

| | |
|-----------------------------|---|
| Report to: | Council 27 February 2024 |
| Lead Cabinet Member: | Cllr John Batchelor (Lead Cabinet Member for Housing) |
| Lead Officer: | Peter Campbell (Head of Housing), Peter Maddock (Head of Finance) |
| Key Decision: | No |

Ermine Street Housing - Additional Growth

Executive Summary

1. This report recommends that an investment fund of £20 million be made available to the Council-owned company South Cambs Limited trading as Ermine Street Housing (ESH).
2. This will enable ESH to borrow further funds to take advantage of new investment opportunities as they arise and to purchase homes for single homeless people in the district using Government Homeless Reduction grants to cover the modelling viability gap for such purchases.

Recommendations

3. It is recommended that Council agrees:
 - a. To allow Ermine Street Housing (ESH) additional borrowing from the Council of up to £20 million to take advantage of new investment opportunities where viability assessments provide a positive return with an interest rate of 1% above base rate. This arrangement is to be reviewed annually.
 - b. To allow ESH to purchase single person properties for homeless people to prevent the use of expensive temporary accommodation, using the interest rate applying to ESH (currently 4.25%). This rate recognises the initiative as a 'spend to save' investment, providing savings to homelessness budgets.
 - c. To allow the Head of Housing, in consultation with the Lead Cabinet Member for Housing, to authorise individual purchases (and

therefore borrowing) up to the value of £2 million as per the current arrangements.

- d. To note that this proposal is subject to the agreement of the Ermine Street Housing Board.

Overview and Scrutiny Committee 18 January 2024 comments

4. Clarification was required regarding the amount of the homeless grant that is available. The amount is up to £500,000 and is in addition to the proposed £20 million investment fund.
5. Relating to all purchases, a viability assessment is thoroughly tested to ensure the acquisition is viable and full property surveys including health and safety compliance will be carried out prior to completion. The homes acquired for homeless households will be leased to and managed by Shire Homes.
6. Drawdown from the investment fund for all purchases will only take place on completion of the conveyancing process and at that point the loan commences. The drawdowns are phased over a two-year period which could be extended. Purchases are subject to market conditions and availability and conveyancing time periods.
7. The £20m required would not be taken out in one go. The Council will take out loans as and when they are needed to finance amounts to be lent to Ermine Street Housing based on the amount required by them on a scheme-by-scheme basis. The loan may also not be required at the point of lending to Ermine Street and the counterparty used will be dependent on the rates available and the loan term required. However it is likely that lending will be sought from the Public Works Loan Board (PWLb).

Details and background to Ermine Street Housing

8. In November 2012, the Council set up a subsidiary housing company registered as South Cambs Limited, which has been trading under the name Ermine Street Housing (ESH) since 2014. It is an independent property company wholly owned by the Council.
9. The principal activities of ESH are to manage both purchased and leased properties for the purpose of residential lettings. ESH aims to provide a quality service in this sector.
10. The Council approved a Business Plan in November 2015, and recommended capital allocations of £100 million to acquire 500 properties over a 5-year period.
11. In March 2022 ESH achieved its target of 500 acquisitions. This was a positive result for ESH and the Council, and it was achieved within the budget of £100 million, having spent £89.5 million on property acquisitions and £5.1 million on cash flow loans, totalling £94.6 million.

12. However, further acquisition opportunities were presented to the Council, and it was agreed that ESH could pursue these opportunities in the financial year 2022-23.
13. As a result, a further 22 properties were added to the portfolio, taking the overall spend to £100 million at the end of March 2023, of which property acquisitions expenditure was £94.6 million and £5.4 million was the total amount for cash flow loans.
14. Loans for the property portfolio only cover the purchase cost of the acquisitions and do not include stamp duty, legal and surveying fees. These additional costs have been met by cash flow loans.
15. There is currently no arrangement in place for ESH to borrow any additional funds from capital funding allocations.
16. ESH acquires property on the open market, borrowing from the Council at an agreed interest rate. ESH then lets the property at market rents to facilitate a reasonable pay back on the investment. To date, all assets have been acquired with 100% borrowing. A viability modelling tool is used to determine the required yield of over 5% and payback period within 40 years.
17. The original financial objectives for the creation of ESH were:
 - i) to generate a revenue stream to enable to Council to continue to deliver its services at a time of reducing Government grant and
 - ii) to generate capital gains for the benefit of wider Council services. These two objectives have enabled an annual financial return to the Council and potential longer-term financial gains.
18. In 2023/24 financial year, the return on loans is forecast to be £4.25million income at an interest rate of 4.25%. The interest rate was proposed by the Council and is reviewed annually following discussions with ESH at the time that the Business Plan is being refreshed annually in quarter 3.
19. The Council recharges ESH for services and staff costs, Company staff are directly employed by the Council. ESH relies on the Council for accountancy support, financial services (for use of the General Ledger and other associated systems and for accountancy support) HR, ICT, insurance, internal audit, and specialist housing support, particularly health and safety compliance. The budget for the recharge in 2022-23 was £418,619 for staff costs and £429,700 including VAT for supports costs and overheads.
20. ESH's portfolio has the potential to increase in open market valuation, although the gains can only be realised on sale (with its associated marketing and legal costs and tax implications).
21. The Council, therefore, as sole shareholder, owns a company with assets appreciating in capital value. As at the 31 March 2023, ESH has 522 properties

