REPORT:		**Cabinet**
DATE OF DECISION		**26th July 2023**
REPORT TITLE:		**Lease acquisition and Underlease disposal at Red Clover Gardens**
CORPORATE DIRECTOR		**Jane West – Corporate Director of Resources and S151 Officer** **Susmita Sen – Corporate Director of Housing**
LEAD OFFICER:		**Beatrice Cingtho-Taylor - Head of Temporary Accommodation Housing Resident Engagement Allocations** **Huw Rhys Lewis – Director of Commercial and Property**
LEAD MEMBER:		**Mayor Jason Perry – Executive Mayor** **Cllr Jason Cummings – Lead Member for Finance** **Cllr Lynne Hale – Deputy Mayor and Lead Member for Housing**
KEY DECISION?	**Yes**	Key Decision **5123EM** – Decision incurs expenditure, or makes savings, of more than £1,000,000 or such smaller sum which the decision-taker considers is significant having regard to the Council's budget for the service or function to which the decision relates
CONTAINS EXEMPT INFORMATION?	**Yes**	Public with exempt Part B report and exempt appendices 2, 3, 4,5 & 6 Exempt under paragraph(s) 3 & 5 of Schedule 12A of the Local Government Act 1972 and the public interest in withholding disclosure outweighs the public interest in disclosure.
WARDS AFFECTED:		**All**

1. Summary of Report

1.1 This report seeks Cabinet approval to enter into a Headlease with Regen Capital of 85 units at Red Clover Gardens, Coulsdon, and to subsequently underlease the units to a Registered Provider (RP) subsidiary of Mears Group. The entire development is being acquired and funded by Regen Capital with the Council not making any upfront payment and will not be required to do so for two years.

1.2 The Council has identified a significant need for new affordable homes as demands levels for housing support are high whilst at the same time private sector landlords are exiting the affordable market in return for better returns elsewhere.

1.3 An offer from Mears has been received, and agreed in principle, to take on the underlease from the Council and to grant tenancies to help support delivery of affordable housing. The key criteria to engage with an underlease is to ensure the

Council avoid Right to Buy risks and therefore have a sustainable allocation of properties for a period of time whilst giving the Council flexibility to change tenures.

1.4 This report details the key considerations of Regen Capital's proposal, including an explanation of the financial benefits and the options that were available to the Council in relation to selecting an underlessee.

2. Recommendations

For the reasons set out in the report and its appendices, the Executive Mayor in Cabinet, is recommended:

2.1 To approve that the Council enter into a Headlease with Regen Capital or an associated entity for 125 years of 85 units at the RCG development as detailed in this report, with lease payments over 50 years but with a 2 year rent free period at the start of the term of the Headlease and the option to buy the freehold interest for a £1 at the end of the 50^{th} year of the term of the Headlease and to delegate authority to the Corporate Director of Housing in consultation with the Corporate Director of Resources, Lead Member for Finance and Lead Member for Housing to enter into final agreements subject to final financial and legal due diligence.

2.2 To approve that the Council enter into an Underlease with Mears or one of its subsidiaries for 10 years of 85 units at the RCG development as detailed in Sections 5 and 6 of this report and delegate authority to the Corporate Director of Housing in consultation with Corporate Director of Resources, Lead Member for Finance and Lead Member for Housing to enter into final agreements subject to final legal due diligence.

2.3 To note that the proposal set out in this report can only progress once final funding is confirmed by Regen Capital, which is subject to financial funding rates and macroeconomic conditions that will be prevalent on the day of completion.

2.4 To delegate authority to the Corporate Director of Housing, in consultation with Corporate Director of Resources, the Executive Mayor, Lead Member for Finance and Lead Member for Housing, to renegotiate terms of the Headlease or Underlease, should this be required due to macroeconomic conditions prior to completion, but not to deviate by more than £2.00m from reported benefits of this proposal as set out within this report.

2.5 To note that the Council will receive 85 affordable housing units subject to the approval by the Council's Local Planning Authority to a variation of the existing S106 Planning Agreement, to provide much needed affordable homes which are currently being sourced from the private rental market at a premium.

2.6 To note subject to Recommendation 2.3 that the Council will hold 100% Nomination rights for all 85 affordable units for the period of the lease as (originally) required under the S106 Agreement entered into between the Council's planning authority and Brick by Brick Croydon Ltd, the developer (BBB).

3. Reasons for Recommendations

3.1 New proposal for the Council taking a long lease and disposing to an Underlessee on new residential units that will cost above the levels delegated to officers within the constitution. The offer of these units also generates cost reductions compared to costs currently incurred by the service.

4. Background and details

4.1 The deal with Regen Capital requires the Council to take a headlease of three blocks currently comprising of 33 affordable rent, 46 shared ownership and 6 private units. The Council has an option to convert the 46 shared ownership and the 6 private units to affordable rent and has agreed in principle to exercise that option, subject to planning approval. A variation to the S106 agreement will be required and if approved the proposal will provide the Council with 85 affordable rent units within 3 blocks. The 2 other blocks within the RCG development will remain for private use with a total of 72 units and these will be held by Regen Capital for either onward disposal or private rental.

