FORM 2

SHEFFIELD CITY COUNCIL

Cabinet Report

Report of:	Executive Director (Place)
Report to:	Cabinet
Date:	17 September 2014
Subject:	Disposal of sites for Affordable Homes Programme
Author of Report:	Dave Mason (27 35349)
Key Decision:	YES
Reason Key Decision:	Affects 2 or more wards

Summary:

The Homes & Communities Agency (HCA) recently announced the initial grant allocations from the Government's Affordable Homes Programme 2015/18 (AHP). Local Registered Providers (RPs) have, with the City Council's support, secured funding for 350 affordable homes in Sheffield (see Appendix A). Only just over half of the AHP funding has been allocated to date, with the remainder to be allocated later through the HCA's Continuous Market Engagement process, for which further schemes will be proposed in Sheffield. Some of the AHP schemes are proposed for Council-owned land.

This report considers the continued disposal of Council sites to RPs in the context of the alternative options, in particular retention for new build council housing. It also examines the evolving lease terms required by RPs, specifically mortgagee exclusion clauses, and recommends that the Council accepts a small measure of risk in order to unlock approximately 20% additional development capacity within the local RP sector.

Reasons for Recommendations:

The 2013 Strategic Housing Market Assessment identified an annual requirement for 725 affordable homes in addition to the projected supply. Whilst the Council is embarking on a Stock Increase Programme for Council Housing, the HRA does not have sufficient resources to meet the projected need for affordable housing. Further investment is required from Registered Providers and the HCA.

As grant funding to RPs reduces, they must look to maximise the potential of their existing asset base to realise additional resources for new affordable housing supply. By accepting a small measure of risk in granting RPs' requests for mortgagee exclusion clauses, the Council would increase RP development capacity by 20% at no financial cost to itself.

The Council's emerging Housing Delivery Investment Plan is designed to accelerate total housing delivery across all sectors. Removing restrictions on mortgagees as a barrier to delivery would significantly improve delivery within the social sector.

Recommendations:

R1 That Cabinet notes the ongoing issues regarding securing development finance for affordable housing and supports the principle of assisting Registered Providers where appropriate by offering flexibility around mortgagee exclusion clauses.

R2 That Cabinet supports the requests from RPs for mortgagee exclusion clauses on the schemes named in Section 6.12 of this report subject in the case of new disposals to the RP entering into an agreement for lease with the lease to be granted upon completion of the construction and that the Director of Capital & Major Projects be authorised to negotiate or renegotiate terms for the leases as appropriate and to instruct the Director of Legal and Governance to complete the necessary legal documentation.

R3 That the Director of Capital & Major Projects, in consultation with the Director of Regeneration & Development Services and the Cabinet Member for Homes and Regeneration, in relation to social housing sites that have previously been disposed of by way of a long lease, be authorised to consider and where appropriate agree future requests from Registered Providers to vary the terms of those leases to include mortgagee exclusion clauses and to instruct the Director of Legal and Governance to complete the necessary legal documentation.

Background Papers:

Category of Report: **OPEN**

Statutory and Council Policy Checklist

Financial Implications
NO Cleared by: Paul Schofield
Legal Implications
YES Cleared by: David Blackburn
Equality of Opportunity Implications
YES Cleared by: Ian Oldershaw
Tackling Health Inequalities Implications
NO
Human Rights Implications
NO
Environmental and Sustainability implications
NO
Economic Impact
NO
Community Safety Implications
NO
Human Resources Implications
NO
Property Implications
YES
Area(s) Affected
ALL
Relevant Cabinet Portfolio Lead
Cabinet Member for Homes and Regeneration
Relevant Scrutiny Committee
Safer and Stronger Communities
Is the item a matter which is reserved for approval by the City Council?
NO
Press Release
YES

REPORT TO CABINET

DISPOSAL OF SITES FOR THE AFFORDABLE HOMES PROGRAMME

1.0 SUMMARY

1.1 The Homes & Communities Agency (HCA) recently announced the initial grant allocations from the Government's Affordable Homes Programme 2015/18 (AHP). Local Registered Providers (RPs) have, with the City Council's support, secured funding for 350 affordable homes in Sheffield (see Appendix A). Only just over half of the AHP funding has been allocated to date, with the remainder to be allocated later through the HCA's Continuous Market Engagement process, for which further schemes will be proposed in Sheffield. Some of the AHP schemes are proposed for Council-owned land.

