


Executive Decision Report

A10

Decision maker(s) at each authority and date of Cabinet meeting, Cabinet Member meeting or (in the case of individual Cabinet Member decisions) the earliest date the decision will be taken	Full Cabinet Date of decision (i.e. not before): 16 th July 2015 Forward Plan reference: KD04592/15/K/AB	 THE ROYAL BOROUGH OF KENSINGTON AND CHELSEA
	Date of meeting or formal issue(i.e. not before): 16th July 2015	
Report title (decision subject)	BUSINESS CASE FOR PURCHASING PROPERTIES FOR THE PROVISION OF TEMPORARY ACCOMMODATION	
Reporting officer	Laura Johnson, Director of Housing	
Key decision	Yes	
Access to information classification	Public Part A with Private Part B appendices	

1.0 EXECUTIVE SUMMARY

- 1.1 The Council housed 1859 households in Temporary Accommodation (TA) at the end of April 2015 and faces increasing challenges in procuring a stable supply of good quality TA at the required levels and at affordable rates. This poses significant reputational and financial risks and undermines the Council's ability to deliver its statutory housing responsibilities. As a result of these cost pressures, the TA budget for 2015/16 has been increased by £1 million; the need for further budget increases should be anticipated in future years.
- 1.2 Officers have undertaken considerable research which has identified a number of areas where a financial business case could be made to purchase properties on the private market for the provision of TA. These properties would be held in the General Fund. This would help to improve quality, increase supply, offer stability to homeless households and contain costs.
- 1.3 It is recommended that the Council agree an initial budget of £10m to purchase such properties and that delegated authority be given to the Director of Housing to proceed with these transactions.
- 1.4 A business plan has been developed that sets out an operating model for the purchase of the properties. Benefits are anticipated from an operating surplus, avoiding costs that would otherwise arise and capital appreciation. Details are set out in Appendix 1.
- 1.5 Acquiring a portfolio of permanent properties can enable the Council to provide and control suitable quality accommodation for homeless households, reduce the risk of legal challenge and help contain the increasing costs of procuring TA.
- 1.6 Whilst purchasing properties with a budget of £10m would not eradicate the reputational and financial risks the Council faces in securing quality TA, it will enable the Council to diversify this risk.
- 1.7 The Council would own and control these assets, that if maintained properly would appreciate in value based on historical house price inflation trends.
- 1.8 A number of other boroughs have started to invest in the private housing market for the provision of TA. Enfield has agreed a credit facility of £100m; Oxford has identified £10m provision; Ealing is seeking to purchase 83 properties at £21m and both Croydon and Westminster are purchasing properties.

2.0 RECOMMENDATIONS

- 2.1 Authorise the Director of Housing to acquire properties on the open market for the purpose of providing TA, at a maximum cost of £10m,

including the purchase price, initial repairs and refurbishment and acquisition costs on the basis set out in the business plan. The maximum price of £450,000 per property will be applied.

- 2.2 To agree that provision of £10m be included in the Capital Programme for the purchase of such properties. This will be funded through internal borrowing. The majority of the budget is likely to be spent in 2016/17.
- 2.3 Authorise the Director of Housing to select an agent to identify and acquire the properties.
- 2.4 Authorise the Director of Housing to invite and evaluate tenders for the management and repair of properties to be used for TA.
- 2.5 Authorise the Director of Housing to agree the acquisition of individual properties, subject to a maximum purchase price of £450,000 per property and subject to a satisfactory legal report on title.

3.0 BACKGROUND

- 3.1 Officers have been considering options for increasing the number of properties the Council can access in order to:
 - Secure a sufficient supply of good quality TA at a time when it is becoming increasingly difficult to source – our supply of new properties has reduced in recent months, averaging 20 new properties per month since April 2014, compared to over 30 every month since January 2013; recently we have also seen the number of families in Bed and Breakfast start to rise again and there are currently 9 households residing there;
 - Have more flexibility and firmer control of how long we use properties for TA for as opposed to our current 28 day leasing arrangements that are easy for the landlord and agents to give notice on. Currently there are over 116 units that landlords want back and with one specific supplier we have seen our portfolio fall from over 100 properties to just 16 since April 2012; there is a need to offer more stability to households in TA;
 - Address the projected reduction in the number of in-borough TA units as a result of the Cale Street redevelopment (83 units), the loss of HALS¹ properties (200 units), and the potential change of use of HRA hostels (70 units);
 - Reduce and diversify the financial risk to the Council associated with accommodating households in TA;
 - Reduce the overall number of households living in TA in the medium term, which has been rising consistently since April 2010 until recently, by discharging our housing duty into the private rented sector;

¹ Housing Association Leasing Scheme

- Procure difficult to obtain / bespoke properties. It is very difficult to procure TA units that are suitable for wheelchair users, or households with specific requirements. We could purchase individual units that could meet these needs.