4.2 Regen Capital have yet to fully determine the final funder and there is at least some risk that the pricing set out may not be able to be achieved, in which case careful consideration of the various terms will be required and further report will be brought back to cabinet or proposal rejected if material gains are not achieved by the Council.

4.3 The affordable housing units will consist of 10 3-beds, 22 2-beds and 53 1-bed properties. Housing Services have confirmed that the mix of properties will be suited for their needs and will be able to occupy all properties within a very short space of time and therefore avoiding a prolonged void period. Housing Services have also indicated that they will be used to support the discharge of the Council's Homelessness duty.

4.4 The Council proposes to underlet the 85 units to Mears (or one of their subsidiaries), which is a registered provider (RP). The Council is keen to work with a RP so that the level of service provided to tenants and the properties is in line with standards issued by the Housing Regulator. The Council will then rely on the nominations agreement to place tenants. This will ensure assured shorthold tenancies will be provided to tenants at affordable rents. In formulating the proposed arrangements being recommended, the Council took legal advice from its external solicitors Browne Jacobson, provided in Confidential Appendix 3, confirming that the proposal to underlease would be a better option as opposed to the direct Council management within the HRA as it removes any prospective challenge from tenants to claim potential RTB rights.

4.5 The Council directly engaged with a number of organisations to take on the underlease and this process included contacting nine RPs and non-RPs. It has been a challenging process and a number of RPs have declined to proceed largely on the grounds that the proposal does not fit with their business objectives. Key concerns have been around the level of revenue against the risk associated with taking on the underlease in the current economic climate. However, the response from Mears was ideal as its business model specialises in the provision of homes to those who are faced with Homelessness and need affordable rent properties.

4.6 The Council has a legal duty to provide housing to eligible residents and therefore has a legal obligation to meet that need. Housing Services need affordable homes to support the growing demand within the homelessness sector whilst at the same time Housing Services is experiencing the loss of many properties from private landlords. This is not only causing significant risk to the type and quality of accommodation provided but will also result in significant budget overspends within Housing Services as the Council is required to subsidise higher rents.

4.7 Whilst the Council can fulfil its obligation via a number of options, the supply of housing is critical to ensure a value for money service is provided. The supply of housing needs to be at a cost-effective rate as otherwise the Council subsidises the difference between rents and the benefits or contributions tenants can make towards their rent.

4.8 To test the financial implications of Regen Capital's proposal, a financial analysis has been carried out to compare against the current Homelessness costs. Section 4 provides further detail and the financial schedule has been attached to confidential Appendix 4 in respect of the lease schedules. The analysis has been tested and updated against advice sought from Savills, who have provided assurance that the financial modelling and the assumptions applied to it are sound and in line with general market approach. Savills' advice note has been attached as Confidential Appendix 5a and 5b. Savills advice was commissioned under a two-step arrangement, which included pre and post agreement of the Heads of Terms. This was done to ensure that, once key terms were agreed, these were in line with the Council's initial expectation and that the proposal remained commercially sound.

4.9 Whist the advice points to a number of risks with the proposal, which is further explored in paragraph 4.9 below, it largely provides the assurance that the approach to modelling is in line with market norms.

4.10 The Council, in common with many other Local Authorities, increasingly finds itself in a challenging position to balance costs associated with Temporary Accommodation (TA) procurement and management while acquiring an affordable supply of accommodation to meet the growing demand for housing. The problem has been made worse by rising rents, benefit shortfalls, the acute shortage of affordable housing and a sharp reduction in the supply of private rented sector (PRS) properties. A high percentage of households approaching the Council for housing assistance have been evicted from the private rented sector due to their inability to afford the high rents.

4.11 The Council currently has responsibility for approximately 3,500 homeless households (as of 22nd May 2023) living in TA. The majority are living in TA in the private rented sector acquired via managing agents. Managing Agents are requesting annual increases in rents, due to the growing gap between the Council's offer of local housing allowance and the market rents. The Council has seen an increase in the number of families living in emergency accommodation in 2022/23 as it is becoming increasingly challenging to retain a cost-efficient longer-term TA portfolio.

4.12 The Council is also holding onto significantly expensive rental properties from private tenants, some costing more than £500 per week. A review identified that in total 44 properties have rents in excess of £500 per week, for 2 and 3 bed properties. The average cost per unit under the proposed headlease between the Council and Regen Capital is priced at £291 per week and therefore this opens up significant opportunities for the Council to acquire affordable units and reduce costs, by exiting the more expensive tenancies. With 1 bed properties being of a decent size and standard, these properties can also house young families and therefore increases the potential for usage by a larger tenancy cohort.

4.13 This proposal contributes to the Council's ambition of meeting housing need and ensuring that those who do qualify for housing support are able to live in good quality and affordable settled homes. As part of the allocation process the Council will ensure all cohorts of Council service users are considered for these properties and this may include care experienced people, young working families, key workers, and those on independent living schemes.

4.14 Over the past couple of months, the Housing market has faced a number of challenges. The increases in the Bank of England base rate coupled with general slowdown in the economy seems to be causing caution in the market for property transactions including funding opportunities. The Council is wary of these risks and is keen to ensure despite those challenges the best deal achievable is delivered.

