Corporate Policy & Resources Committee

11 September 2023

Title	*Revised Direct Affordable & Private Rental Housing Delivery Strategy*
Purpose of the report	To make a Key Decision
Report Author	*Coralie Holman, Group Head of Assets & Paul Taylor Chief Accountant*
Ward(s) Affected	All Wards
Exempt	No
Corporate Priority	Community Affordable housing Environment Service delivery
Recommendations	**Local Government is facing significant financial challenges, demonstrated by an increasing number of authorities expressing concerns about their financial position. Consequently, Spelthorne has been proactively monitoring and continually assessing its financial options. Based upon recent considerations the Committee is asked to:** **1. Confirm its support to suspend the Council's residential developments,** **2. Support in principle that Council explores new ways of delivering the affordable & private rental housing delivery strategy.** **3. Bring back revised strategies and policies to the October Committee meeting and subsequent Council meeting on 16 October.** **Support in principle recommending to Council that this authority explores new ways of delivering the Council's affordable housing development schemes, by moving away from direct delivery, apart from the Local Authority Housing Fund Acquisitions Scheme (single property) acquisitions to initially house Afghan families – funded with a higher level of government grant.**
Reason for Recommendation	*The current Public Works Loan Board interest rate of 5.42% (22 August 2023), with further rises predicted, make the current direct*

	housing development plan financially unviable, and the Council, must reconsider its options going forward. *This report seeks support from the Committee for officers to review the alternative options for the housing development schemes and bring forward revised plans for this Committee and Council to review, assess and approve.*

1. Summary of the report

1.1 Due to the increasing risks associated with residential development from rising interest rates and the impacts of significant construction inflation, officers in discussion with Group Leaders have concluded that it is no longer preferable or appropriate for the Council to directly bear this risk and additional financial exposure from increased borrowing needs to deliver the Council's housing schemes.

1.2 Instead, it is recommended that alternative methods for delivery (including joint ventures, direct disposals, and conditional sales) are explored. There is one exception, being a small scheme, which can be financed from internal resources, reducing the borrowing requirement to a negligible amount.

1.3 It is proposed, subject to the Committee's support, that more detailed papers are taken to the next Development Subcommittee in September and Corporate Policy & Resources Committee in October setting out options, associated risks and recommended approaches for each site. This will include:

(a) An emerging mixed use place making strategy brought forward for Staines-upon-Thames town centre. The aspiration being to create a portfolio of assets to deliver key regeneration benefits that will include housing, retail, community, and other key uses that will strengthen the vitality, vibrance and longevity of our lead town centre.