purchased for £94,637,798 and the valuation carried out for the 2022-23 financial accounts valued the portfolio at £116million - an increase of £21million.

22. Actual cash flow loans at 31 March 2023 amount to £5.4 million, the total borrowings therefore are £100 million.
23. The Council commissioned an independent report into ESH by Savills in July 2020, which was reported to Cabinet in September 2020.
24. The report forecasts, based upon property and net present value assumptions, an asset gain of £106 million, which is the net gain, after tax and initial costs to acquire the portfolio. Therefore, if ESH were to be wound up at the end of 50 years, the net value of ESH to the Council would be £106 million less marketing and winding up costs.
25. The ESH Business Plan over 50 years, predicts that ESH would be debt free, and no further loans would be required to offset any remaining debt. This position is monitored annually with each refresh of the Business Plan and the position could change in years of high capital expenditure in accordance with the stock condition survey.

Current Opportunities – improved financial return.

26. The current housing market is providing some additional opportunities, but ESH is unable to pursue these opportunities because the original targets have been met in terms of borrowing and the size of the portfolio.
27. The opportunities have arisen because of ESH's established relationships with developers and estate agents operating in the defined travel to work area and they offer greater yields than those in the current portfolio and a reduced payback period, which would provide the Council opportunities to increase the interest rates on the borrowing, therefore providing additional income streams.
28. It is therefore proposed to set up an investment reserve enabling ESH to borrow additional funds to take advantage of the offers.
29. ESH access to the fund would be conditional on the usual viability criteria required for all acquisitions carried out by the Housing Accountant, and because of the value and greater yields there will be the opportunity for the Council to charge a higher interest, (to be reviewed annually, and only applying to the new acquisitions) providing additional income. It is proposed to use a benchmark of 1% above the current base rate for this viability assessment, which is equivalent to other investment opportunities available, but with the additional value of purchasing assets that are likely to grow in value.
30. In line with recent decisions, and to reflect Government guidance, any purchases will be in the defined travel to work area for the district.

31. The financial implications of additional loans for the Council assuming the current Bank of England base rate of 5.25% plus the 1% premium (i.e., an interest rate of 6.25%) for every £1million lent to ESH the return to the Council would be £62,500 per annum. See table below at paragraph 40.

Current Opportunities – Homelessness reduction grant

32. There is currently a national crisis associated with homelessness and the provision of temporary accommodation, threatening the viability of council budgets across the country. With over £1.7b being spent nationally on temporary accommodation between April 2022 and March 2023.

33. The Council mitigates against such financial pressures partially by using its own stock for temporary accommodation, and using accommodation provided by Shire Homes Limited, the private sector leasing company. Ermine Street Housing leases accommodation to Shire Homes which are used as HMOs (Houses in Multiple Accommodation) for single people and some family sized homes in the leased stock.

34. However, it is not viable for Ermine Street Housing to purchase single person accommodation within the district because the potential rental income will not cover the combined cost of loan interest payments and management costs creating a viability gap.

35. Moreover, although the Council does have access to its own housing stock, this remains in high demand, especially properties that are suitable for single people.

36. However, the Council does have additional grant funding that is ringfenced for homeless reduction initiatives and these funds could be made available to ESH to cover the 'viability gap' to purchase single person accommodation in the district. This accommodation would require more intensive housing management and would therefore be managed by Shire Homes.

37. This also has the advantage that Shire Homes can grant shorter length tenancies, whereas with only a few exceptions the Council needs to grant secure tenancies.

38. This option would alleviate the cost of bed and breakfast to the Council and offer substantial savings as a result.

39. With the grant funding, ESH would borrow the balance of funds from Council and the rental income would cover the interest payments and management costs, and the viability gap funding providing by the grant would result in the Council retaining an equity stake within the property as a percentage which could be redeemed with appreciation should it be agreed that ESH dispose of the asset.

