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Living MK: Brief Review of the Proposal

Local Partnerships has been asked by Milton Keynes Council to spend a few hours undertaking an independent review of a selection of background papers relating to the proposed establishment of Living:MK. A list of the documents we have considered is attached at Appendix A.

MKDP secured an independent review of the Living: MK proposition from Savills dated December 2020. Savills are recognised as being leading advisors to local government in this specialist area. This paper should be read alongside this advice, as it does not seek to duplicate.

This proposition recommends a rapid evolution of MKDP to include a greater focus on housing delivery and placemaking, alongside creating a new Local Housing Company (LHC) ("Living:MK") as a wholly owned subsidiary of MKDP and in the form of a Registered Provider (RP). MKDP will initially bring forward 19 mixed-tenure sites for development in Milton Keynes at scale, with proposals for portfolios of up to 2,500 affordable homes in an overall programme in excess of 4,000. The LHC is proposed to be a 'Not for Profit' subsidiary of MKDP (with charitable status) and to register as a Registered Provider of Social Housing (RP), with the Regulator of Social Housing.

As the council takes forward this proposition, it will do so against the background that HM Treasury guidance is to follow a business case process. A business case is a framework for scoping and planning spending proposals leading to efficient and effective spend. The business case that has been prepared for Living:MK therefore aims to have the following uses:

- To facilitate internal and external approvals,
- Provide accountability for public funds,
- Support programme and project management,
- Be a repository for information / evidence base,
- Be the basis for post project implementation evaluation.

The public sector is advised to use business cases to reduce the risk of lack of value for the public purse. Good business cases provide:

- Clear links to organisational strategic priorities,
- Consideration of a number of options,
- A framework for identifying a range of risks.

With this guidance in mind, this short review considers if the papers supplied provide answers to the following key questions:

- Is the programme / project APPLICABLE: Does it meet strategic and operational needs?
- Is the programme / project APPROPRIATE: Does it offer optimal public value?
- Is the programme / project ATTRACTIVE: Is there a viable procurement route?
- Is the programme / project AFFORDABLE: Can it be delivered within an agreed funding envelope?
- Is the programme / project ACHIEVABLE: How will it be successfully delivered?

APPLICABLE:

The papers highlight that the establishment of a wholly owned Local Housing Company (LHC) is a "well-trodden path". They reference the 2019 research by UCL for the RTPI which, along with the Smith

Institute report in 2017[1] , provide the most comprehensive survey of this category of delivery vehicle. However, whilst the popularity of this vehicle in local government is beyond dispute, the delivery track record is less certain. Indeed, UCL comment "The survey has not focused on the number of dwellings being built or provided by each council and it may not be possible to determine these for another couple of years"[2]

Local Partnerships has supported several councils where new LHCs are falling well short of their intended output targets. We have recently completed Gateway Reviews of 5 LHCs in a variety of market settings. In general terms (and generalisations need to be treated with caution), LHCs tend to underperform and commonly encountered reasons for this, we find, are:

- Confusion about governance arrangements, especially the role and responsibilities of council LHC Board members where conflicts of interest (real or perceived) have led to loss of confidence in the new vehicle. In the worst cases, this has led to adverse comment in local media,
- Lack of a viable land pipeline. Several LHCs we have encountered stalled for lack of land dedicated to them and/or the sites they have been allocated (on closer examination) have proved to be non-viable. Some councils do not have asset management arrangements firmly in place to feed suitable sites into the new vehicle,
- Up front establishment costs are high, and disproportionate to the scale of the land pipeline,
- Lack of capacity and capability within the officer team. This can be linked to an unbalanced dependency on external consultancy advice.

The indications are the Living:MK may well avoid most of these potential pitfalls. Costs of external advice in the establishment phase can be defrayed across a substantial pipeline of land and the existing MKDP officer team have a track record of successfully acting as client to property development transactions. With careful planning and appropriate resourcing, the risks outlined above can be mitigated.