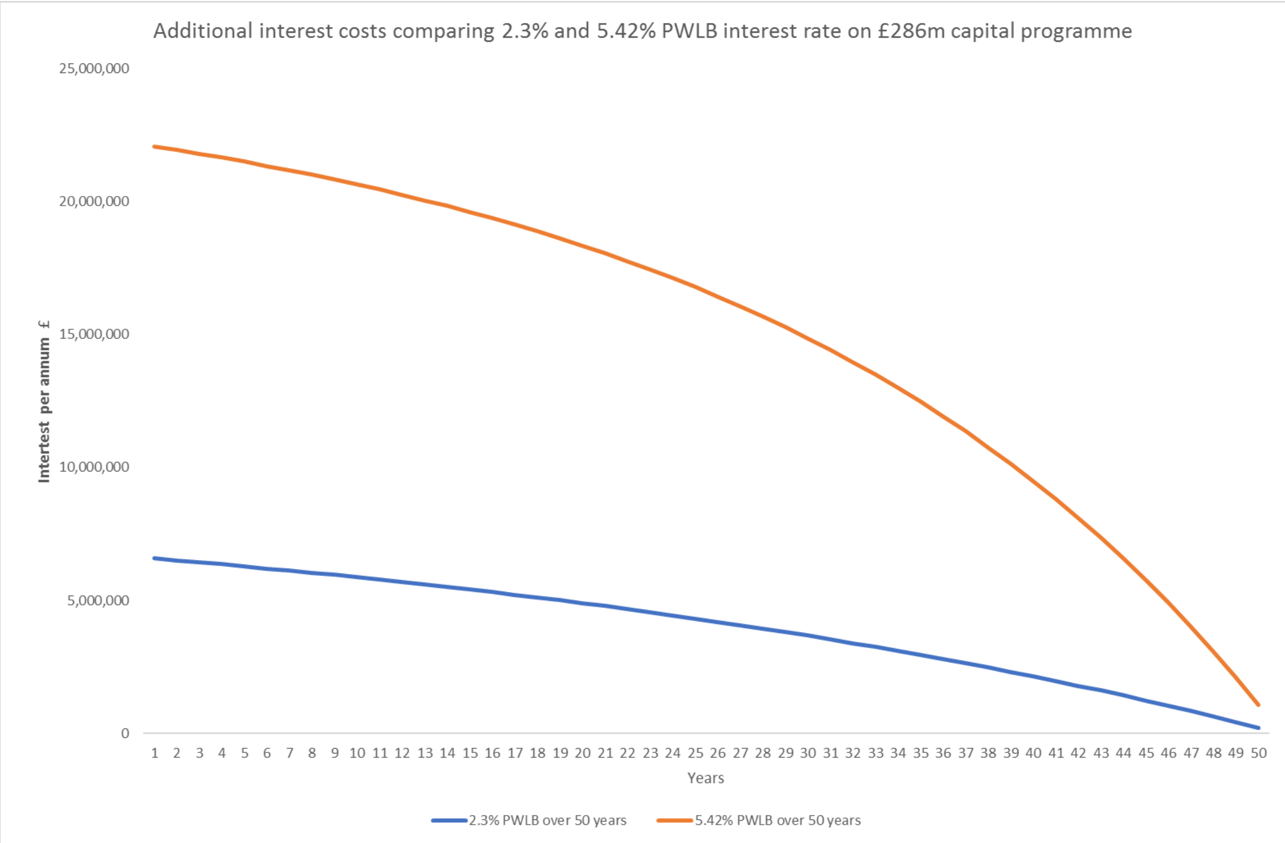
(b) Suggested delivery routes for those sites not in Staines.

Each option will be fully evaluated, highlighting risks and the advantages and disadvantages of the delivery mechanism to assist the Committee with understanding and decision making.

1.4 This report recommends moving to suspending the direct delivery of the current housing developments, until alternative delivery methods are presented to this committee in October and suitable delivery mechanisms are agreed.

2. Key issues

2.1 The Council, approximately five years ago, in response to the Housing Needs analysis, underpinning its Housing Strategy, identified the need for more affordable, keyworker and private rental accommodation to be provided for the Borough's residents, and decided to seek to directly make a difference through progressing its own residential schemes to address those needs, However, it has increasingly become clear that trying to undertake residential developments over the last 1.5 – 2 years has seen greater challenges around cost certainty due to very significant construction cost inflation, the increase of interest rates impacting financing costs, in addition to the normal risks of planning uncertainty etc. The externalities we are dealing with now have significantly changed since the Council initiated its ambitious housing delivery programme in 2018 to address the needs of its residents by directly improving the supply of affordable rental housing in the Borough. The previously low fifty-year fixed term, averaging 2.3% PWLB interest rates which were available for us as a Council to access are now, 5.42% (as at 22nd August 2023), more than three times the rate at the end of calendar year 2022, rendering the remaining projects financially unviable.



2.2 The additional interest charge between 2.3% and 5.42% amounts to £350.5m over 50 years, or the average of £7m per annum to the Council.

2.3 Since the beginning of 2022, interest rates have risen dramatically, and we have seen over the last two years cumulative construction inflation of approximately fifty percent. In that context, the Council has been considering options for evolving and changing its strategy for delivering its desired housing outcomes. Noting that improving the supply of affordable housing for our residents remains a corporate priority for the Council and Councillors will need to decide how the authority will now achieve this over the coming years..

2.4 Following the May 2023 election, where 22 (out of 39) new Councillors were elected, this Council has adopted new ways of working, an objective of which is to implement more collaborative approach, allowing more voices to be heard and putting our communities at the forefront of everything the Council does. This administration recognised the significant number of economic factors that were changing producing greater challenges with direct delivery of new housing and greater risk and exposure for the council.

