Manchester City Council
Report for Resolution

Report to: Executive – 3 June 2020

Subject: A Housing Delivery Company

Report of: Deputy Chief Executive and City Treasurer

Summary

The Executive received a report at its meeting on 25th March 2020 outlining plans for the creation of a Housing Development and Management company. This proposed vehicle would provide direct delivery options for a range of new affordable homes utilising City Council land assets. This report illustrates working examples of projects, details the proposed legal structure and indicates the proposed financial framework.

Recommendations

Executive is requested to:

1. Endorse the proposal to establish a Housing Delivery Corporate Structure and authorise the Deputy Chief Executive & City Treasurer, the City Solicitor and the Strategic Director - Growth & Development to finalise the detailed arrangements to establish the structure, in consultation with the Leader, Executive Member for Housing & Regeneration and the Executive Member for Finance & Human Resources.

2. Delegate authority to the Deputy Chief Executive and City Treasurer, the City Solicitor and the Strategic Director - Growth & Development to determine the most appropriate structure and arrangements for providing any funding to facilitate the delivery of housing through the Housing Delivery Structure, in consultation with the Leader, Executive Member for Housing & Regeneration and the Executive Member for Finance & Human Resources.

3. Note that the business plan and any associated financial matters associated with the establishment of the structure will be submitted to a future meeting of the Executive for approval.

4. Approve an increase to the revenue budget of £1.5m, funded from the Housing Investment Reserve, to fund the next phase of development work, and delegate authority to the Deputy Chief Executive and City Treasurer, in consultation with the Executive Member for Finance & Human Resources, to approve spend against this budget.

Wards Affected: All

Environmental Impact Assessment - the impact of the issues addressed in this report on achieving the zero-carbon target for the city
Development will be net zero carbon in use. Through the procurement structure the Council will seek to maximise the mitigation of embedded carbon in construction whilst maintaining a net zero carbon in use position. There will be a financial consideration for the zero carbon components that will affect volumes. These will be factored into financial viability assessments.

Manchester Strategy outcomes	Summary of how this report aligns to the OMS
A thriving and sustainable city: supporting a diverse and distinctive economy that creates jobs and opportunities	A successful economy has to be supported by a vibrant and diverse housing market. The provision of a multi-tenure, high quality, low carbon range of housing options will assist the City to attract investment and provide a housing offer to those working on lower incomes in the city
A highly skilled city: world class and home grown talent sustaining the city's economic success	A successful jobs and skills market has to be supported by a vibrant and diverse housing market. The provision of a multi-tenure, high quality, zero carbon range of housing options will assist the City to attract and retain talent.
A progressive and equitable city: making a positive contribution by unlocking the potential of our communities	The scale of development programmes envisaged will provide much needed affordable accommodation in the city.
A liveable and low carbon city: a destination of choice to live, visit, work	All homes being developed will be expected to contribute to our zero carbon targets. We will expect all housing offers developed through the workstreams in this report to be net zero carbon.
A connected city: world class infrastructure and connectivity to drive growth	Housing development makes a direct and influential impact on infrastructure and growth. By ensuring an accelerated delivery programme there will be a stimulus to investment and development.

Financial Consequences

Some setup and project management costs will be incurred to get the project underway, requiring approval of up to £1.5m to be met from the Investment Reserve. Once the next phase of development work is completed the capital and revenue implications of pursuing the proposed structure will be reported to members.

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Background documents (available for public inspection):

- Draft Residential Growth Strategy, Executive, 4th November 2015
- Housing Affordability in Manchester, Executive, 1st June 2016
- Housing Affordability in Manchester, Executive, 14th December 2016
- Housing Affordability Plan, Executive, 18th October 2017
- Housing Affordability Plan New Products, Executive, 7th March 2018
- Delivering Manchester's Affordable Housing Strategy, Executive, 12th December 2018
- Delivering Manchester's Affordable Homes to 2025, Executive, 11th September 2019
- Delivery of new affordable homes in Manchester, Executive, 25th March 2020

1.0 Introduction

1.1 The ‘Our Manchester’ strategy has established a series of high level aims to secure the 2025 vision for the city, in particular the need to build well designed, energy efficient, sustainable and affordable homes to rent and buy. Creating more homes to meet the needs of a growing population and economy is a significant priority.

1.2 The Residential Growth Strategy (2015-2025) sets out the city’s approach to providing the right mix of housing for all residents. The Strategy now commits to building 32,000 new homes in Manchester between 2015 and 2025 - including a minimum of 6,400 new affordable homes.

