targeting a capitalisation of £300m with accommodation units totalling more than 1,000.

The Council has been invited by Resonance to invest in NHPF2 which would, along with the hope of a financial return, enable LBC to have nomination rights on up to 242 units within their borough. Resonance has promised the Council that they will target the acquisition of the additional units in the borough should the Council invest as well as transfer the existing 146 units from RLPF1 into NHPF2.

However, the original £29.4m investment by the Council in 2013 is currently valued at £36m within RLPF1 and would, once repaid, represent a significant contribution to the Council's requirement to reduce its debt holdings of £1.6bn. This is an over-riding priority given the Council is currently operating under a Section 114 notice.

APPROACH

Due to the time constraints of our commission which saw us contracted on the 16th December and required to produce our analysis by the 23rd December, we have had to focus our work on the value for money and financial implications of the choices facing the council.

The choices being to:

Option 1: Continue with the delivery model platform offered by Resonance and recycle the capital maturing from RLPF1 into NHPF2, retaining nomination rights over the existing 146 properties and, over two years, gaining access to a further 96.

Option 2: End the relationship with Resonance once RLPF1 has matured and use the capital to reduce the council's debt holdings, losing access to 146 temporary accommodation units and a further 96.

Option 3: End the relationship with Resonance once RLPF1 has matured and use the entirety of the capital receipt to purchase as many accommodation units as possible to mitigate against the lost access to 242 properties per Option 1.

Our normal expectation would be that a decision of this nature would be based upon a HM Treasury Green Book standard business case. This would involve consideration of the strategic and operational policy context as well as the council's capacity and capability to deliver each of the possible options.

However, at this point in time, there does not appear to be the opportunity to undertake that work before a decision has to be made with regard to the Resonance funds.

Our work has been restricted to assessing the monetary flows associated with each option. We have taken the information supplied to us by the council and constructed an appraisal workbook featuring: i) discounted cash flow analysis, ii) revenue fund analysis, and iii) scenario testing functionality.

This has allowed us to assess the value for money and affordability implications of the options and test the risks and uncertainties linked to each.

RESULTS

LOCAL PARTNERSHIPS

BASE CASE – VALUE FOR MONEY

When the monetised cost and benefit flows of each option are discounted back to an appraisal start date of 1st February 2023, Option 1 produces the most favourable outcome in value for money terms. Under Option 1, the receipt being guaranteed from RLPF1, if recycled into NHPF2, is £36m. Under Options 2 and 3, a receipt featuring a modest appreciation on the invested £29.4m is assumed, once assets are liquidated, with this being banked under Option 2 and used to finance the purchase of properties under Option 3. Those properties, under Option 3, are assumed to experience the same appreciation in value over the 15 year appraisal period as the properties held in NHPF2 under Option 1. A cost of interest is applied to reflect the opportunity cost of recycling the receipt into the new fund under Option 1 and the purchase of properties under Option 3. The housing benefit rebate reflects the income received for meeting the temporary housing needs of 242 households whether through owned or nightly rate accommodation.

Value for Money	Option 1 Total (£'000s)	Option 2 Total (£'000s)	Option 3 Total (£'000s)	Option 1 NPV (£'000s)	Option 2 NPV (£'000s)	Option 3 NPV (£'000s)
Benefits						
Expected annual fund return	11,232			6,390		
Expected capital return at fund maturity	57,668			23,570		
Receipt on maturity of RLPF1	36,000	31,483	31,483	31,007	27,117	27,117
Housing benefit rebate on placements	618	24,329	28,464	527	14,459	16,880
Expected value of properties at the end of the appraisal period			50,432			20,613
Total	105,517	55,812	110,379	61,494	41,576	64,610
Costs						
Capital investment	36,000		31,483	29,957		25,033
Finance cost – interest on LBC debt	24,750	77	20,269	14,904	66	11,885
Placement/dilapidations costs	4,640	15	849	2,787	13	493
Cost of emergency accommodation	1,504	73,020	44,636	1,282	42,216	25,992
Rental to housing providers						
Housing management and maintenance costs			1,668			961
Total	66,894	73,112	98,904	48,930	42,295	64,364
Net benefit	**38,623**	**(17,300)**	**11,475**	**12,565**	**(719)**	**245**