5. Key features of Regen Capital Proposal – The Headlease

5.1 This section provides some of the key characteristics with the Regen Capital offer. It is important to note that no proposal is risk free as some degree of risk is inherent in all projects. The key to risk will be the options available to the Council to manage those risks but also those risks will need to be analysed considering the broader context of demand for services, supply of housing need and cost of the alternatives. There is always future unknown risk particularly with regards to national policy and the future direction of legislative changes.

5.2 Regen Capital's proposal is not unique, and a number of such proposals have previously been presented to the Council. However, taking into account the wider commercial terms and the details of the offer from Regen (as detailed in Part B), this proposition is better financially with additional non-financial benefits. A key feature to note however is that this proposal will not lead to budget savings but will lead to cost reductions, supporting the service to deliver more housing provision within its existing budget and cut the significant level of overspends for some properties.

5.3 Regen Capital have priced their lease payments at South East Inner London Local Housing Allowance. Based on the bed sizes this equates to a starting lease of £1.285m for the 85 units. The Council engaged to negotiate this price down to match the Outer London Local Housing Allowance, however the proposal was rejected due to significant increases in financing costs currently experienced by investors. The Bank of England base rate along with the UK gilts have increased by over 2% in the past year which is adding to development and property acquisition costs.

5.4 Looking into specifics of the proposal the following are a number of qualitative and quantitative benefits from the Regen Capital proposal:

1. Regen Capital will actively take a stake for 72 units over 2 blocks and therefore the arrangement does not solely rely on the Council taking the risk and therefore the Red Clover Garden development therefore allows for a genuine private public arrangement. This could act as a test bed for a future regeneration consideration.
2. Most proposals require inflationary uplifts linked to CPI or another benchmark, however Regen have agreed to fix this at 3% inclusive and applied every 5 years, therefore effectively providing uplifts that are below 3% as no compounding interest is applied.
3. The Council will have the option to buy the freehold for £1 at the end of 50th year of the term of the Headlease.
4. The Council will not pay any rent under the Headlease for a period of 2 years from the start date of the Headlease.
5. The Council can flexibly use the properties to meet any tenure including social housing requirements, as long as the Headlease commitments are observed and performed by the Council.
6. The Council will achieve a minimum of £0.450m in revenue cost reductions by exiting the most expensive private sector tenancies based on like for like property sizes.
7. Rent increase only every 5 years at the fixed rate and no annual lease increase and therefore allows for time to plan when the rent under the Headlease is due.
8. 85 properties will be made available to the Council to support the growing demand for Housing need under a structure that is priced below market rents for the tenants of those properties.
9. No upfront payment for the properties by the Council and therefore no additional charge for Minimum Revenue Provision and Interest. The costs associated with the Headlease will be funded from existing budgets within Housing Services.
10. Regen Capital have agreed to take on Grounds Maintenance at their sole cost and pay for CCTV monitoring subscriptions. Regen Capital will provide the Ground Maintenance to the Council/Underlessee without any cost during the first 10 years of the term of the Headlease and allow the Council and its underlessee access to the CCTV subscription at nil cost during the same period.

5.5 The deal with Regen Capital provides the flexibility to underlease the properties and therefore receive a lease payment in return. The net cost to the Council is therefore reduced as the lease income from the underlease will help meet payment under the Headlease. The Council will set the underlease rent at below market rents and will aim to charge as close as possible to the Local Housing Allowance levels to match the benchmark used when assessing Housing Benefits eligibility.

5.6 The key benefits can be improved if the variation of the S106 Agreement is approved by the Local Planning Authority to increase rents charged to the tenants, whilst still being within the affordable rent range. The financial viability to the Council is improved whilst ensuring an affordable property is made available if the rent is increased by a minimum of 9.5%. Paragraph 7.6 in section 5 within this report explains this further.

5.7 The benefits listed above are broadly confirmed subject to final due diligence and are certain to be achieved. However, as stated all proposals will contain an element of risk that may or may not materialise. The Table below sets out the risks and risk mitigations associated with the Regen proposal.

Risks and risk mitigations

5.8 Table below details some of the key risks that are prevalent with this proposal and suggests risk mitigation options considered along with further options to minimise the financial impact.

Risks	Risk Mitigations	Other considerations
LHA for the Council may not rise as expected due to Govt policy	The model already assumes no rises in Council's LHA for 5 years and therefore the financial model is prudent to highlight future gains. Savills report already states that Govt will need to increase LHA rates for the Council rates in the near future as current levels are unsustainable and will only lead to pressures for local government.	Savills have picked this up as a key policy risk and one that is fully in the control of the National Government.
The Council will take on a 50-year commitment to pay the rent and other payments under the Headlease with no break clause.	The level of need for Housing support is likely to be there for years to come. Whilst the market for housing in UK is buoyant this adds to the pressure on Council to source affordable properties. Therefore, receiving properties at below market rates is beneficial financially and sustainable over a longer term.	The Council ends up owning the freehold interest in the 85 units/properties and will have the flexibility of using the properties for TA or Social Housing purposes.

Potential reduction in Temporary Accommodation demand in the future and therefore these properties fail to meet the initial objective	The agreement with Regen Capital provides the Council with flexibility to use the properties for Social Housing and support the housing register. As these properties are priced at below market level they can always be retained for affordable housing which help in avoiding taking on expensive properties at market rates from private landlords.	The risk of housing demand falling below 85 over the next 50 years is highly unlikely.