1.3 Despite the impact of COVID-19, Manchester’s residential pipeline remains a significant part of our delivery programme, providing thousands of new homes each year for our residents. In 2019/20 4,201 new homes were built (2,869 in the city centre and 1,332 in the rest of the city). This is on top of the 2,927 built across the city in 2018/19, bringing the total new homes built over the last five years (April 2015 to March 2020) to 13,259.

1.4 In 2019/20, 480 new affordable homes were built, bringing the total delivered in the same five year period to 1,514, representing approximately 25% of the 6,400 to 2025 minimum target. In addition to this a further approximately 680 new affordable homes are currently on site and expected to be delivered by 2022/23.

2.0 Affordable homes delivery in Manchester: 2015/16 to 2024/25

2.1 Over the last 5 years the supply of new affordable housing in Manchester has increased year on year. However the current scale of delivery remains below what is needed to meet the city’s Residential Growth Strategy target with only approximately 4,800 homes planned by 2025. The table below sets out the affordable pipeline to date and what would have been the expected development capacity of RPs on existing sites identified for affordable housing.

Table 1 - Manchester Affordable Pipeline 2015-2025

	Social Rent[1]	**Affordable Rent**	**Shared Ownership**	**Other[2]**	**Total**
Affordable Completions 2015-16	34	87	34	0	155
Affordable Completions 2016-17	14	156	84	0	254
Affordable Completions 2017-18	20	180	97	0	297
Affordable Completions 2018-19	56	136	141	5	338
Affordable Completions	97	27	143	203	470

	Social Rent[1]	Affordable Rent	Shared Ownership	Other[2]	Total
2019-20					
Total Affordable Completions - 2015-16 to 2019-20	221	586	499	208	1,514
Total Under Construction - 2020-21 to 2022-23+	337	84	220	45	686
Total Planned Pipeline- 2020-21 to 2022-23[+]	919	923	569	197	2,608
Total	1,477	1,593	1,288	450	4,808

[1] Including extra care & LD schemes available at social rent
[2] Includes all Rent to Buy & Discounted Market Rent schemes
[+] Includes all schemes where a planning application has been submitted / a site identified

2.2 The overwhelming majority of these homes have been and are expected to be delivered through Homes England's Affordable Home Programme (AHP) funding. In the March 2020 Budget, the AHP was provided with an additional £9.5bn, creating a new £12.2bn five-year programme from 2021/22. At the same time, the Chancellor announced a new £400 million Brownfield Housing Fund. Work is progressing with Homes England to capture and maximise the investment opportunities that arise from these additional monies being allocated to drive forward the creation of new homes.

2.3 Over the last five years the affordable housing pipeline has been dominated by a small number of Registered Provider (RP) partners with Wythenshawe Community Housing Group (WCHG), One Manchester and Southway accounting for approximately 70% of total completions since April 2015. However, over the past 12 months there have been examples of larger scale RPs showing an appetite for development in the city such as Your Housing Group have also recently acquired the 44 acre Jackson Brickworks site in Newton Heath.

2.4 With this in mind the City Council is continuing to work with new and existing RP partners to identify opportunities to help bolster the delivery of affordable homes. Current indications suggest these have the potential to deliver approximately 1,000 homes in addition to the circa 4,800 identified in Table 1. As such, even with this additional capacity, it remains unlikely this will be enough to meet the Residential Growth Strategy target of a minimum 6,400 new affordable homes by 2025.

2.5 The existing delivery platform that we have established with RPs, whereby the Council uses its land assets alongside land the RPs have acquired in the open market (working in conjunction with Homes England investment programmes), remains key to the delivery of new affordable homes in the city. However, all the forecasting now suggests that this in itself is not enough to meet the growing demand for affordable housing and importantly will not deliver a significant increase in the number of socially rented homes in the city. With this in mind an additional delivery layer is now required with the capacity to drive investment and therefore affordable house building, beyond the reliance and capabilities of the existing local development delivery framework.

2.6 COVID-19 and the associated measures implemented by the Government to limit the spread of the virus has created additional challenges to the property market in Manchester and the UK. The economic impacts could mean delays to development and market uncertainties for RPs as they take time to assess the financial implications of the pandemic. There is likely to be a slowing down in some aspects of RP development. Many will need to consolidate their finances and consider their liquidity before committing to further investment.

2.7 As part of development of a dynamic and proactive Manchester Economic Recovery Plan, the Council is committed to sustaining confidence in the development market by reinforcing our current approaches to new development to ensure that our existing core messages to investors and developers (including RPs) remain as strong.