The average length of stay for a household placed in dispersed accommodation by the Council is 5 years so this dictates the costs of tenancy churn under each option, labelled as 'Placement/dilapidations costs'. There is a placement fee payable to the fund, under Option 1, each time a new household is placed in a property while an allowance has been made for dilapidations for properties owned under Option 3. A provision has been made for management and maintenance costs under Option 3 for the stock that would be owned by the Council. Finally, the cost of emergency accommodation is a consequence of the fact that the options are all based on the provision of the same level of units as each other with the scale being dictated by what Option 1 delivers i.e. a portfolio of 242 units. it is assumed, under each option, that emergency accommodation, dependent upon the rate and level of acquisition, will be the default alternative if the stock levels are not at 242 units. Hence, under Option 1, a small and temporary cost is incurred as the portfolio expands from 146 units to 242 units while, at the other end of the spectrum, under Option 2,the entirety of the modelled need is met by emergency accommodation.

SCENARIOS AND SWITCH FACTORS

It is important to note that the base case value for money analysis is a product of a set of assumptions (see Appendix 1) which are all, by definition, uncertain. The table below shows how the value for money results differ if any of the key assumptions are changed and helps identify which assumptions are the most significant determinants of the preferred option. It is evident that Option 1 remains the preferred option in all but two scenarios. The first of these is where the assumed tenure length is reduced significantly to 24 weeks. The aggregate cost of placement fees under this option would increase by c. a multiple of 10 in direct proportion to the increased level of tenancy turnover which, at £5k per placement , introduces a significant additional cost into this option as well as, on the same basis, increasing the quantum of dilapidation costs under Options 3.

Option RAG rating - value for money

		1	2	3
1	Base - zero housing value growth over the 15 years	12,563	(720)	244
2	In-house placement costs to equal NHPF2 placement fee	12,563	(720)	(237)
3	NHPF2 target cash yield is 150bp higher	16,557	(720)	244
4	Average stay in temporary accommodation to be 24 weeks	(14,844)	(3,432)	(7,192)
5	Cost of nightly accommodation to be 100% higher	11,282	(42,936)	(25,749)
6	Duration of in-house acquisition 50% longer	12,563	(720)	1,096
7	Time between RLPF1 liquidation and start of in-house acquisition 50% longer	12,563	(720)	623
8	Capped LHA rebate indexation is 100% greater	12,563	(3)	1,086
9	Net cost of council tenants in long term rent is 25% higher	12,563	(720)	244
10	Zero housing value growth over the 15 years	3,707	(720)	(7,501)
11	All of above	(20,988)	(49,258)	(49,100)
12	All of the scenarios except 5	(19,707)	(2,713)	(16,715)
13	All of the scenarios except 4 and 5	7,701	(3)	(5,821)
14	All of the scenarios except 3,4,5 and 10	12,563	(3)	1,924

The base case assumes house price values change in accordance with Savills November '22 projections over the next five years and at 5% per annum for the subsequent ten years. If this is amended to reflect a net nil appreciation over the appraisal period, per Scenario 10, it adds, in net present value terms, a significant cost to Options 1 and 3.

A further significant uncertainty is the value of the council's current stake in RLPF1 and what it would realise if the fund was liquidated rather than its assets transferred into NHPF2. The aforementioned projections from Savills project a significant softening in price levels for the London residential market in the short term and we have applied their predicted level of deflation to determine a value for the RLPF1 receipt in the modelling of Option 2 and 3.

The other scenario where Option 1 is not the preferred scenario is Scenario 12 where the major additional cost factor on it is retained i.e. increased churn, while removing the major cost impact on Option 2 i.e. higher emergency accommodation costs. This leads to Option 2 becoming the most favoured option in value for money terms.