1.2 This report considers the continued disposal of Council sites to RPs in the context of the alternative options, in particular retention for new build council housing. It also examines the evolving lease terms required by RPs, specifically mortgagee exclusion clauses, and recommends that the Council accepts a small measure of risk in order to unlock approximately 20% additional development capacity within the local RP sector.

2.0 WHAT DOES THIS MEAN FOR SHEFFIELD PEOPLE

2.1 The 2013 Strategic Housing Market Assessment identified an annual shortfall of 725 homes within Sheffield, in addition to those already projected to be provided through the Affordable Homes Programme. Assisting local Registered Providers in maximising their development capacity will help narrow this gap.

3.0 OUTCOME AND SUSTAINABILITY

3.1 The recommended approach regarding mortgagee exclusion clauses would enable RPs to continue to generate development finance to deliver further affordable housing to help meet projected future need.

4.0 AFFORDABLE HOMES PROGRAMME

4.1 For many years, the Council has worked with local housing associations, currently known as Registered Providers, to secure capital funding from the Government for new affordable housing. Over the last 30 years since the Council ceased to build houses on a significant scale, most of the new social housing built in Sheffield has been provided by housing associations on land sold to them by the City Council at a nominal value.

4.2 However, with the arrival of the self-financing Housing Revenue Account and plans developing for a programme of new build Council housing, disposal of Council land to Registered Providers is no longer the default option for affordable housing delivery on Council-owned land. Now, where there is a proposal to dispose of land at nominal value to facilitate social housing, this must be evaluated against the alternative of retaining for new Council housing.

5.0 DISPOSAL TO RPs vs NEW COUNCIL HOUSING

5.1 Now that the Council is in a position to develop new housing again, the advantages of retention of land for Council housing are clear. Firstly, the Council maintains full control of the social housing asset, both its design and its use during its lifetime. Secondly, the Council retains the value of the property asset, both the land that the houses are built on and the homes themselves, which will generate income for the Housing Revenue Account. However, with an identified shortfall of 725 affordable homes each year, it is necessary to maximise the potential funding streams for affordable housing coming into the city, whether from the Council's HRA or local RPs bringing in their own funding along with HCA grant.

5.2 In this context, the question is not whether one route is preferable to the other, but how best to employ all of the available resources to maximise affordable housing delivery. This is being considered as part of the emerging Housing Delivery Investment Plan, which will outline the proposed delivery routes for all tenures on key housing sites across the city. The answer for affordable housing depends on a variety of factors, including location, ease of neighbourhood management, specialisms of different providers, tenure mix, site assembly and the relative consequences of Right to Buy set against the Right to Acquire.

5.3 The housing association equivalent of the Right to Buy is the Right to Acquire, for which there is a fixed discount of £10,000 (in Sheffield). Under Right to Buy, the minimum discount on Council properties is 35% after 5 years as a qualifying tenant, rising to a maximum of 70%, capped at £77,000, over a further 35 year period. The 'cost-floor rule' means that, for the first 15 years after completion, a Council tenant cannot purchase their home for less than it cost to build, but after 15 years the appropriate discount will be applied.

5.4 The discount available on Council homes through Right to Buy is significantly more generous than that available on housing association properties under Right to Acquire. Therefore, despite the cost-floor rule, if the Council builds properties rather than an RP, it is more likely that those units will eventually be bought by tenants and lost to the social sector. This needs to be balanced against RPs' recent requests for mortgagee exclusion clauses in leases from the Council.

6.0 FINANCING AFFORDABLE HOUSING

6.1 Commonly, RPs do not borrow against properties they are planning to build in order to finance the building of them. More often, they use borrowing secured in advance, against their existing stock, to fund the development of new properties. Given that grant funding rates have more than halved in recent years, RPs need to "sweat their assets" and maximise borrowing to continue developing. Therefore, in order to maintain their development capacity, RPs need to ensure that any new properties they build can themselves be borrowed against to fund future development. They also need to ensure that the money they can raise against those properties is maximised and the cost of finance is reduced as far as possible.