6. Underlease Options

6.1 The Council is keen to ensure there is a clear separation between the Council's role as the Housing authority and the management of the tenancies and the properties. Furthermore, the Council also needs to avoid the risk of Right to Buy and secure tenancies and legal advice assures that seeking an underlease allows the Council to secure properties over a longer period whilst ensuring a company with the right skills and experience delivers a better property management service.

6.2 Underleasing the properties allows for the Council to achieve its objectives whilst ensuring the Council receives an income. In order to ensure the properties, remain affordable, the Council is committed to setting the rents for the underlease at Local Housing Allowance levels.

6.3 The underlease rate considers the need for voids and bad debt risks and the need to pay for management and maintenance (services). All of these will need to be deducted from the gross lease charge and a net lease payment will be due to the Council. The voids and bad debt could range between 2% and 3% whilst the cost for the services could range between £2,000 to £3,000 per annum per property. The final cost set by the chosen underlessee is indicated within Section 6 of this report.

6.4 When selecting an underlease the Council had 3 high level options and the considerations are detailed below.

Independent Register Provider (RP)

6.5 Independent Registered Providers are regulated by the Housing Regulator and therefore are required to meet set standards to retain their RP status. Some RPs such as Mears have built their business model to work closely with Local Authorities to support provision of affordable housing across a number of cohorts. A key cohort is for those in need of a homeless service along with housing with care and general affordable housing.

6.6 The fact that RPs are regulated would provide the Council with added assurances that the management of tenancies and properties would be at standards set by the regulator.

6.7 The Council approached a number of other RPs, however some RPs did not have the same model as Mears and other feedback received indicated that this proposal may not be of the right scale to meet their business objectives.

Independent Non-RP

6.8 Non-RPs would largely constitute private companies that provide standard property management services. The private market has a number of such companies, however the challenge with private firms was to identify one that had the necessary experience with provision of services that the Council was seeking.

6.9 The Council approached Capital Letters to see if the entity would be interested in taking the underlease. Interest was expressed and a formal Bid was also made. Capital Letters is a not-for-profit (but not a charity) company limited by guarantee and is owned by Member London Councils with financial support from Government. Capital Letters was set up to respond to the capital's homelessness crisis, by working in partnership with London councils and private landlords to provide the much-needed affordable homes.

6.10 The business model of Capital Letters suits the need of the Council and there are direct synergies between the Housing objectives of each organisation. Capital Letters have a dedicated business objective of tackling homelessness and are keen to work with Local Authorities to make this happen. However, Capital Letters do not have the same volume of properties as Mears and are a smaller outfit with limited history of trading.

6.11 Capital Letters submitted a similar bid to Mears. As with Mears, Capital Letters also indicate that they would take a 10 year lease under standard terms. However, upon review of all options, it is not recommended the Council proceed with Capital Letters owing to the size of the entity and having less experience than Mears and not being a RP.

Croydon Affordable Housing LLP Company

6.12 The Council is very familiar with the existing LLP structures that is jointly owned between the charity Croydon Affordable Housing and the Council's subsidiary London Borough of Croydon LLP. The Council has already transacted through the existing LLP companies and currently the Council has access to 344 properties via two existing LLP companies, Croydon Affordable Homes LLP and Croydon Affordable Tenures LLP.

6.13 As with the existing structures the Council would seek to enter into a contract to provide property management services. Various commercial adjustments would need to be made to allow for an effective provision of services. Currently, the provision of services to the LLPs is provided by the Council for existing properties. However, when commissioning repairs and maintenance works the LLPs are bound by existing Council polices, due to the Council's legal responsibility to follow internal governance and procurement regulations, which hinder the ability to deliver an efficient service. This is not in tune with the level of service a private entity would expect. It is recommended that for this option to be most effective it would be necessary to provide a greater degree of autonomy from the existing structure so that they could appoint their own repairs and maintenance contractors and have the right staffing structures in place.

6.14 The LLP did not bid for the underlease but it is known that the average cost based on the existing structure is c£2000 per unit per year and therefore considerably less than the other two bidders. The Council has the option to enter a longer lease with the LLP which would not be possible with the other two bidders.

Advantages and Disadvantages with each underlease options

6.15 Table below provides a summarised position on key advantages and disadvantages for each of the options for proceeding with an underlessee.

Underlessee	Criteria	Advantages	Disadvantages
Independent RP	**Lease Period**	▪ **10 Years** - This provides the Council and the Underlessee flexibility to exit should issues occur with either tenancies or property management After 10 years the Council will always have the fall back option to provide the underlease to the Council's LLP structure.	▪ **10 Years –** risk of needing to identify a new underlessee in 10 years. This provides a risk and potential void period whilst new operator/terms are agreed. ▪ May ask for a termination clause within the 10 year agreement, which may not be commercially appropriate for the Council
	Property Services	▪ Extensive experience in managing affordable housing/homelessness tenancies as well as residential property management ▪ Regulated by the Housing Regulator and therefore subject to audits. This provides the Council with added assurance that the provision of housing services will conform with Government set standards.	Some RPs ay seek certain commercial concessions within the underlease or nominations agreement. This may relate to the lease point above where a termination clause maybe requested which may complicate matters for the Council
	Cost	▪ **£2200 - £3100 per unit per year**. The Council generates a net NPV cost reduction of c£0.300m to £0.450m.	▪ This cost is likely to be higher than other options due to the extra scrutiny on RPs.
	Homelessness Service	▪ Experience with provision of services that meets Council expectations. Some RPs have built models on	▪ The price quoted reflects core provision of property services and therefore Mears may not be incentivised to