BASE CASE – AFFORDABILITY

There is marginal difference across two of the three options in terms of affordability over the appraisal period with Option 1 standing out as delivering a much lower cash pressure. For Option 2 and Option 3, the only income to the council is housing benefit rebate received for the costs of temporarily housing tenants in accommodation that the council has acquired either through purchase, PRS rental or on nightly rates in the emergency accommodation market. For the latter, the council can only recover the 1-bed rate irrespective of the size of accommodation acquired which explains why the income level is lower than for Option 3. For all three options, the rebate equates to 90% of the 2011 LHA rate which, as the table shows, is insufficient to cover the costs involved i.e. rent or, on purchased property, finance, management and maintenance costs.

Financial	Option 1	Option 2	Option 3
	Total (£'000s)		
Revenue			
Expected annual fund return	11,232		
Housing benefit rebate on placements	618	24,329	28,464
Total	11,850	24,329	28,464
Expenditure			
Finance cost – MRP and interest on LBC debt	37,722	117	30,892
Placement/dilapidation costs	4,640	15	849
Cost of emergency accommodation	1,504	73,020	44,636
Rental to housing providers			
Housing management and maintenance costs			1,668
Total	43,866	73,152	78,044
Net revenue impact	(32,016)	(48,823)	(49,580)

The General Fund impact of Option 1 is the extent to which the annual dividend return offsets the cost of borrowing on the capital invested in the fund and the placement fees that are incurred each time a tenant is placed in a fund property.

Given the short-term cash constraints of the Council, the adjacent table shows how the General Fund impact differs across five yearly intervals. Although Option 1 produces the lowest cost pressure over all, Option 2 appears to have lower net cost demands in the shorter term.

	Option 1	Option 2	Option 3
	Total (£'000s)		
5 yearly cash flow totals			
1-5 years	(11,497)	(10,479)	(11,643)
6-10 years	(10,400)	(17,108)	(17,673)
11-15 years	(10,120)	(21,236)	(20,263)
Total	(32,016)	(48,823)	(49,580)

BASE CASE – CAPITAL IMPACT

The table below shows the capital impact of each option. A receipt from exiting RLPF1 is banked under all options and re-committed on property purchases under Option 3 and investment in NHPF2 under Option 1. The values reflect an assumed zero appreciation in capital values over the 15 year appraisal period,

Financial	Option 1	Option 2	Option 3	Option 1	Option 2	Option 3
		Total (£'000s)			NPV (£'000s)	
Capital						
Capital receipt - RPLF1	36,000	31,483	31,483	31,007	27,117	27,117
Capital investment - NHPF2	(36,000)			(29,957)		
Expected capital return at fund maturity	57,668			23,570		
Cost of property purchases			(31,483)			(25,033)
Expected value of properties at the end of the appraisal period			50,432			20,613
Total	57,668	31,483	50,432	24,620	27,117	22,697

From a purely capital perspective, Options 2 delivers a better outcome in net present value terms. It is evident that taking the cash now, albeit at an assumed lower value of £31.5m compared to the £36m recycled within Option 1, produces a higher net present value overall due to the impact of the forecast deflationary pressure in the housing market in the near term.

IMPLICATIONS AND POINTS TO CONSIDER

If the council decides to withdraw from its association with Resonance on expiry of RPLF1, it will lose access to nomination rights over 146 properties. If, as it is understood, NHPF2 acquires those properties then the existing tenants will remain in-situ until permanent accommodation is found for them. This typically takes 5 years so at the end of that period it can be assumed it will have lost access to the entirety of this portfolio.

If it continues with its partnership with Resonance and re-invests its RPLF1 receipt into NHPF2 then it will retain access to these properties as well as a further 96 properties that Resonance has promised to acquire through NHPF2.

In addition to the permanent loss of 146 units, reliance will also need to be placed to a greater or lesser extent on the emergency accommodation market* to deal with the additional demand for placements that is created while the replacement portfolio is built up.

This has implications for those who would have had access to such accommodation under Option 1. Clearly, the council has to be mindful of the suitability of accommodation for households as well as the actual costs of securing that.

The modelling has made assumptions about values such as the nightly costs of emergency accommodation based upon the information made available and this analysis, per slide 7, has also tested the impact on the value for money outcome if those values are different. It is highly probable that this accommodation will become increasingly more expensive.