2.5 Due to the increasing risks associated with residential development, officers in discussion with Group Leaders have concluded that it no longer preferable or appropriate for the Council to directly bear this risk and additional financial exposure from increased borrowing needs to deliver housing schemes. Instead, we need to reduce our exposure to financing risks by working with the market and adopting alternative approaches to delivering our housing priorities.

2.6 The Council's Assets Service have been reviewing the Asset Management Strategy which details how the Council will manage its land and property portfolio, as well as setting out key priorities and focuses over the forthcoming 5-year period. This review has been undertaken for a number of reasons including, responding to market changes post COVID, the need to align with the emerging Asset Management Strategy and also the increased challenges and risks associated with property development. The review, together with internal and market specialist discussions has identified other options that would allow the Council to deliver its housing and wider regeneration objectives without the need to bear the direct construction risk. Officers are currently at the early stages of exploring the opportunities via an emerging mixed use place making strategy for further consideration by Councillors.

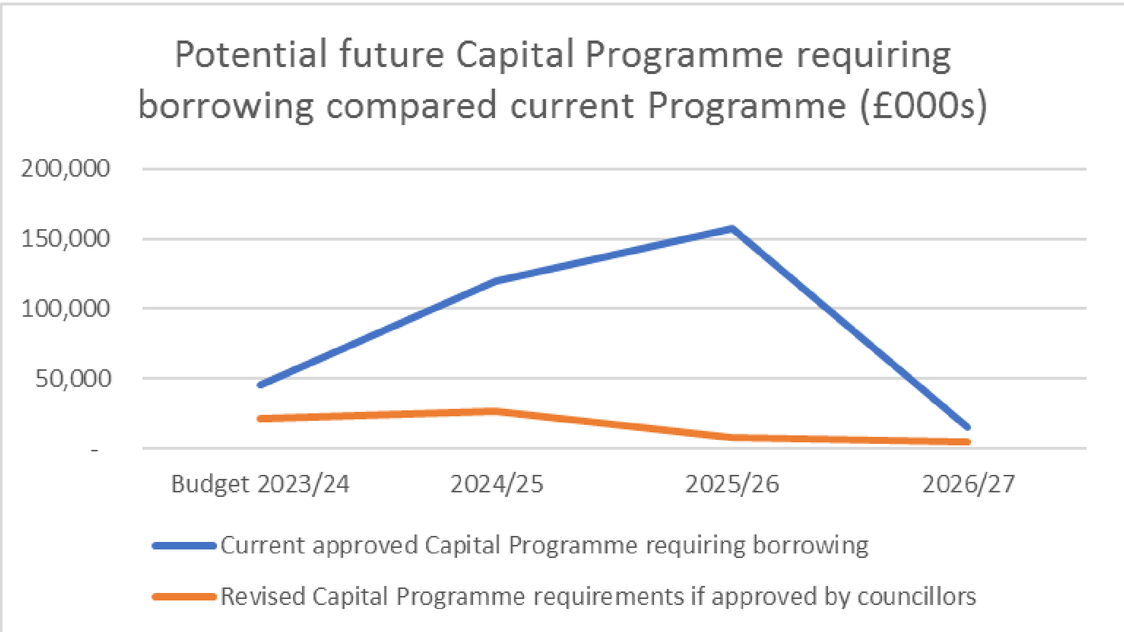
2.7 When determining the best approach, consideration will be given to the value, size, and location of the site. Possible methods for alternative delivery include joint ventures, direct disposals, and conditional sales. Except for one small scheme, which can be financed from internal resources rather than borrowing, all other development schemes will be suspended until alternative suitable delivery mechanisms are identified.

2.8 The purpose of this report is to highlight that it is proposed, subject to the Committee's support, that we take more detailed papers to our Corporate Policy & Resources Committee and Full Council in October setting out options and a recommended approach, that if approved will see:

- i) an emerging mixed use place making strategy and delivery options brought forward for Staines-upon-Thames town centre. The aspiration is to create a portfolio of assets to deliver key regeneration benefits that will include housing, retail, community infrastructure, and other key uses that will strengthen the vitality, vibrance and longevity of our lead town centre.
- ii) Suggested delivery options for those sites not in Staines or that are not included in a portfolio for Staines place making purposes.