4.0 BENEFITS IN PURCHASING PROPERTIES

4.1 There are a number of benefits:

- **Quality and stability** - increasing the supply of good quality stable TA for homeless households.
- **Available stock** - there is a supply of homes which are financially viable within the Greater London area at an acceptable distance from the borough.
- **Quicker than other options** - as the homes already exist this portfolio can be acquired in a relatively short period. It is estimated that within our target areas a portfolio of 39 homes could be achieved within 18 – 24 months.
- **Long term asset value** - the homes build up a long term asset value which can be sold at the end of the project and any appreciation in value realised or the properties could be transferred internally for other accommodation uses.
- **Potential to reduce operating costs** - the business plan has taken a cautious assumption on running costs, levels of voids and repairs which are all higher than the industry norm. Good quality management will reduce these and improve performance.
- **Greater ability to plan financially for the future** - costs are under the Council's control and spend relating to these properties can be more accurately predicted. See Appendix 1 for a financial summary of the business plan performance.
- **Flexible and Simple to exit** - the properties can be used at the discretion of the Council.
- **It helps to contain costs and diversify the financial risks** - housing these households in alternative accommodation within the private sector will result in net costs to the Council of at least £600,000 over a 5 year period. The actual costs would depend upon the inflation experienced on rent levels over this period.

5.0 BUSINESS PLAN MODELLING

5.1 Business Plan Assumptions

5.1.1 The table below outlines the business plan assumptions used in creating the model for the Council. Explanatory notes are set out in Appendix 2.

RBKC - Business Plan Assumptions

Description	Assumption	Notes
<u>Generic BP Assumptions</u>		
Business Plan years	5	1
Discount rate to be used	5.00%	2
Interest rate to be charged on debt	2.82%	3
Depreciation	0.00%	4
Rent increase	0.00%	5
Cost inflation	2.50%	6
House price inflation	3.00%	7
Disposal percentage	97.50%	8
Minimum Revenue Provision Required	2.00%	9
Forecast Annum Increase in HB Loss	4.00%	10
<u>Acquisition Assumptions</u>		
Stamp Duty Rates	As per Latest rates	11
Refurbishment / Fit out costs	2.75%	12
Acquisition Fees	1.75%	13
VAT Rate - Assume 50% Irrecoverable	20.00%	14
<u>Running Costs</u>		
Voids in year 1	5.00%	15
Voids thereafter	2.50%	15
Ground rents/service charges per annum	£800	16
Day to day management per annum	£1,000	17
Day to day maintenance per annum	£1,000	17
Bad debt provision	2.50%	15
Capitalized Investment	£7.5k per plot Every 5 years From year 6	18

5.2 Areas Selected and Performance

5.2.1 It was agreed that a number of locations would be considered within London, the M25 area and the southern counties to assess the level of properties available in each area and their performance.

5.2.2 The criteria used to investigate the areas were as follows:

1. Affordability and performance of properties (rent calculated at 90% of LHA and £40 admin subsidy)
2. Ability to manage
3. Historic house price inflation averages
4. Local amenities
5. Distance and travel times to RBKC offices.

5.2.3 The best performing areas are predictably outside of London; however these areas are the furthest away from RBKC and the preference is to try and place households within Greater London and the M25 corridor.

5.2.4 The next best performing areas were in outer London, particularly in East London and in some areas of South London. These areas are considered acceptable in respect of time and distance from the borough and therefore the business plan has been created using data on house prices and potential rental income from these areas.

5.3 What the Business Plan Models - Units to Be Purchased

5.3.1 The analysis showed that £10m could purchase up to 39 properties, consisting of 27 2 bed properties and 12 3 bed properties in these areas.

5.3.2 This is indicative of what the £10m could purchase and is not set in stone and it is recommended that the performance of each property is analysed as part of the due diligence exercise during the purchasing stage of the business plan.