2.8 Against this backdrop a new form of Local Delivery Vehicle (LDV), has the potential to both increase the quantum and rebalance the delivery of affordable homes at or below Local Housing Allowance (LHA) through a comprehensive utilisation of Council land assets. This will be funded in part through a cross subsidy mechanism, derived from the delivery of an associated pipeline of market housing for sale and rent. Current estimates indicate the potential for the LDV to deliver approximately 2,000 additional new affordable, low carbon homes in addition to the homes set to be delivered by RPs helping the city to meet and exceed the existing 6,400 minimum target by 2025. We would seek to ring-fence any future returns from the delivery vehicle to future housing development.

Land Supply

2.9 Since the Executive report in March work has been underway to critically appraise the Council's existing landholding that could be brought forward for residential development through this vehicle, as well as maintaining supply to support the other routes to delivery by RPs as referenced earlier in this section.

2.10 This work remains ongoing, and will be informed to some extent by the nature of the delivery vehicle and funding route that is proposed. The intention is to allocate the Council's assets at a strategic level to the optimum delivery route at the relevant time.

2.11 Work has commenced to identify a tranche of development sites that would be suitable for inclusion within the model. One of the key critical drivers of this vehicle will be to bring forward sites for development that would otherwise be unviable, through a process of cross-subsidy by more profitable developments. The development must also deliver in-phase and overall portfolio viability. This will be tested out through the due diligence phase.

Details on a recommended portfolio of sites will form part of the final Business Plan to be considered by a future meeting of the Executive.

3.0 Review of Housing Delivery Models

3.1 As outlined in the March report to Executive there are a number of housing delivery models operating across the country therefore it was necessary to review these and decide what the best option would be for Manchester. In order to undertake the review the following criteria were established as a checkpoint against the current models:

- Deliver up to 500 new homes per year;
- Provide a mix of affordable and market housing;
- The market housing should be able to cross subsidise the affordable homes;
- The Council should be able to retain control over the operation and delivery of the model;
- Allow the Council to invest land and Right to Buy receipts; and
- Have the ability to return a surplus/dividend back to the Council.

3.2 A new vehicle could also have the capacity to acquire new or existing homes within the city.

3.3 A number of local authorities have implemented a range of housing delivery models across the country to facilitate the delivery of all tenure types appropriate to local needs. These tend to fall within the two categories below:

A Joint Venture Company Arrangement

3.4 The Council engages with developers, investors or registered providers to pursue certain delivery objectives.

3.5 The Council enters into a joint venture agreement with a private sector partner for the purpose of developing sites owned by the Council. This usually takes the form of a Limited Liability Partnership (LLP) as it may offer tax transparency to the relevant partners. The Council's share of the LLP is based on its land contribution, which may potentially be enhanced further by equity contributions.

3.6 The vehicle is responsible for the development of the site. The funding of the development is usually sourced from a mix of the private sector partner's funds (its equity share) , short term development financing (repayable through longer term institutional funding) or prudential borrowing.

3.7 The private sector partner provides the professional expertise and will lead on delivering the development. Risk would generally be shared based on the relative shares in the JV.

3.8 An example of this is the Council's Housing Investment Fund model with appointment of a development partner ("Matrix Model") The Council has established a joint venture arrangement with a funder, Greater Manchester Pension Fund and procured one single point of contact for the JV structure to manage the risk in the delivery of the design and build of the new estates, the sales and marketing of the sale properties, rental management of the build to rent properties and overall lease management of the sold properties. This model delivers mixed tenure market housing, with the returns from market sales of higher value properties supporting development on more challenging lower value sites.

3.9 Risk and control is shared equally based on relative contributions into the JV structure.

A Wholly Owned Company with subsidiaries (development and ownership)

3.10 A wholly owned development vehicle is owned 100% by the Council, the Council assumes the risk and reward of developments and assumes full control over the development activity. The clear difference between this model and that described above is based on the level of control that the Wholly Owned Company possesses.

3.11 The Council does not partner with the private sector and therefore in this scenario will need to identify the level of expertise it requires in the vehicle to deliver its objectives. Being wholly owned means that the Council may have more cash flow in the vehicle (through a reduction in developer profit leakage), in order to facilitate further housing development.

3.12 Whilst the company is wholly owned by the Council, there are well established strategies available through the various contracting arrangements to manage and mitigate key risks through the design, development and sale or letting phases.

3.13 This option provides for the council to establish a wholly owned company to carry out a developer role and also take a long term stake in the assets which are created (affordable rented accommodation, Market rents and possibly mixed use schemes). The business operates via subsidiaries to allow for the flexibility to bring on board funding partners and facilitate different types of development. This creates a flexible platform to separate out the developer role from that of the ownership role and provides the company with the ability to establish subsidiaries when they are needed.