2.9 In advance of the October CPRC meeting, papers are going to Development Sub-Committee on 25th September, which sets out the key stages of developing this emerging strategy, incorporating detailed resident consultation, prior to moving forward, and adopting the agreed strategy as formal Council policy.

2.10 This in turn means that the Council's Capital Strategy, Treasury Management and Capital Programme would not need to provide for directly delivering and financing the housing schemes currently in our residential delivery pipeline in the current approved Capital Programme. Subject to the Committee's and Council's support in October it is proposed that Spelthorne will initiate (with effect from October Full Council) an immediate reduction in this authority's borrowing requirements. In doing so, it is anticipated that over the next four years the Council can reduce its borrowing by around £286m (gross cost saving of £384m) compared to what was previously planned. The table below shows the potential impact of this change on our Capital Programme. The table shows net financing figures are allowing for grant funding. This indicates that over the next four years the Council's Capital Programme will fall to a total spend of approximately £57m, the bulk of which relates to the financing of our new leisure centre which is already under construction



2.11 Subject to approval by CPRC and Council, the portfolio of sites currently in the housing delivery pipeline will form a key part of the emerging mixed use place making strategy, ensuring the Council retains control where needed, so that our regeneration objectives (including housing) are achieved. The Council may seek to utilise partnership arrangements, whereby the partner secures the finance needed to facilitate delivery of the strategy, plus brings additional expertise to ensure successful delivery on a site by site or combined portfolio basis.

2.12 Initial assessments would suggest that this change of approach could potentially offer... many other advantages, as well as the financial benefits, for our residents and communities. Officers suggest that the regeneration of Tothill and other locations in Staines-upon-Thames, should be viewed as a whole, rather than a piecemeal development to support the initial direct housing development projects.

2.13 The options will need further exploration with Councillors and stakeholders before a final decision can be reached on the preferred route of delivery on both a portfolio of sites and individual site basis. This process will take some time to work through as outlined in **Appendix 1**, which also sets out some of the key workstreams that will need to be progressed as part of finally determining what the correct strategy is for individual sites or a more comprehensive mixed-use place making strategy.

2.14 For clarity as outlined above, it is suggested that the Council will suspend any further development work and borrowing from the Public Works Loan Board or any other market providers to take new housing development/regeneration schemes forward (but will need to undertake some borrowing to complete the construction of our leisure centre and other small elements of the Capital Programme). In the interim and in line with best value requirements, we will consider all available options for the sites, to offset holding costs, whether this be alternative use or disposal.

2.15 Officers will also be reviewing options to tackle the deficit relating to the existing housing portfolio, currently managed by Knowle Green Estates Ltd (KGE). The Council and the Board will evaluate several options about the future of the Company, including its shape and size. Options could include transfer to a Registered Provider or reducing the portfolio and incorporating a reduced portfolio into the Council's Balance Sheet. There are a number of complexities and impacting factors that need to be considered as part of this decision, all of which will be fully outlined to our Members, prior to any decision being taken. Proposals will be worked up and brought back for consideration of councillors and KGE Board.

2.16 Over the last few months, the Bank of England Base Rate has continued to rise and following the latest inflation figures announced on 16 August, indicated that a further rise in the base rate was predicted. So rates have risen higher and look like they will remain higher for longer than the Council and commentators were anticipating when we were previously the viability of our affordable housing and private rental housing delivery strategy on the 2nd February 2023 Extraordinary Council Meeting.

2.17 At current interest rates, the financial viability of the remaining direct housing development projects are not sustainable for the Council to continue to seek to directly deliver and to finance from a combination of borrowing and Homes England grant, even with the Tothill mixed use development in Staines.

2.18 Therefore, it is recommended that the Committee supports in principle, subject to more details reports in October, to suspend the current Council residential development schemes in the Capital Programme, apart from the Local Authority Housing Fund Acquisitions (single property acquisitions to initially house Afghan families – funded with a higher level of grant than available for general Affordable Housing)

Suspending the schemes will allow officers to look for alternative solutions, which may include joint ventures and disposal of sites, to deliver much needed affordable housing for the residents of the Borough, for Council to consider the revised options.

2.19 The remaining non-housing capital projects, i.e., the leisure centre, will continue, as approved by Council.

2.20 This review will also impact on Knowle Green Estates (KGE) and its future financial viability, therefore, the process to apply to become a Registered Provider has been put on hold, pending the review by officers and any decision made by Council, as to the long-term future of KGE.