Valuations of social housing

6.2 The higher the value given to a social housing property by a lender, the more the RP can borrow against it, and so the more additional properties they are able to develop using the borrowing raised. Therefore, it is in RPs' interest to secure a higher valuation for their stock.

6.3 Social housing is generally valued at either EUV-SH (Existing Use Value – Social Housing) or MV-STT (Market Value – Subject To Tenancy). The latter is still significantly less than Open Market Value, because it is subject to the lifetime tenancy held by the resident. However, it is significantly higher than EUV-SH.

6.4 Whether the lender ascribes EUV-ST or MV-STT to a property depends on the terms under which that property is held by the RP – for example, the terms of a long lease of the land from the Council. The key factor is the freedom that the lender has to dispose of the property in the unlikely event that the RP defaults on its loan. If there is an unconditional restriction on the use of the property as social housing that continues to apply in that event, then the lender will not generally ascribe anything more than EUV-SH, thus limiting the RP's development capacity.

6.5 In order to lend at MV-STT, lenders require a mortgagee exclusion clause that allows them to dispose of the property with minimal conditions in the event that they take possession. Therefore, RPs seek to include clauses within their leases from local authorities that do not commit a mortgagee in possession to the continued provision of social housing.

6.6 There are a variety of mortgagee exclusion clauses: some are absolute clauses that permit the mortgagee to dispose of the property on the open market (albeit with a sitting tenant on a lifetime tenancy); others are conditional clauses that require the mortgagee to first seek to dispose of the property to another RP (at a price that covers the outstanding debt) or have some sort of clawback provision for the local authority.

Consultation with local RPs

6.7 Officers have consulted with local RPs and their legal and financial advisors regarding the changing funding environment for affordable housing. The key point to emerge is that with grant funding diminishing it has become ever more critical to secure MV-STT valuations for their stock. The feedback is that this increases development capacity by around 20% compared to the lower valuation and that, therefore, getting the lease agreement right is crucial to future development.

6.8 The RPs were asked about the lease conditions that the Council might impose and how these would be viewed by lenders. The answers differed slightly between RPs depending on the advice they have received from their respective consultants. Some were advised that only an absolute mortgagee exclusion clause would suffice, whereas others were told that certain minor conditions, such as a requirement to first attempt to find another Registered Provider to take the property on, would still allow an MV-STT valuation.

6.9 The common theme, though, was that the lending market has seen and continues to see significant tightening with lenders less and less willing to lend, at all, against properties that carry any restrictive covenants that would affect a mortgagee in possession. So, whilst it may currently be possible to secure borrowing from some lenders, even at MV-STT valuations, with a conditional mortgagee exclusion clause, the only way for an RP to 'future-proof' its stock and ensure that new properties will be mortgageable in the future is to secure an absolute mortgagee exclusion clause.

6.10 If RPs are unable to negotiate the desired flexibility for their future lenders then they cannot be sure that they will be able to attract future development finance. It is, therefore, a significant risk for a developing RP to move forward with a scheme financed by borrowing against existing stock without the knowledge that the new scheme will itself be able to sustain future borrowing and development.

6.12 The Council has also been approached by a number of local RPs seeking to renegotiate the terms of existing leases in order to realise the full borrowing potential of those units to bring forward additional affordable housing supply. These include:

- Yorkstone Close, Wybourn (Great Places)
- Adlington Phase 1, Parson Cross (Great Places)
- Sevenfields, Wisewood (Pennine)

The following leases have yet to be agreed but the RPs have again requested a mortgagee exclusion clause, which could not happen under the existing Cabinet authority for their disposal:

- Catherine Street, Burngreave (Arches)
- Hazlehurst/Chantrey, Jordanthorpe (SYHA)
- Cricket Inn Phase 2, Wybourn (Great Places)
- Maltravers Way, Wybourn (Great Places)

7.0 ANALYSIS OF BENEFITS AND RISKS

7.1 In order to decide whether to grant RPs' requests for mortgagee exclusion clauses, the Council must consider the benefits to be gained against the risk of the worst-case scenario. That scenario is that an RP becomes insolvent (or otherwise defaults on its loan) and that RP's lender disposes of the property to a non-RP, which leads to the loss of the property from the social sector. This could be fairly long term, if the default occurs after completion and occupation of the development (i.e. the loss would only occur once the sitting social tenant's lifetime tenancy comes to an end), but could happen immediately if the default occurs prior to completion of the development.