		working with Local Government to help ease Homelessness pressures.	provide an effective homelessness service.
Independent Non-RP	**Lease Period**	▪ **10 Years** - This provides the Council and the Underlessee flexibility to exit should issues occur with either tenancies or property management After 10 years the Council will always have the fall-back option to provide the underlease to the Council's LLP structure.	▪ **10 Years -** The Council will need to go through the process of identifying a new underlessee in 10 years This provides a risk and potential void period whist a new operator/terms are agreed.
	Property Services	▪ Some Non-RPs such as Capital Letters Ltd have a business model that is directly focused on provision of homeless service. ▪ Private property management companies have a strong commercial experience of managing properties.	▪ Such organisations are not a RP and a similar level of assurance and control cannot be expected as from RP or the LLP option respectively.
	Cost	▪ **£2200 - £2700 per unit per year**. The Council generates a net NPV cost reduction of £0.300m to £0.460m.	
	Homelessness Service	▪ Few organisations are set up to provide Homelessness Service. However, Capital Letters have been set up specifically to provide homelessness service and help tenants become less reliant on state support. Their experience and skill set should ensure more households are moved out of affordable housing and into private accommodation.	▪ With the level of service focused on provision of property private property management companies may not be incentivised to provide an effective homelessness service. The level of price quoted seems to reflect property management only and does not indicate additional services would be provided. Such additional service would include, support to employment, health support and various other guidance to take a private sector tenancy.

LLP Company	**Lease Period**	▪ The Council has an option to agree a 10 year or a longer lease period. ▪ **10 Years** - This provides the Council and the Underlessee flexibility to exit should issues occur with either tenancies or property management. As the underlessee would be the LLP companies, the Council with its minority interest and existing property arrangements, is more familiar with the LLPs. ▪ **50 Years** - the possibility of entering into an upfront 50 year lease allows the Council to avoid any risks in 10 years time and also passes the risk of Lifecyle works to the LLP.	▪ **10 Years -** The Council will need to go through the process of identifying a new underlessee in 10 years. ▪ **50 year –** this may lock the Council in and reduces the flexibility to change providers.
	Property Services	▪ The LLPs currently manage 344 properties and have built up 3-5 years of experience. The RCG properties are new and therefore highly unlikely that much work will need to be undertaken in the early years and therefore this will allow the LLP to gain further experience. ▪ Gives the Council an opportunity to bid for management services which provides control to the Council to ensure suitable and industry standard provision of care to tenancies and properties.	May need additional internal resource. The Tenants may perceive the landlord as the Council and previous experiences show that this may affect the ability to achieve 100% rent collection and adversely impact the tenant and landlord relationship.
	Cost	▪ **£2000 - £2200 per unit per year.** This is the most cost-effective option and will result in the Council achieving cost reduction of £0.510m.	
	Homelessness Service		▪ The LLP has no experience of supporting households in Temporary Accommodation and will only be able to provide property and tenancy management services. Careful placement of tenants will therefore be required to ensure those with the lowest support needs are placed within these properties

6.16 Council's assessment is that a RP provides the better option as it ensures a clear distinction between key stakeholders whilst at the same time proven expertise on housing management and homelessness services is provided. The returns to the Council may be less under this option but working with an established and regulated organisation allows for assurance on tenancy and property management.

7. Mears – The Underlease

7.1 The attraction of Mears is their track record and ability to work with Local Authorities to provide temporary accommodation to alleviate homelessness and help people get back on their feet. This meets the needs of the Council for proceeding with the Regen Proposal.

7.2 Mears Group is a publicly listed company listed on the FTSE-All Share index. The company started trading in 1988 and has c5400 employees. Being a public company provides added assurance to the Council that the company will be held to a high corporate governance and commercial standards.

8. Financial Cost Benefit Analysis

8.1 The financial objective from this proposal is to generate efficiencies within the Housing service, specifically a reduction in Homelessness costs. Over the past two years the Housing services has been under pressure from increase in demand for housing support whilst at the same time faced with shortage of supply of affordable properties.

8.2 The Council's financial position is stretched and with high debt levels it makes it difficult to take on more debt to finance upfront acquisitions. Taking on a lease allows the Council to use its existing budget to pay for the lease without needing to add growth to the budgets such as additional minimum revenue provision and interest costs.

8.3 The opportunity to acquire 85 affordable units in a single development supports the need for additional homes. The financial assessment has considered the net cost of acquiring the 85 units at the RCG development versus the net costs incurred against existing arrangements. In order to ensure these homes are affordable the Council is aiming to lease them as close to Local Housing Allowance levels as possible.