In terms of both *demand and need* and *strategic fit,* the business case provides compelling evidence in support of this proposition. From the brief overview we have undertaken, there appears to be little doubt that Living: MK will help to address the unmet need for more affordable homes and provide a demonstrable commitment to meeting the council's wider policy objectives relating thereto. The LHC proposal is applicable to the council's strategic needs.

As regards its applicability to the council's operational needs, expertise has been obtained from legal, commercial and financial consultancies: Sharpe Pritchard, Savills and PwC. The undoubted quality of this advice provides a solid foundation for council decision-making. The advice is shaped by the powers, processes and culture of local government so it is more than reasonable to conclude that the recommended operational model set out in the business case will be applicable to the council's operational needs.

However, the business case does point out that a whole suite of legal documents and operational tools will be needed to begin the work of the LHC: shareholder agreement, various documentation arising from the proposed lease structure, loan documentation, land and property transfer and development

[1] http://www.smith-institute.org.uk/wp-content/uploads/2017/10/LHCs-Summary-Report.pdf
[2] https://www.rtpi.org.uk/media/4440/tableoflocalauthorityhousingprovision2019.pdf

agreement documentation. This list could no doubt be extended to include programme and financial management tools. All of these will be required before the council's operational needs are fully satisfied.

There is no suggestion that those leading the establishment of Living:MK have over-looked any of these requirements. The council will need to ensure that a comprehensive work plan is assembled, and the necessary resources put in place to tick off items from this list. There is an acknowledgement that further work will be needed at the next stage to settle on the financial and personnel resource requirements of the new company.

We whole-heartedly endorse the recommendation that suitably experienced non-executive directors should be included on the new Board and that its chairperson is independent.

Subject to more work, the indications are that the council's operational needs can potentially be met.

APPROPRIATE:

The business case relies on the advice of the consultants who have highlighted a lease-based structure as the optimal funding route. This analysis is both logical and consistent with the findings of other councils considering a similar scale of ambition for their new LHC. Indeed, the consultants themselves are advising multiple council clients on the same shortlist of alternative funding routes. The advice concludes that the lease option provides the 'path of least resistance' to the establishment and operation of Living:MK.

It appears that the financial analysis has been modelled in ways that demonstrate how Living:MK will be assimilated into the overall business plan of MKDP. For example, MKDP has a wider portfolio not included in the LHC programme and therefore it has access to future income streams from site disposals and commercial activities. This may mean that the new vehicle has not been considered as entirely free-standing, but to do so would be a somewhat perverse denial of the facts on the ground, as it were.

The narrative notes that "a series of schemes will need identifying so that viability can be tested on an ongoing basis". This would appear to point towards the advisors using headline assumptions on rental values, informed by market research undertaken by the MKDP team. At the next stage, this market research may need to be augmented when a site-specific pipeline is agreed for transfer. Indeed, it is made clear that "these assumptions represent a benchmark approach to an initial outline business plan".

Allowances have been included for voids, management, maintenance, and bad debts. The anticipated cumulative surpluses retained in the company at year 50 are projected to amount to c. £25million. Further work may be needed to refine tax implications and to make a case-by-case consideration of the proposed level of subsidy. As a check list as to what level of detail may required under this heading and others, the diagram at Appendix B may be helpful.

It will be for the Director of Finance to adjudicate on whether the financial projections provided by the team meet value for money and investment case criteria. From our cursory review, it would appear that the expected allowance headings have been included and the market facing experience of the MKDP team has been factored in.

ATTRACTIVE:

The key test under this heading is whether the LHC project has been distilled into a viable/credible procurement route. The latest business case relies on the analysis in the SOBC and as such takes forward the Partnership Plus preferred delivery option. This option assumes that land is sold to a selected developer who designs and builds the homes. The LHC acquires the desired level of affordable/interim rent housing upon completion, essentially taking on the role of a housing association (RP). Presumably, this buy back transaction is agreed "off-plan" as a forward commitment to purchase, so that risk mitigation and cashflow benefits can flow through to an increased land receipt to MKDP.