7.2 There are demonstrable benefits that would arise from the inclusion of mortgagee exclusion clauses. Take the schemes named in 6.12 as an example: these together comprise 201 units of social housing, currently likely to be valued at EUV-SH for charging purposes. If we assume an average open market value of £100k, then the corresponding values for charging purposes might be approximately:
EUV-SH = £47k
MV-STT = £64k

Assuming that the lender requires 110% security cover for EUV-SH and 125% for MV-STT (these figures do vary) the amount that could be borrowed against the different values would then be as follows:
EUV-SH = £42.7k
MV-STT = £51.2k

Multiplied across all the units in schemes, the total borrowing potential would be:
EUV-SH = £8.583m
MV-STT = £10.291m
Difference = £1.708m

Therefore, given the assumptions above, simply by accepting a mortgagee exclusion clause on these schemes and so allowing the stock to be valued at MV-STT, the Council would effectively create an extra £1.708m of affordable housing funding, which, when combined with further HCA grant, might equate to another 15-20 homes at no extra cost to the Council.

7.3 Set against this benefit is, firstly, the risk that an RP becomes insolvent (or otherwise defaults on its loan). The social housing sector is highly-regulated and considered a low-risk sector for lenders. Maintaining that position has become critical to the sector's continued access to relatively low-cost development finance. As such, on the rare occasions when RPs have experienced financial difficulties, the HCA as regulator has always stepped in to prevent the situation escalating, as to allow one RP to go under would have an extremely detrimental effect on the rest of the sector. Therefore, it is considered highly unlikely that an RP would become insolvent. It is also considered unlikely that an RP would otherwise default on its loan, as again the HCA would seek to intervene. However, whilst the risk is low, there is no absolute guarantee that the HCA would step in or that they would be successful in averting the default.

7.4 Secondly, in the unlikely event that the RP should default and a mortgagee takes possession, there is the risk that the property would be sold to a non-RP. If this happens after the development has been completed and the properties occupied, the risk of an adverse impact is relatively low. The property may be sold to a non-RP who eventually disposes of the property on the open market once the sitting tenant's lifetime tenancy ends. However, in this scenario, it is likely that the property would form part of a larger portfolio, and the lender's priority would be to recoup its costs and move on as quickly as possible. As such, they would be looking for a buyer for a portfolio of multiple social housing properties, all with sitting tenants on lifetime social tenancies. Outside of the established social housing sector, there would be limited interest in taking on such a portfolio, and so the probability is that, even if sold on the open market, the property would be sold to an RP, although clearly this would not be guaranteed.

7.5 If, however, the default occurs prior to completion of the development, there is a significant risk that the property could be sold to a non-RP who would be free to deal with the property as it sought fit as it would not be burdened by the occupation of the property by sitting tenants. The construction phase of the development is also the most risky phase as that is the point at which the financial exposure is the greatest, along with the inherent risks of dealing with a construction project, such as long periods of adverse weather, other delays, contractor insolvency etc. This potential can be minimised by granting the original purchasing RP an agreement for lease, with the grant of the actual lease only being made once the development has been completed. The risk of the RP defaulting between completion and occupation still remains, but it is unlikely in this short period.

7.6 In summary, whilst the worst-case scenario outlined in 7.1 cannot be ruled out, it requires two unlikely events to occur and is set against the benefits outlined in 7.2. The risk can be mitigated by an agreement for lease as described in 7.5, as well as by the standard checks on a Registered Provider's status that the Council carries out before entering into a lease.

8.0 LEGAL IMPLICATIONS

8.1 The Secretary of State has issued a general consent under section 25 of the Local Government Act 1988 which is for the disposal of land to registered providers of social housing and is given on condition, among others, that any housing accommodation developed on the land is to be let by the RP as social housing. The consent provides that this condition need not be binding on any mortgagee of the land or any person whose title is derived through such a mortgagee.

8.2 The local authority must consider on a case by case basis whether or not it wishes a mortgagee in possession to be bound by this condition since the effect is that the land may ultimately fail to be used in accordance with the terms approved in the decision to dispose.