8.4 The deal structure as provided in Appendix 1 shows that the land interest or use of properties will flow as indicated by the black arrow and the flow of funds by the red arrow. The Tenants will pay rent to the underlessee who will then deduct their costs for managing the properties and pay the Council a pre-agreed lease payment and the Council will then pay Regen Capital the Headlease payment.

8.5 The proposal will result in cost reductions for the Council where the properties at RCG development will be used instead of commissioning properties from the private market sector. Whilst the headlease payment is larger than the underlease income the proposal will generate a benefit to the Council due to alternative accommodation costs from private landlords being considerably higher than the net cost of this proposal.

8.6 To improve the financial viability to the Council, a proposal to uplift rates to the tenants is being considered, subject to planning approval. Outer London LHA rates are c60% of market rents and therefore if the Council can increase those rents by c10% whilst ensuring the tenants can meet their rental commitments then more income will flow to the Council. This will require the Housing team to carefully select the tenants that are placed within these properties. During the assessment stage the Council will need to ensure that the tenant can contribute towards their rent and the rest can be funded from Housing Benefits or Universal Credit.

8.7 The Council also engaged with the Greater London Authority (GLA) to seek grant funding to support the delivery of affordable housing. However, the GLA indicated that they would not be able to fund the proposal as the proposal did not meet the criteria under which grant funding can be awarded. Furthermore, the Council will not incur a Stamp Duty Land Tax (SDLT) charge as the acquisition is being carried out under planning obligations as advised by the Council's Tax Advisors PSTAX. Advice note has been provided in confidential Appendix 6.

8.8 The Lease payment and income schedule is attached in confidential Appendix 4 and a detailed financial analysis has been provided in Part B. The model compares the costs of the Regen Capital proposal versus the cost currently incurred by the Council in using the private rented sector. It is expected that a c£0.450m of costs reduction will be achieved with an additional savings in the first two years of the Headlease by way of a rent-free period.

8.9 The financial model has been attached in confidential Appendix 4. The model compares the costs of the Regen Capital proposal versus the cost currently experienced by the Council using the private rented sector. It is expected that a c£0.450m of costs reduction will be achieved with additional savings in the first two years of the Headlease by way of a lease free period.

8.10 The modelling for current temporary accommodation costs is based on best available data from the Housing Services. Whilst detailed work is ongoing to obtain the most accurate data, certain assumptions have been made to ensure an accurate reflection of the current costs. As indicated in paragraph 3.14 there are c44 households in expensive accommodation and therefore by acquiring the 85 affordable units the Council will be able to transfer households into cheaper yet excellent quality accommodation.

8.11 As the difference in cost between the Regen Capital properties and very expensive council rented properties is c£500 per week per property a total maximum cost reduction potential is £1.320m. However, there are a number of risks and potential delays that could arise from allocations and the assessment process. Identifying the right and acceptable property can take time and therefore impacts the total cost reduction achievable. The Council has taken a prudent view in light of the operational challenges and therefore projects a c£0.450m in cost reduction.

9. Alternative Options Considered

9.1 The Council considered acquiring the 85 affordable units directly. Selling part of the RCG development to the Council would have made it extremely difficult to sell the remaining part and this would have directly impacted on the values achieved.

9.2 The Council also considered buying the entire site, which would include 157 units however this was deemed not viable as the Council would not have the capacity to manage the wider site and did not have the capacity to operate and deal with the private units. Furthermore, with the Council's significant debt burden, an upfront acquisition would have meant that the Council would add to its borrowing costs through growth in Budget for Minimum Revenue Provision and Interest costs.

9.3 There are a number of benefits for the Council with the Regen Capital proposal and also some terms offered by them are more favourable than what the Council has previously been offered. The availability of homes to the Council supports Housing Services to reduce costs, provides a genuine mixed development scheme and gives the Council an opportunity to work with a new Housing partner in Mears.

9.4 Financial and operational risks are inherent with the proposal and it is imperative that these are mitigated by Housing Services in the future.

9.5 The Council also considered not taking on the Headlease, however with the increase in demand for Homelessness services and the shortage of affordable properties, it was assessed that not doing anything would be costly due to alternative accommodation costs needing to be procured at private market rates.

9.6 The proposal to enter into the Headlease and the financial assessment has been tested and reviewed with the Independent Assurance Panel set up by Central Government along with advice sought from Legal and Housing advisors in Browne Jacobson and Savills respectively.

10. Implications

10.1 Financial Implications

10.1.1. The Council's Homelessness service is facing considerable overspends against budget and in 2022/23 the service experienced a net overspend of £3.7m after adjusting for one off grant monies. The cause of this overspend relates to increase in demand for Homelessness service and the reduction in affordable homes.

10.1.2. The proposal from Regen Capital will provide affordable homes that will allow Housing Services to discharge the duty to those households whose needs are not met by the private sector. This proposal will result in a cost reduction of c£0.450m but will not result in budget savings. The receipts generated by BBB from Regen Capital will be used to pay down the loan to the Council, which will contribute towards reducing future Minimum Revenue Provision (MRP) charges to the Council.

10.1.3. The cost of acquisition is spread over 50 years via the payment of rent under the Headlease, however the Council will receive rent income under the underlease. The total cost of the Headlease will be £127.91m but the Council will receive rents from the underlease of £73.64m. This will generate a net cost of £54.57m. In addition, the Council will achieve a total cost avoidance of £43.68m over the next 50 years and will achieve a reduction of MRP costs therefore generating a net benefit of £31.61m over the 50 years.