*Option 2 assumes permanent reliance on the emergency accommodation market.

It will be important for the council to assess its internal capacity and capability to acquire and manage properties as part of its strategy for replacing both the lost properties and the function that the Resonance model provides. It would be helpful if the council could negotiate an extension to the RLPF1

In its discussions with Resonance about the mechanism and timetable for liquidating RLPF1, it should explore the option of acquiring units that the fund owns within the Borough. It should also be mindful, in any approach to acquisition, of the price forecasts for the London area and the projected decline in value that is expected over the next few years.

CONCLUSIONS

LOCAL PARTNERSHIPS

CONCLUSIONS AND LIMITATIONS

Overall, the value for money analysis points to the Council continuing its partnership with Resonance. This is primarily due to the ability to have access to a portfolio that contains significantly more units than represented by its investment share.

This conclusion is based on a set of assumptions provided by the Council and a set of assertions and promises made to the Council by Resonance.

Our analysis has helped identify that there are assumptions that have a material impact on the relative value for money of each option particularly the churn of tenants and the costs involved in tenant placements.

It should also be noted that key assumptions regarding the Resonance funds such as expected valuations and returns are likely to be somewhat out of date given they are based on projections produced in July 2022.

Finally, as we noted in the value for money analysis, the results are purely quantitative and need to be fused with considerations of qualitative factors too, not least the needs and circumstances of those requiring accommodation as well as the capability and capacity that exists within the council to deliver the options under consideration.

APPENDICES

LOCAL PARTNERSHIPS

APPENDIX 1: KEY ASSUMPTIONS FOR BASE CASE

Appraisal start date	01-Feb-23	
Price base	01-Dec-22	
LBC WACC	4.77%	
Real discount rate	3.50%	

Appraisal period starting	01-Feb-23	01-Feb-24	01-Feb-25	01-Feb-26	01-Feb-27	01-Feb-28	01-Feb-29	01-Feb-30	01-Feb-31	01-Feb-32	01-Feb-33	01-Feb-34	01-Feb-35	01-Feb-36	01-Feb-37
CPI	11.80%	3.00%	0.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
Rental inflation (CPI+x%)	7.00%	4.00%	1.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
House price growth	-12.50%	-1.00%	2.00%	6.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%

NHPF2 target cash yield	2.40%	*per annum*
NHPF2 Placement fee	5	*£'000s*
In-house placement costs (dilapidations & letting administration)	2.5	*£'000s*
Average stay in temporary accommodation	260	*weeks*
Cost of nightly accommodation premium	0%	
Capped LHA rebate % increase	0%	
Net cost of council rented stock	7	*£'000s per annum*
Total target units	242	
RLPF1 liquidation period	12	*months*
RLPF1 fully liquidated	21-Feb-24	

		1 room	1 bed	2 bed	3 bed	4 bed	
90% January 2011 weekly LHA	£	65.89	140.02	172.96	230.62	288.27	
Rental rebate income	£	65.89	140.02	172.96	230.62	288.27	
Rental rebate income - emergency accommodation	£	65.89	140.02	140.02	140.02	140.02	
Local housing allowance	*£ per week*	104.00	201.00	253.00	316.00	399.00	
Nightly housing rates	*£ per night*	45.00	45.00	45.00	45.00	45.00	
Acquisition cost	*£'000s*	0.00	273.00	328.00	424.00	0.00	*Resonance model*
Management and maintenance cost	*£ per annum*	0.00	1000.00	1000.00	1000.00	1000.00	*Per LBC*
Average stay	*weeks*	260.00	260.00	260.00	260.00	260.00	*Per LBC*
RLPF1 portfolio	*units*	0	19	127	0	0	
NHPF2 target portfolio	*units*	0	0	121	121	0	
In-house target portfolio	*units*	0	0	121	121	0	
Net cost of council tenancies in rented stock	*£'000s per annum*	7.00	7.00	7.00	7.00	7.00	
Rental cost of in-house stock	*£ per week*	200.51	274.63	307.58	365.23	422.89	

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