3.14 As noted above there are a number of models and options which the Council wishes to evaluate in order to identify the optimum model which will support and promote a flexible platform to deliver the Council’s housing strategy and key outcomes, namely:

- **Growth** - increasing the quantity of housing to ensure the right types of housing are available in the right places;
- **Place** - raising the quality and sustainability of our homes and neighbourhoods; and

- **People** - enhancing opportunities to access homes for residents with raised aspirations and a sense of self-esteem.

3.15 The precise nature and form of the legal entity will need to ensure, amongst other things, that:
- It will enable maximum flexibility that will allow for further addition of other partnership arrangements or subsidiaries and third party investment
- Appropriate governance and risk management arrangements are established; the financial and tax position is optimised; and.
- It takes account of the most efficient way to develop sites and procure works and services.

3.16 Any delivery structure will deliver its objectives through an agreed business plan. Any arrangement will need to provide that certain strategic matters would be reserved matters requiring the approval of the member(s) or the Council in certain instances.

3.17 Under any delivery structure adopted, there will also need to be appropriate governance arrangements to enable the business(es) to operate flexibly and without undue shareholder involvement, whilst at the same time being balanced with the necessary oversight and control to reflect the investment of public monies and overarching duties of the Council as a local authority.

3.18 The Council will prepare a detailed strategic business case and business plan that covers the objectives of the business, considers the housing delivery options, identifies shortlisted options, governance arrangements, the investment, the resources and any other risk which the business may face (and the significance of those risks) together with the financial and delivery outcomes to be expected. The business case will be presented to the Executive for consideration and approval before the delivery structure is legally established.

4.0 Financial implications and potential investment options

4.1 The models detailed above provide two key financial outcomes which mean that it has the potential to create a sustainable housing vehicle. The first is that through the mixed tenure approach, with the holding company holding both market rental and affordable housing there is the opportunity to cross-subsidise. This means that affordable housing development which, in isolation, may be loss making becomes viable.

4.2 The second outcome is that the Council has the opportunity to create a sustainable base of affordable housing in the city. The model should provide certainty in respect of the numbers of homes that will remain under management in the medium to long term, allowing more strategic decision making in respect of the delivery and funding structures. There is also the potential to support funding of the affordable housing element of the model through the Council’s existing right to buy receipts.

4.3 The Council has commissioned high-level financial modelling to support the development of the vehicle to date, which give some indication of how the cash flows could work, with a range of assumptions such as build costs, management arrangements and costs, voids and bad debts, professional fees, and financing costs.

4.4 It is important to note that the models are only indicative at this stage, and a key element of the next phase of establishing the vehicle will be to undertake further due diligence, refine and evidence the assumptions on a site-specific basis, including any site-specific costs.

4.5 The modelling has shown that by using Council land and the Government funding support available, the rental income is sufficient to fund the management and maintenance of the homes and the capital financing costs associated with their build.

4.6 The modelling also highlights that the vehicle creates long term stable income streams, assuming that demand, voids, bad debts and maintenance costs remain stable. This will be attractive to external investors, given the long term nature of the income streams.

4.7 Traditional funding routes, such as the Council borrowing to fund the build of the homes and using the income streams to pay down the debt and associated interest, will be considered.

4.8 However, there is also the opportunity to examine other funding routes. This could include a lease based model with a funder, where a funder purchases a lease over the developed homes, with MCC Holdings making annual indexed rental payments to the funder for the length of the lease. Such an approach has the benefit of minimising the Council's capital exposure through the initial capital receipt from the lender. At the end of the lease the homes would revert back to the ownership of MCC Holdings for a nominal (£1) sum.

4.9 The intention is to meet with potential funders during the next phase of the model's development to establish in further detail the risks and costs of such funding routes. It will also be important to determine market sentiment to partake in such structures in light of the prevailing economic conditions at the relevant time. These will be reviewed alongside the financial models referenced above, and will form part of the final business plan.

4.10 A key part of these discussions will be what the investor appetite is regarding funding the development period of the homes. Depending on the risk profile associated with the contractual arrangements such a funding structure may be more expensive than if the Council provides the initial financial support, if it passes significant/all construction risk through to the third party funder.

4.11 Further financial modelling and legal advice will also be required regarding tax, specifically SDLT, VAT and corporation tax, to ensure that the tax requirements of the final structure of the vehicle are fully understood.

5.0 Risks and mitigations

5.1 The wholly owned company structure, would fundamentally mean that the Council takes all the risk involved in the development and management of the sites and homes. There are well established contractual arrangements that can be employed to mitigate and move elements of this risk to funders, contractors or managing agents. This risk transfer would manifest through increased funding or construction costs, or higher management fees.