10.1.4. The Council will retain responsibility for lifecycle and major works for the affordable blocks. The financial modelling has taken this into account and as advised by Savills a proportion of rent will be set aside annually to cover the lifecycle works when needed. The rent model has accounted for £0.030m per property over the 50 years which results in a total allocation of £9.59m and this considers the impact of inflationary increases. This will mitigate the need for the Council to find additional funds to cover lifecycle in the future.

10.1.5. An outright acquisition of the freehold interest in the 85 properties/units (which is only part of the RCG development) would have provided a better outcome, however the Council is unable to acquire part of the RCG development.

10.1.6. The Council also considered acquiring the whole of the RCG development, which would consist of 157 units. To acquire the whole of the RCG development, the Council will need to borrow to fund the acquisition, and this will result in an increase in budgets for interest and minimum revenue provision, which is something the Council cannot afford. If the Council bought these properties using PWLB borrowing over a 50-year period, assuming the private units could be sold over a 3-year period, it would have cost the Council c£106.34m at interest rates of 6.50%. Further analysis of the next benefits and net cost of this proposal has been provided in Part B.

10.1.7. The option to purchase the entire RCG development, would carry a significant level of risk that would not be appropriate for the Council to take in the current unstable macroeconomic climate. The Council would be taking on a greater financial and operational risk associated with the private properties.

10.1.8. The Council also has the option to do nothing and not pursue this proposal. Based on the review of costs currently faced by the Council for procuring properties to support Homelessness, not doing anything would cost the Council £80.2m over 50 years. This will be very costly as the Council will continue to utilise expensive private accommodation and with increase in demand for Homelessness the costs of delivering the service will only increase.

10.1.9. Further detailed analysis has been provided within Part B of the report.

10.1.10. The Council has tested the accounting of this arrangement and believes that key risks and benefits from this arrangement remains with the Council. The Council will hold 100% nominations rights and therefore will benefit by using the properties for its tenants, but at the same the Council will retain key lifecycle expenditure responsibilities for the three blocks.

10.1.11. The financial model includes an allocation of lifecycle costs and is in line with Savills report provided in Appendix 5a and 5b. It would be recommended that proportion of lifecycle costs is transferred to a lifecycle reserve annually. This fund could be drawn down when needed to fund the necessary costs. Alternatively, the Council could take the contribution as revenue gains and identify an alternative capital resource when lifecycle works need to be carried out.

10.1.12. The Council will also need to provide some furnishings for the 85 units and these will be funded from various Housing support grants the Council receives from Central Government and will not cost more than £0.160m. This will have no financial impact as these grants are used as part of ongoing placements in the private sector where needed. The need for furnishing will only apply to affordable units as the shared and private units have most furnishing fitted as part of the build.

10.1.13. Under Accounting regulation, SIC-27 the entity that retains the risk and reward is required to hold the assets and liabilities on their balance sheet. This applies to the Council under this proposal and the assessment agrees with the independent assessment carried out by the Underlessee.

Comments approved by the Sarah Attwood - Head of Finance Date 06/07/2023

10.2 Legal Implications

10.2.1. The recommendations in this report seek to support the discharge of the Council's duties under Section 8 'Periodical review of housing needs' and of the Housing Act 1985 and Part 7 'Homelessness' of the Housing Act 1996, in which the Council is required to consider housing conditions and needs within the Borough including addressing homelessness.

10.2.2. The Council has various powers to acquire and dispose of properties, including to discharge statutory duties. Of particular relevance are the following provisions:

10.2.3. Section 9 ‘Provision of Housing Accommodation’ of the Housing Act 1985, under which the Council has the power to provide housing accommodation by acquiring houses (including flats). These powers may equally be exercised in relation to land acquired for the purpose (a) of disposing of houses provided, or to be provided, on the land, or (b) of disposing of the land to a person who intends to provide housing accommodation on it.

10.2.4. Section 17 ‘Acquisition of land for housing purposes’ of the Housing Act 1985, under which the Council has the power to acquire houses, or buildings which may be made suitable as houses, together with any land occupied with the houses or buildings. This includes power to acquire land for the purpose of disposing of houses provided, or to be provided, on the land or of disposing of the land to a person who intends to provide housing accommodation.

10.2.5. Section 120 ‘Acquisition of land by agreement by principal councils’ of the Local Government Act 1972, under which the Council has the power to acquire land to enable the fulfilment of its functions (in this case housing functions).

10.2.6. Section 12 ‘power to invest’ of the Local Government Act 2003 and the Council’s powers to invest for any purpose relevant to its statutory functions or for the purposes of prudent management of its financial affairs.