3. Options analysis and proposal

3.1 **Option 1 (Preferred)** The Committee confirms its support for moving to suspending the developments, and for more detail papers with the relevant strategies and policies parameters changes to go to October CPRC and Council. This will give officers the opportunity to assess all the options available and present them to Council for consideration. The options will be worked up in consultation with councillors and residents and could include a move towards a place shaping strategy. It is proposed that papers come to October CPRC and Council setting out options for moving forwards.

3.2 Should the Committee decline to move towards a suspension of residential capital schemes, officers will still be required to review the appropriateness of continuing to capitalise other costs, i.e., architect's fees, because of the continued delays in building the Council's development properties and will be removing many of the costs from the balance sheet to the revenue budget, in accordance with the CIPFA Code on capitalising cost.

3.3 **Option 2: Continue with current strategy**: This is not recommended as the Council cannot afford to continue with these projects because of the current level of PWLB Fixed interest rate and therefore, must suspend the development of the various direct housing projects.

3.4 Further proposals will be presented to the Committee and the Council in October

4. Financial implications

4.1 Following discussions with the Chartered Institute of Public Finance & Accountancy (CIPFA), Council can suspend the developments and retain the capitalised interest on the land and building acquired, on the basis that the Council intends to build affordable housing on these sites in the future. Whilst the future is not specified, it can exceed 10 years.

4.2 Officers will need to assess each development project and the 'other' costs incurred, to quantify the level of costs that can remain capitalised and in the balance sheet, and those that need to be written back to the Revenue Budget and consequently the General Fund. This is likely to be a substantial figure.

4.3 Alongside this review, officers will also need to assess the Council's Earmarked Reserves, to identify funds that can be used to mitigate the impact of these costs. A refreshed Reserves Strategy would be brought forward to October Committee and Council.

4.4 The proposals are likely to result in a significant reduction in the scale of the Council's Capital Programme moving forward and to reduce the amount of additional borrowing (with the exception of financing the leisure centre currently under construction) required in the future.

4.5 The reduction in the Council's Capital Programme will in turn mean a significant reduction in the amount of new borrowing the Council will need over the next four years and will enable the Council to consider reducing its Authorised Limit and Operational Limit, borrowing limits significantly.

4.6 The following Financial and Assets strategies and policies would be impacted and would require refreshing as a result of the proposed change of strategy direction:

(a) Medium Term Financial Plan

(b) Impact on the 2023/24 Revenue Budget

(c) Impact on the 2024/25 Budget

(d) Reserves Strategy

(e) Capital Programme

(f) Treasury Management Strategy, including reducing future borrowing limits:

Authorised Limits & Operational Boundary, and other Prudential Code Indicators

(g) Capital Strategy

4.7 It is proposed that the Assets Team bring forward an Emerging Mixed Use Place Making Strategy**.**

4.8 Whilst rising interest rates are making the delivery of new housing schemes much more challenging, it is worth noting that the rising interest rates do not impact on the Council's commercial investment assets, as the loan financing of those assets were all fixed, at an average of 2.3%, at the time of acquisition of those assets.

5. Risk considerations

5.1 **Risk:** Higher interest rates result in reductions in the market value of some financial assets, which could present further risks if exposures are not prudently managed.

5.2 **Mitigation**: By suspending the direct housing development programme, this will provide an opportunity for officers to assess and evaluate all the options available and present robust options to Council for consideration.

5.3 Whilst the continued rises in PWLB fixed interest rates has been a significant factor in the recommendation to suspend the housing development projects, other substantial risks will emerge as the Council implements its review and submits detailed reports, starting at Development Subcommittee in late September, including but not limited to the following:

5.4 Disposing of sites without planning approval will not deliver a maximised capital receipt, as there is greater development risk for a purchaser.

5.5 The Council's acceptable development densities and site design preferences may not achieve financially viable schemes where developers are seeking to achieve usual profit levels of 18%+ on their investment into a site.

5.6 Different delivery mechanisms offer varying control verses risk options i.e., the greater control the council wishes to retain on any site from a landowner perspective could result in increased development risk and sites being unattractive to potential purchasers.