5.2 There are a number of risks associated with this type of direct development approach and in general to the provision of newbuild affordable homes due to COVID-19 and the recession. Although not an exhaustive list these are centred around:

- The impact on the construction industry and its supply chain in terms of deliverability and increased cost
- The investment market and its appetite to enter into new long term funding arrangements
- Restricted lending on affordable home ownership products such as shared ownership

5.3 The recovery in the housing market after the 2007/2008 recession was heavily supported by the public sector in terms of funding and delivery. The first-movers back into building new homes were Registered Providers constructing affordable homes. It is likely that there will be an increased demand for affordable housing, and particularly social housing, as the consequential recession impacts on the residents of Manchester.

5.4 Through the next phase of the due diligence a detailed construction and funding-led risk analysis will be undertaken to support the final proposed structure and business plan. Scenario testing of the relevant options will be key to ensuring the optimal delivery structure and mitigation strategies required to provide the necessary comfort to move to the delivery stage.

6.0 Next Actions

6.1 Subject to approval by the Executive and not encountering any major issues the detailed development of the Local Delivery Vehicle will follow:

6.2 Initially the detailed due diligence and robust financial modelling will be undertaken which will result in a final business case being presented to the Executive, which will outline in detail the proposed delivery structure and seek approval to the funding required to set up and deliver the first phase of new homes. In addition the business case will consider specific sites that can be included in the delivery vehicle programme. In order to achieve this stage it will be necessary to engage with the investment and funding markets and to appoint a professional team to support council officers, for example, KPMG have been appointed to provide independent tax advice.

6.3 Following ratification of the proposed delivery structure the next phase is the drafting of requisite legal documentation to support the creation of the corporate structure. Appropriate corporate governance will be instituted which will facilitate the commencement of the procurement of the relevant delivery partners.

6.4 Assuming that there are no challenges to the procurement and an early works arrangement is put in place at an early stage to secure planning permission for the sites.

6.5 The work conducted since March will allow progression to the next phase and appoint the advisors to assist developing the detailed model. It is requested that £1.5m be allocated from the Housing Investment Reserve to fund the detailed development activities.

7.0 Conclusion

7.1 The establishment of a Local Delivery Vehicle for the delivery of new homes in Manchester will be an intrinsic part of the City's economic recovery. It will be more important than ever for the council to lead the recovery of the Manchester housing market and out of the recession.

7.2 A new wholly owned delivery vehicle will increase delivery capacity for new homes, at a time when major housebuilders may be reticent to bring forward large volumes of for sale property. Creating a long term stable investment proposition will provide confidence and certainty for the wider Manchester market. The scalability and long term ambitions of the Council proposition will allow suppliers and those in the supply chain to make confident long term decisions to invest and innovate both in respect of social value outcomes and technology to support the low carbon objectives of the Council.

8.0 Contributing to a Zero-Carbon City

8.1 Development will be net zero carbon in use. Through the procurement structure the Council will seek to maximise the mitigation of embedded carbon in construction whilst maintaining a net zero carbon in use position. There will be a financial consideration for the zero carbon components that will affect volumes. These will be factored into financial viability assessments.

9.0 Contributing to the Our Manchester Strategy

(a) A thriving and sustainable city

9.1 A successful economy has to be supported by a vibrant and diverse housing market. The provision of a multi-tenure, high quality, low carbon range of housing options will assist the City to attract investment.

(b) A highly skilled city

9.2 A successful jobs and skills market has to be supported by a vibrant and diverse housing market. The provision of a multi-tenure, high quality, zero carbon range of housing options will assist the City to attract and retain high quality local and imported talent. .

(c) A progressive and equitable city

9.3 The scale of development programmes envisaged will provide much needed affordable accommodation in the city.

(d) A liveable and low carbon city

9.4 All homes being developed will be expected to contribute to our zero carbon targets. We will expect all housing offers developed through the workstreams in this report to be net zero carbon.

(e) A connected city

9.5 Housing development makes a direct and influential impact on infrastructure and growth. By ensuring an accelerated delivery programme there will be a stimulus to investment and development.

10.0 Key Policies and Considerations

(a) Equal Opportunities

10.1 None at this stage

(b) Risk Management

10.2 As outlined in the report.

(c) Legal Considerations

10.3 The Council is considering options for the creation of a Local Housing Development Structure that will provide direct delivery options utilising Council land assets. The Council has wide powers for the delivery of housing. The proposed Housing Delivery Model aligns with the Council's objectives and aspirations. In developing and finalising a housing delivery model the Council’s legal team will ensure it aligns with all legal and regulatory requirements.