10.2.7. The Council is under a duty not to dispose of land, otherwise than by way of a short tenancy, for a consideration less than the best that can reasonably be obtained other than with the consent of the Secretary of State (SoS). A short tenancy for these purposes is where the lease term is 7 years or less (which is therefore not applicable here in respect to the 10 year lease to Mears). The duty does not require a particular disposal process to be followed (including e.g. seeking offers) and therefore it is the outcome that is important. A general consent is in place (avoiding the need to seek SoS consent) where the local authority considers that the purpose for which the land is to be disposed is likely to contribute to the achievement of any one or more of: (i) the promotion or improvement of economic well-being; (ii) the promotion or improvement of social well-being; (iii) the promotion or improvement of environmental well-being; and the “undervalue” (i.e. the difference between the unrestricted value of the interest to be disposed of and the consideration accepted) is £2,000,000 or less. However, in the context of the proposed transaction, the Council has taken valuation advice from Savills which concludes that the transaction (taken as a whole) “*would not appear to be out of kilter with the market, save for the unusual 5-year “ratchet” mechanism within the headlease and the “fixing" of indexation within the lease. In fact, there are aspects of the proposed financial arrangements that would appear to generate value compared to other similar sorts of offers in the market, in particular what we have interpreted as the expected net initial yield*.” Notwithstanding the caveats made, this advice supports a conclusion that in overall terms the transaction satisfies the “best consideration” requirement. In relation to the underlease to Mears, the report explains why they are a suitable counter-party and notwithstanding a financial offer made by Capital Letters. The s123 duty does not oblige seeking alternative offers where other factors relevant to the overall "consideration" are demonstrated (including the nature and relevance of the Mears business model and their consequent ability to meet tenant obligations under the lease), and on the basis that their offer is within the scope of what would ordinarily be expected in the market.

9.2.7 In conjunction with these statutory provisions, the Council may rely upon the General Power of Competence ("general power") provided for in Section 1 of the Localism Act 2011. The general power is a wide power which allows the Council to do anything that an individual may do (subject to public law principles), but it is subject to certain statutory limitations. There is no statutory limitation in relation to this exercise of the general power in this context. As mentioned, the Housing Act 1985 impose a duty on local authorities to review housing needs in their district and provides them with related powers to provide housing accommodation. These powers can include provision via third parties. As such, this further statutory duty remains relevant and supports the decisions being taken.

9.2.8 Whilst therefore the Council has sufficient statutory powers to pursue the recommended scheme, the Council is nonetheless under a fiduciary duty. It must be prudent in its use of public funds and base its decision on all relevant facts (disregarding irrelevant ones), acting in a rational manner. This means, in practice, that the Council should be generally satisfied that the arrangements described in this report are capable of rational justification in that sense. Section 7 of this report sets out the financial cost benefit analysis of the recommendations in this report.

9.2.9 The Council also needs to have regard to the Subsidy Control Act 2022 which came into force on the 4 January 2023 in order to ensure no subsidy is passed on to Regen Capital or Mears as a result of the transaction. The easiest practical way of doing this is to ensure that the transaction is on market terms. The regime under the Act introduces a concept of the "commercial market operator" which acts in a similar way to the previous "market economy operator principle" in the EU State aid regime. Therefore, provided the Council ensures the transaction is on terms that would be acceptable to a prudent private sector investor in the same circumstances and disregarding any public sector benefits, there will be no subsidy. Given the way in which the transaction has been put together on arms' length terms and assessed against other options available, the Council's external solicitors, Browne Jacobson confirm that no unlawful subsidy is present.

9.2.10 The Council is also under a general Duty of Best Value to make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness (Section 3 of the Local Government Act 1999 (as amended by s137 of the Local Government & Public Involvement in Health Act 2007)).

9.2.11 Further legal advice is included within the external legal advice note, at confidential Appendix 3.

Comments approved by the Head of Commercial & Property Law on behalf of the Director of Legal Services and Monitoring Officer. (Date 13/07/2023)

10.3 Equalities Implications

9.3.1 The Council has a statutory duty to comply with the provisions set out in Sec 149 of the Equality Act 2010. The Council must therefore have due regard to:

(a) eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under this Act.
(b) advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it.
(c) foster good relations between persons who share a relevant protected characteristic and persons who do not share it.

9.3.2. An equality analysis has been carried out it identified a positive impact for residents of all characteristics in respect of alternative housing. However, there may be a potentially negative impact for all characteristics in that it will be necessary to move to Coulsdon. There is a negative impact for disabled residents in that the properties in Coulsdon may not be suitable for some disabled people. In mitigation the department will engage and seek agreement from each household in line with homelessness legislation. Alternative accommodation will be sought for disabled residents who are unable to move to the accommodation in Coulsdon.

9.3.2 The department will continue to consider equality implications throughout the duration of the project including the needs of disabled residents affected through any transitions.

Comments approved by Denise McCausland Equalities Programme Manager. Date 08/06/23

10.4 HR Implications

10.4.1. There are no HR implications arising from this report.

Approved by: Gillian Bevan, Head of HR, Resources and Assistant Chief Executive Directorates, on behalf of the Chief People Officer. (Date: 09/06/2023)

11. Background documents

11.1 Brick by Brick Croydon Ltd Update Report – **30th November 2022**

12. Appendices

Appendix 1 – Property Deal Structure
Appendix 2 – Valuation from BBB – Confidential
Appendix 3 – Legal Advice – Confidential
Appendix 4 – Lease schedules - Confidential
Appendix 5a – Initial Savills Commercial Advice - Confidential
Appendix 5b – Updated formal Savills Commercial Advice - Confidential

Appendix 6 – PSTAX SDLT Advice – Confidential