In general terms both the SOBC and the latest business case are light on procurement detail. We consider this likely to be as the partnership plus route is akin to business as usual for MKDP. There is an assumed level of knowledge on the part of the reader. Standing back from that vantage point, it would be useful to see a fuller explanation of:

- The proposed key contractual arrangements and whether precedent documentation exists,
- A list of the contractual documents that will need to be initiated or adapted,
- The process for developer selection and the key criteria,
- Whether existing delivery partner frameworks will be utilised e.g., the successor to Homes England DDP3, and if not, why not,
- How key performance indicators will be used within contracts to safeguard outputs.

The SOBC identifies several risks arising from the preferred delivery route, inter alia:

- Units acquired from the development partner and/or passed over in lieu of land value, presents OJEU/Public Works Contract issues.
- Potential for lengthy procurement exercise.
- Limited by partners that will respond to this type of procurement i.e. PLCs rather than SMEs.

It will be beneficial to work through these aspects to be sure that the delivery plan is robust.

A key aspect of the delivery plan is for Living:MK to secure Registered Provider status. As Savills point out, this is by no means a common feature of LHCs, although they point to examples where this has been achieved. Given the primary objective for the new LHC is to provide an increased supply of affordable homes and all schemes will aim to be policy+, the prize in prospect via the RP accreditation is access to Homes England grants.

We know that the failure rate of applications for RP status is c85%. This demonstrates that a high bar of evidence is required. Whilst there is no reason to suspect that this challenge has been underestimated by the MKDP team, the delivery plan hinges on this assumption.

AFFORDABLE:

Savills conclude that "the financial model appears to be fit for purpose and covers the development phase pipeline in detail". They add "Whilst I have not subjected the model to a full audit of its functionality, and I am not in a position to comment on the site-by-site property-mix assumptions, it is clear that the basis for the modelling is robust and that there are no inconsistencies between the way the inputs are processed to the outputs".

It may be useful for the council to commission advice that aims to help reconcile bespoke programme specific financial models (of the sort assembled for Living:MK and for Phase B of The Lakes) with ProDev and the HRA business plan. As the council's estates regeneration programme gathers pace, it becomes even more important for the senior executive team to implement a consistent approach to financial modelling irrespective of whether this is for proposals in MKDP, in the HRA or in the General Fund.

As part of that endeavour, working towards a shared understanding (across MKDP, Finance and Housing teams) of the level of financial modelling detail that is required at each business case stage would also be a good thing.

Like Savills, we conclude that the proposition appears to be viable and affordable. However, this is no substitute for seeing this investment in the context of rival calls on the council's financial headroom and appetite for risk.

The business case recognises the potential for a mixed economy blend of funds including capital grants, capitalisation of income streams, deferring or forgoing land values, acquiring units with s106 funds, external finance via portfolio leverage. This is appealing and helps to mitigate risk but there is a consequential requirement for skills on the client side to lock these arrangements into place, phase by phase.

<u>ACHIEVABLE</u>:

Successful management and operation of Living:MK will depend on appropriate skills and capacity to act as intelligent client to a substantial and progressive pipeline of projects, as well as resources dedicated to governance. The business case provides high level estimates of costs for people and advice but is clear that more work will be needed to pin these down. The suggestion is that this will emerge via the application process for RP status. Certainly, the Regulator will scrutinise the resources that the council intends to put behind this vehicle very carefully.

Whether the resource estimates need to be adjusted remains to be seen. However, it is not too difficult to imagine that:

- MKDP will need to attract additional development management talent – preferably mid-career development surveyors who have a track record of leading property development/house building projects on time and to budget,
- That the resource deficit is the ability to operate as a confident client not the lack of narrow technical skills (which can easily be bought in e.g. cost consultants)
- This will be difficult as there is a scarcity of such people, especially those willing to take up employment in the public sector,
- That contracting with a delivery partner will in no way eliminate the need for astute commercial skills inside the client team.