9.0 FINANCIAL IMPLICATIONS

9.1 The financial implications of disposing of sites at 6.12, and others, to RPs at less than market value were addressed in the original reports to Cabinet recommending their disposal. There are no direct financial implications for the Council arising from the recommendations to include mortgagee exclusion clauses in the leases for those sites. In the event of the worst-case scenario outlined in 7.1, it is possible that a purchaser could eventually extract the value from the site that the Council originally gave up in order to enable social housing. However, as explained in Section 7, this risk is remote and outweighed by the benefits of the additional development capacity created by the insertion of the clauses. Any fees resulting from lease renegotiations would be payable by the leaseholder (i.e. the RPs).

10.0 EQUALITIES IMPLICATIONS

10.1 Fundamentally this proposal is equality neutral, affecting all local people the same regardless of age, sex, race, faith, disability, sexuality, etc. However, it should be positive for the less well off and financially excluded due to unlocking approximately 20% additional development capacity within the local Registered Providers sector. This should also prove positive for community cohesion. No negative equality impacts have been identified.

11.0 ALTERNATIVE OPTIONS CONSIDERED

11.1 The refusal of RPs' requests for mortgagee exclusion clauses would absolutely protect the ongoing social housing status of any social housing built by RPs on Council land. However, it would not increase the available funding for social housing and may lead to some RPs ceasing to develop in Sheffield.

12.0 REASONS FOR RECOMMENDATIONS

12.1 The 2013 Strategic Housing Market Assessment identified an annual requirement for 725 affordable homes in addition to the projected supply. Whilst the Council is embarking on a Stock Increase Programme for Council Housing, the HRA does not have sufficient resources to meet the projected need for affordable housing. Further investment is required from Registered Providers and the HCA.

12.2 As grant funding to RPs reduces, they must look to maximise the potential of their existing asset base to realise additional resources for new affordable housing supply. By accepting a small measure of risk in granting RPs' requests for mortgagee exclusion clauses, the Council would increase RP development capacity by 20% at no financial cost to itself.

12.3 The Council's emerging Housing Delivery Investment Plan is designed to accelerate total housing delivery across all sectors. Removing restrictions on mortgagees as a barrier to delivery would significantly improve delivery within the social sector.

RECOMMENDATIONS

R1 That Cabinet notes the ongoing issues regarding securing development finance for affordable housing and supports the principle of assisting Registered Providers where appropriate by offering flexibility around mortgagee exclusion clauses.

R2 That Cabinet supports the requests from RPs for mortgagee exclusion clauses on the schemes named in Section 6.12 of this report subject in the case of new disposals, to the RP entering into an agreement for lease with the lease to be granted upon completion of the construction and that the Director of Capital & Major Projects be authorised to negotiate or renegotiate terms for the leases as appropriate and to instruct the Director of Legal and Governance to complete the necessary legal documentation.

R3 That the Director of Capital & Major Projects, in consultation with the Director of Regeneration & Development Services and the Cabinet Member for Homes and Regeneration, in relation to social housing sites that have previously been disposed of by way of a long lease, be authorised to consider and where appropriate agree future requests from Registered Providers to vary the terms of those leases to include mortgagee exclusion clauses and to instruct the Director of Legal and Governance to complete the necessary legal documentation.

Appendix A

Initial allocations from the 2015/18 Affordable Homes Programme

Registered Provider	Scheme	Land Ownership	No. of homes
Guinness Northern Counties	Cricket Inn Road, Hyde Park	Private	36
Guinness Northern Counties	Portland Road, Beighton	Private	12
South Yorkshire HA	Seaton Crescent, Manor Park	SYHA	28
Sanctuary HA	Paper Mill Road, Shiregreen	Sanctuary / Private	10
Sanctuary HA	Woolley Wood Road, Shiregreen	Sanctuary	46
Sanctuary HA	Sheffield Indicative (sites tbc – probably in Arbourthorne)	TBC probably SCC	50
Great Places HA	Darnall Works	SCC / Private	50
Great Places HA	Sheffield Housing Company Phase 2 (various sites)	Private	25
Pennine Housing	Fairfax Road, Manor	Private	48
Sheffield City Council	Long Term Empty Acquisitions	Private	45
		TOTAL	**350**