5.7 Development delivery objectives may not fully align with planning objectives, therefore a considered and aligned approach needs to be agreed.

5.8 Conditional and joint venture delivery options typically result in longer timeframes to achieve financial receipts/other council objectives, where terms need to be negotiated with partners.

5.9 It may not be possible to mitigate non recoverable holding costs on specific sites and instead demolition and other options involving financial output maybe required in the short term to offset these non-recoverable costs.

(a) The failure by the Council to grant planning permission on the development sites, will significantly reduce the value of each site, when it comes to considering the Council's future options, i.e., to dispose of the site, or use the site values as part of a joint venture and this could generate significant realisable losses that will impact on the General Fund and lead to services being cut to residents.

(b) The high interest rates, will deter developments from being progressed with a joint venture, leaving the Council to service the annual interest charge on the loans taken out to purchase the development sites, which will place further pressure on the Council's General Fund, and this will have an impact on service.

(c) The construction industry is experiencing significant double-digit inflation on its material and labour costs, due to the cost-of-living crisis and a shortage of labour, which has been adding over 20% per annum to the total construction fees, for the last two years, i.e., the costs have increased by over 40%, which is putting severe pressure on the Council's finances. This has also significantly affected the financial viability of progressing development schemes.

(d) The lack of cohesive affordable housing strategy and affordable housing stock in the Borough, is putting severe pressure on the Council's homeless budget, and as the cost-of-living crisis progresses, the council expect to see more homeless cases materialise, with no housing stock to accommodate these families. This could consequently have an adverse impact on the health and wellbeing of families or individuals in the community.

(e) There could be an associated reputational risk to the Council as a result of the proposed change in strategy direction and approach. Communication and consultation with the public and stakeholders will be very important to promote understanding of why it has been necessary for the Council to change its approach to Housing delivery arising from continued risk exposure to wider externalities, ongoing uncertainty and significant financial challenges presented.

(f) Effective and timely delivery of some of the Council's corporate priorities, particularly relating to Housing delivery may be impacted further in planning for this revised approach.

(g) The risks relating to each of the alternative options for financing that have been referred to in this report and the impact for the Council's finances as well as wider implications require early identification, continued analysis, assessment and evaluation . For example, joint venture arrangements are likely to present a number of risks as well as opportunities and it will be critical that this detailed analysis is undertaken in concluding on the optimal approaches and outcomes for Spelthorne.

(h) There could be a risk that any changes in direction and options proposed do not support other relevant Council strategies which could result in fragmented approaches being proposed/adopted. Therefore consideration of how the preferred options dovetail with other critical strategies in a cohesive way will be important in effectively delivering the Councils corporate priorities and corporate plan.

6. Procurement considerations

6.1 Any procurements required as a result of the approval of any recommended options will be carried out in accordance with the Council's Contract Standing Orders and with the Public Contracts Regulations 2015 where applicable to ensure compliance and achieve value for money.

7. Legal considerations

7.1 The legal implications of options will be set out in the October papers to this Committee and Council.

8. Other considerations

8.1 Over the last few months it is becoming clear that a number of other councils are increasingly struggling to finance and deliver their housing aspirations and are having to revisit their approaches, which will include encouraging the private sector to play their part in delivering the affordable housing needs of the Borough

9. Equality and Diversity

9.1 Equality impact assessments will be worked up to assess impacts of the options put forward.

10. Sustainability/Climate Change Implications

10.1 Climate change mitigations will be considered as part of the options analysis.

11. Timetable for implementation

11.1 Based on the recommendation above,

(a) 25th September Development Sub-Committee Updated Development Strategy

(b) Early October – date to be confirmed – all Councillors Budget Briefing

(c) 16th October Corporate Policy and Resources Committee to receive options analysis and proposed amendments to financial strategies and policies, such as borrowing limits to recommend to Council.

(d) 19th October Council to consider CPRC recommendations.

12. Contact

12.1 Coralie Holman - C.Holman@spelthorne.gov.uk & Paul Taylor - p.taylor@spelthorne.gov.uk

Background papers:

Extraordinary Council Meeting 2 February 2023

Appendices: Appendix 1 - Emerging Mixed Use Place Making Strategy