Given the relative inevitability of this challenge, it would be advisable to start to address it now. It may be that given the coincidence of skills between this role and roles within the Housing Team (as the estates regeneration programme gathers pace), some sort of resource sharing could be used to the advantage of both MKDP and the council.

Both versions of the business case contain an analysis of risks and provide an outline programme. One perennial challenge when considering use of a LHC is the risk associated with Right to Buy (RtB). Tenancies held by wholly owned company vehicles appear to be insulated from RtB however, it is well known that government and various lobby groups are not content with councils using this mechanism. Many commentators conclude that it is more likely than not that a challenge to council owned companies will be made in the courts in the near-term future. Whilst Living:MK tenants would have the same Rights to Acquire that apply to all RP stock, a successful legal challenge would impact adversely on the LHC's business plan. A cautious and prudent allowance for this risk needs to be agreed.

The lifeblood of the new LHC will be access to a ready supply of land. In fact, one of the most compelling features of Living:MK is its extensive land bank. The risk of local political turbulence altering the priorities for use of council land needs to be regarded as a risk.

Referring to a high-profile topic, Savills comment in relation to use of the PWLB "The recent move by MHCLG to disallow borrowing by local authorities purely for investment purposes will not apply to such lending. In effect, the risk of such lending should be judged on the risks associated with the provision of affordable housing and its capability of covering the financing costs".

The Regulator will also scrutinise how risk is transferred between contracting parties in the delivery plan. This reinforces the need to work to a greater level of detail in the Commercial and Management Cases at the next stage.

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Appendix A

February 2021 Business Case
SOBC July 2020
Savills advice December 2020

Appendix B

Step	Actions	SOC/OBC /FBC	5 Case Model	Gateway
1. Strategic Assessment	1. Ascertain Strategic Context	PBC	Strategic Fit	0
2. Make Case for Change	2. Agree Strategic Context	(Start) SOC	Strategic Case	
	3. Investment objectives, existing arrangements & business need			
	4. Potential Business Scope and Key Service requirements			
	5. Benefits, risks, constraints and dependencies			
3. Preferred way forward	6. Critical success factors for investment		Economic Case Pt 1	
	7. Long list options (12) and SWOT			
	8. Recommend a preferred way forward	(Finish)SOC		1
4. Value for Money	9. Revisit SOC and determine short list (4)	(Start) OBC	Economic Case Pt 2	
	10. Economic appraisals of short listed options			
	11. Undertake benefits appraisal			
	12. Undertake risk assessment / appraisal			
	13. Select preferred option and undertake sensitivity analysis			
5. Preparing for potential deal	14. Procurement strategy (possibly already outlined)		Commercial Case	
	15. Service streams and required outputs - statement of need			
	16. Potential risk apportionment- risk transfer to party best placed to manage			
	17. Potential payment options			
	18. Contractual issues and accountancy treatment			
6. Ascertaining affordability and funding requirement	19. Prepare financial model and appraisals		Financial Case	
7. Planning for successful delivery	20. Plan project management		Management Case	
	21. Plan change management			
	22. Plan benefits realisation			
	23. Plan risk management			
	24. Plan post project evaluation	(Finish)OBC		2
8. Procuring VFM Solution	25. Revisit case for change	(Start) FBC	Economic Case	
	26. Revisit OBC options inc. PSC / Reference Case			
	27. Detail procurement process and evaluation of BaFOs			
9. Contracting for the deal	28. Set out negotiated deal and contractual arrangements		Commercial Case	
	29. Set out financial implications for the deal		Financial Case	
10. Ensuring successful delivery	30. PM Arrangements		Management Case	
	31. Change management arrangements			
	32. Benefits realisation arrangements			
	33. Risk management arrangements			
	34. Contract management arrangements			
	35. Post project evaluation arrangement's	(Finish)FBC		3
Implementation	Deliver the solution	PPM		4