5.4 Rental Levels

5.4.1 It was agreed that the business plan would be modelled on 90% of the January 2011 Local Housing Allowance (LHA) rates plus a management fee of £40 per week, as this is the existing TA subsidy level. A maximum rent level of £375 per week was agreed as this is the TA subsidy cap in the outer London areas, which equates to c£19,500 per annum.

5.4.2 It is anticipated that the LHA rates could increase in the future, particularly in the East London area and this could lead to an improved return on any investment.

6.0 BUSINESS PLAN PERFORMANCE

6.1 Acquisition Costs

6.1.1 The breakdown of the acquisition costs in relation to the £10m budget is attached at Appendix 3.

6.1.2 The total cost of acquiring 39 units in the locations selected will be c£9.7m, leaving a balance of c£300k for potential abortive costs and project management during the acquisition stage.

6.2 5 Year Business Plan Results

- 6.2.1 A detailed Business Plan has been produced which considers the financial implications that could arise from purchasing properties for TA purposes and the financial analysis is set out in Appendix 1.
- 6.2.2 The business plan assumes that at the end of the programme the properties would be disposed of at market value. This repays the loan with a potential profit to offset the costs of the project. The Business Plan has included fee costs for that disposal and renovation costs needed to achieve a sale. However it could be that it would be more advantageous to keep the properties for other forms of accommodation.
- 6.2.3 This is a cautious model of the savings achievable but indicates that the Council could reduce revenue costs on TA by approximately £600,000 over five years. This is based upon a portfolio of 39 homes with a mix of 27 x 2 bed homes and 12 x 3 bed homes.

7.0 IMPLEMENTING THE BUSINESS PLAN

- 7.1 The Council would need to ensure that there are effective processes in place for identifying potential property purchases and their subsequent management. A number of considerations are set out in the section below.
- 7.2 The Council, like most other authorities, has signed an agreement with central government that allows it to retain the majority of additional receipts arising from Right to Buy sales. Following the increases to discounts available, the number of RTB sales has increased significantly. However, the conditions within the agreement are proving onerous, in particular the restrictions on timescales. The Council has therefore sought legal advice which broadly supports these property purchases being counted towards the affordable housing target within the agreement.

7.3 Criteria for Purchasing Properties:

- 7.3.1 The following criteria would be used in purchasing properties:
- Property availability
 - Ability to cover revenue costs and when taking into account cost avoided deliver an annual revenue return on the investment where possible
 - Potential capital return
 - 2 and 3 bedroom properties
 - Accessibility from and within London – within the M25 corridor
 - Local Authority support

- Population and ethnicity (properties should be selected where possible in areas that are representative of the different types of households accessing TA)
- Services and employment opportunities (schools, hospitals, transport, jobs).

7.4 Property Locations

7.4.1 The market research has identified a sufficient range of properties within a price range of £200,000- £450,000, to ensure we can purchase sufficient numbers to achieve the full portfolio.

7.4.2 The research has also confirmed that it is not possible to purchase properties within central London given the high values. The only time this would occur would be if a bespoke solution was needed for a household and this was supported by a financial business case. Within the borough we would target ex right to buy properties, especially on our regeneration estates where properties have at least a five year life.

7.4.3 The intention is to purchase property within Greater London wherever possible.

7.5 Rents to be Charged to TA Budgets

7.5.1 Rents will be set at the TA Housing Subsidy levels enabling the rental charge to be fully met by Housing subsidy.

7.6 Funding Capital and Start Up Costs

7.6.1 It is anticipated that one off costs of £2,000 would be needed for each individual property purchased to ensure that these were of a satisfactory quality to let and to provide basic facilities such as white goods. Thereafter repairs, maintenance costs and voids works and a contribution towards a sinking fund would be included within the management costs. Additional capital costs would also be incurred for the acquisitions e.g. stamp duty.

7.7 Managing the Stock

7.7.1 The Council could choose to manage the purchased stock directly or could contract with an intermediary to oversee the management of the properties. Corporate Property Services has a framework of suppliers that could be used.

7.7.2 The Housing Department also currently uses a range of agents to procure and manage TA and this includes both Registered Providers and Lettings Agents. These providers have a strong track record in working with households who traditionally use TA. We are therefore confident that there is a market with agents that have both the

expertise in housing management and the experience of working with this customer group.