40. As this funding will be used for accommodation for people facing homelessness, who will have a connection to the district, any properties acquired under this stream will be within the SCDC boundary.

41. The financial implications of this loan agreement are that for every £1million lent to ESH the return to the Council would be £42,500 per annum assuming ESH is charged 4.25% the same rates for the existing portfolio loans. This is below the current Bank of England base rate, but there will also be additional savings of around £12,000 achieved in temporary accommodation expenditure (assuming 4 units of accommodation), giving a total impact (i.e., the sum of the return and the savings) of £54,500 for every £1 million of expenditure. See table below at paragraph 40.
42. In addition, the Council will have an equity share and would benefit from the appreciating value of the homelessness acquisitions.

Reasons for Recommendations

43. To ensure that Council as owner and sole shareholder of ESH is fully aware of the details surrounding the additional borrowing and risks associated with the proposal.
44. To take advantage of investment opportunities that will provide additional incomes streams to the Council.
45. To provide additional accommodation for single homeless people resulting in savings to homeless expenditure budgets.

Options

46. Cabinet could decide not to invest or choose a different form of investment.

Implications

47. In the writing of this report, taking into account financial, legal, staffing, risk, equality and diversity, climate change, and any other key issues, the following implications have been considered: -

Financial and Fraud Risk

48. ESH acquires property on the open market, borrowing at market interest rates from the Council. ESH then lets the property at market rents to facilitate a reasonable pay back of the investment.
49. The Council benefits from both the interest uplift in respect of lending to ESH, and the ability to recharge staff employed by the Council to ESH where they are working on behalf of ESH, therefore delivering an efficiency saving to the Council. The Council will also make savings by further reducing the use of temporary accommodation.

Table 1

| For every £1million invested | Existing interest rates charged to ESH | Potential interest rates for investment (Bank of England base rate 5.25% plus 1%) | Return to the Council | Savings to the Council (temporary accommodation based on 4 units) | Total |
|------------------------------|--|---|-----------------------|---|---------|
| Investment properties | | 6.25% | £62,500 | | £62,500 |
| Homelessness properties | 4.25% | | £42,500 | £12,000 | £54,500 |

50. There are potential benefits from capital growth with the increase the value of assets possibly outstripping general inflation. However, to realise these gains certain costs will be involved such as legal, marketing and tax liabilities.

51. ESH financial performance and forecast information is analysed in the annual Business Plan agreed by Cabinet.

Legal

52. There are no direct legal implications associated with this report. There are, however, legal and tax implications arising from using the homeless reductions grant funding. These implications would be covered in a future report.

Risks/Opportunities

53. Investment in the current portfolio provides a return to the Council, and risk is mitigated by ensuring that all acquisitions/investments meet the agreed viability criteria.

54. Furthermore, ESH is developing an asset management and disposal strategy following a stock condition survey ensuring that portfolio continues to perform providing value for money, ensuring the investment is sound.

55. Risk management is monitored by the Council and the ESH board of directors.

Climate Change

56. ESH mainly purchases properties that EPC rating C and above, where the rating is lower than a C, surveys have been carried out, and contractors have been appointed to assess the energy efficiency and carry out works to improve the ratings, these are short term measures.

57. In the longer term the asset management strategy and stock condition survey will be used to improve the energy efficiency of the portfolio, which move the ESH to Net Zero Carbon and provide energy savings for tenants.

Alignment with Council Priority Areas

Growing local businesses and economies

58. The Company employs a range of local businesses to undertake repairs and maintenance, cleaning, and lettings and management.

Housing that is truly affordable for everyone to live in

59. Company offers some sub-market rent accommodation and works with Shire Homes Ltd to provide temporary accommodation for homeless people and families.

Being green to our core

60. The energy efficiency measures being taken as mentioned above in paragraphs 52 and 53.

A modern and caring Council

61. The business activities of the Company generate income for the Council to invest in services for local people.

Background Papers

The following documents are relevant to this report:

- Business Case for Ermine Street Housing: Report to Cabinet – 12 November 2015
- Business Case for Ermine Street Housing: Report to Council – 26 November 2015
- Ermine Street Housing – Re-phasing of Lending: Report to Cabinet – 7 November 2018
- Ermine Street Housing – Re-phasing of Lending: Report to Council – 29 November 2018
- Ermine Street Housing – Review of Business Plan: Report to Cabinet – 5 February 2020
- Ermine Street Housing-Review of Business Direction -Report to Cabinet 2 September 2020 (the Savills Options Appraisal report).

Report Author:

Duncan Vessey – Head of Ermine Street Housing

Telephone: (01954) 713139