7.7.3 Management costs could be in the region of 15 - 20% depending on the model being used; this includes allowances for voids, bad debts and ongoing capital and maintenance costs.

7.8 Allocating the Properties

7.8.1 Properties will be targeted at households in the greatest housing need and those with the largest shortfall on meeting their rent.

8.0 TIMETABLE FOR IMPLEMENTATION

8.1 The timetable for implementation is set out below

Action	Timeline
KDR Agreed	July 2015
Agent selected to acquire properties	July 2015
3 rd party management arrangement agreed	September 2015
Purchasing of properties commences	October 2015
First occupant into the first property	March 2016
50% of portfolio acquired	December 2016
Business plan evaluated	December 2016
100% of portfolio	July 2017
Project Review – assess performance of the properties and make recommendations on scope for continuing/expanding the project	July 2017
End of 5 year business planning period and option to stop scheme or continue if still needed	October 2021

9.0 FINANCIAL IMPLICATIONS

9.1 Temporary Accommodation Costs

9.1.1 Currently the Council spends approximately £25m (gross) per year on TA; the tenants are responsible for the rent which is recharged to them. There are effective income recovery arrangements in place for collecting this.

9.1.2 Prior to the introduction of the benefit cap, where tenants were entitled to Housing Benefit (HB), their TA costs could be fully recovered through HB or HB and tenant contributions where HB did not cover the full cost.

- 9.1.3 The Borough has a successful track record in negotiating rents well within the TA subsidy levels and historically this has in fact generated a surplus for the General Fund. It is becoming increasingly difficult to contain these costs given the wider housing market pressures, the dominance of nightly lets and the increased costs of private rented accommodation across the capital.
- 9.1.4 The level of surplus is expected to continue to reduce as rent levels increase and the benefit cap takes effect where Discretionary Housing Payments (DHPs) are no longer available to assist households with shortfalls in their rent payments. Anticipating this worsening of the financial position, the TA budget was increased by £1m as part of the 2015/16 budget setting process. The need for further budgetary increases should be anticipated in future years.
- 9.1.5 The future TA subsidy regime for households has not yet been confirmed. We believe the new regime is likely to be confirmed soon and is expected to improve the position for out of borough properties but not those in borough; overall it may not change the financial outlook on TA.

9.2 Comments by the Director of Finance

- 9.2.1 The purchase of residential property for temporary accommodation is capital spending. Under statute and regulation local authorities are required to fund capital spending in full and there are only two sources for this – capital receipts (income from the sale of assets) and/or revenue. Revenue can be funded either from existing revenue (within the revenue budget or from reserves) or from borrowing (which can be internal or external).
- 9.2.2 The Council is currently at the existing limit set for reserve releases for capital investment and therefore would need to fund this capital spending from borrowing.
- 9.2.3 Internal borrowing is the first resort as the Council currently holds substantial cash balances available to spend. The interest cost of internal borrowing is the loss of investment income. The Council currently gets a return of around 0.3 per cent on cash investments.
- 9.2.4 The cost of the capital investment is a real revenue cost which will be funded from the revenue budget.
- 9.2.5 The Council is also exposed to future changes in the residential property market both up and down.
- 9.2.6 This cost of capital investment may or may not be offset (in balance sheet but not cash terms) by positive changes in capital value of the

assets or by additional increases in the market rents saved by the Council being able to provide its own temporary accommodation.

9.3 Business Plan

9.3.1 A high level summary of the financial implications arising from the Business Plan is provided at Appendix 1.

10.0 LEGAL IMPLICATIONS

10.1 The Director of Law comments that external legal advice has been received, advising that the Council can rely upon the general power of competence in S. 1 of the Localism Act 2011 to acquire properties and provide temporary accommodation. The Council is not able to use Housing Act powers, as these would require the properties to be held in the Housing Revenue Account.

10.2 If it is proposed to acquire leasehold properties, the Council will need to be satisfied that they can easily be sold on, if the scheme is brought to an end. Factors to be taken into account include lease length, and any restrictions on assignment or subletting.

10.3 Legal comments added by David Walker, Principal Solicitor 020 7361 2211

11.0 SUSTAINABILITY

11.1 The proposal is neutral in terms of sustainability.

12.0 RISK MANAGEMENT

12.1 The Council already faces serious financial and reputational risks both to its General Fund revenue from the increasing costs of TA provision and from the problems this presents in procuring appropriate quality accommodation in ever more distant locations outside the Royal Borough. This includes the increasing risk of a legal challenge where we are unable to place a household or place them in unsuitable accommodation.

12.2 If the Council were to purchase properties on the open market to deliver TA this would primarily need to be outside of the Borough and will pose some reputational risks that will need to be managed. This would be in effect a diversification of the existing risks we face in relation to the provision of TA; whilst the overall financial and supply risks remain, the purchase of properties will allow us to make some inroads in starting to manage these.

12.3 A summary of the key risks is set out below.

Risk	Mitigation
The General Fund may not be able to purchase sufficient properties to meet TA needs.	The requirement for TA is predicted to rise; any contribution that the General Fund portfolio can make to meet this need and limit its cost will benefit the borough.
Objections from the host local authorities for the placement of a large number of TA households in their borough.	The units purchased will be existing market stock, and used on a Private Rented Sector (PRS) basis, not distorting the market locally. The Council already places households into TA in other local authority Areas and this would not be a departure from current practice. The Council will continue to liaise with other local Authorities under the terms of the Pan London arrangements.
Other local authorities are looking to purchase properties and this may increase prices in target areas.	Market research will be reviewed on a regular basis to inform the acquisition plan and target areas.
Bad debts and arrears.	Universal credit will end direct payments to landlords increasing the risks of arrears. The TA Income Team has a positive track record in managing arrears management and a proactive approach will be taken.
Welfare reform changes.	The properties will be targeted at households that are exempt from the overall benefits cap and affordability should be at acceptable levels.
The regulations around TA and HB may change in future, and the rationale for the use of these units as TA may fall away.	Demand for housing within the M25 will not decrease, and the General Fund can market rent or sell on the units in the event that the need for TA changes.

<p>Management of units at a distance may prove difficult, and cause problems for residents and result in reputational damage to the Council.</p>	<p>Housing has been procuring TA outside the Borough and outside London for some time, and has an excellent track record of protecting residents' wellbeing through working with agents of proven reputation and setting high standards.</p> <p>Third party agents could be used as managing agents to ensure that properties are maintained to a high standard mitigating any reputational risks to the Council.</p> <p>License agreements will stipulate the responsibilities of households in maintaining their property to an appropriate standard.</p>
<p>The business plan modeling is inaccurate and does not provide a sound operating model for acquiring properties.</p>	<p>The business plan reflects a prudent level of running costs which includes a realistic allowance for void loss. It is a cautious business plan model to ensure that the decision to proceed is not made on optimistic assumptions. The Council has the ability to stop the project and dispose of the properties or to use them for a different client group.</p> <p>The business plan will be updated as acquisitions are made so that there is an ongoing evaluation of its performance.</p>
<p>Potential collapse in the need for TA.</p>	<p>There has been an increasing need for TA in the last 5 years. Even if the number of presentations did stabilise or decrease there is a need to sustain an ongoing supply of new TA to meet wider TA market pressures and potential decant needs arising from regeneration schemes.</p> <p>In the event that these properties were not required they could be</p>

	<p>used to discharge statutory housing duties to households for permanent accommodation or be disposed of.</p> <p>Properties could also be let at market rents.</p>
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13.0 CONSULTATION

13.1 No external consultation has been undertaken

14.0 EQUALITY IMPLICATIONS

14.1 There are no equality implications.

15.0 CONCLUSIONS

- The Council needs to develop new options for securing and maintaining an increase in the supply of affordable quality TA at stable supply levels. Maintaining an 'As Is' approach will not guarantee any increase in supply, allowing us to discharge our statutory housing responsibilities and achieve wider estate regeneration ambitions which require properties for decant purposes.
- The Council is now exposed to an increasing financial risk in terms of TA costs; expenditure is now exceeding the rental income that can be charged for these properties. A budget increase of £1m has recently been agreed. This situation is likely to worsen if we are not able to develop new strategies for increasing supply and containing costs.
- Purchasing properties on the private market will allow the Council to make positive progress in securing quality accommodation whilst containing TA costs and generating potential positive capital and revenue returns in the future.
- £10m will support the purchase of 39 units in the identified areas within Greater London.
- The Council will have control and management over these assets.
- Given the fast pace of the housing market delegated authority will need to be given to officers to ensure that purchases can proceed in a timely manner; any purchase will have to be agreed by the Director of Housing.

Laura Johnson
Director of Housing

Background papers:

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