

Real Lettings Property Fund – Investment in Temporary Accommodation

Compliance with statutory guidance on borrowing and investment

Statutory Guidance.

Section 1 of the Local Government Act 2003 gives each local authority in England and Wales the explicit power to borrow money. Section 12 gives a local authority power to invest for "any purpose relevant to its functions under any enactment, or for the purposes of the prudent management of its financial affairs".

Local Authorities are required by The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 to have regard to The Prudential Code for Capital Finance in Local Authorities (the Code) when carrying out their duties in England and Wales under Part 1 of the Local Government Act 2003. The Code sets out proper accounting practices applicable to the council's borrowing and investment activities (treasury management).

Borrowing

The Code requires local authorities to calculate the Capital Financing Requirement (CFR). The CFR represents the Council's underlying need to borrow for a capital purpose. Movement between years will be influenced by in-year capital expenditure and provision for eventual repayment of debt.

The Code allows Local Authorities to undertake unsupported borrowing so they can deliver projects such as spend to save schemes or take decisions to allocate resources from revenue to support the borrowing costs of capital investment to enable service enhancements. However, before using unsupported borrowing, the authority must be satisfied that the additional borrowing costs can be afforded within future years' budgets.

The CFR identifies the capital borrowing need, however ensuring cash is available to meet this demand is purely a treasury management decision based on cashflow analysis. Local Authorities do not always need to increase borrowing to full capacity if internal sources of finance can be temporarily utilised – a process known as internal borrowing. These internal resources may include cash reserves that have been built up over time or capital grants not yet required to service expenditure and that would otherwise be externally invested. This strategy of deferring additional borrowing remains prudent despite low borrowing rates, as in the current economic climate investment returns are low and credit risk is high.

This Council has developed a financial model to forecast the net borrowing requirement per year over a 50-year period. This model is used to identify optimum borrowing opportunities by ensuring the timeframe for any proposed new borrowing is matched to the aggregate provisions set aside annually for

debt repayment. The margin by which borrowing costs outweigh investment returns is known as a cost of carry, and this strategic approach aims to limit this risk exposure.

Real Lettings

The council proposes to make a cash investment of £5m, through the medium of a Partnership (to which the council's liability is limited), in order property be acquired for use as temporary accommodation.

Because the principle objective for the venture is the service benefit (the provision of temporary housing) rather than return on the cash investment (the anticipated revenue interest and capital growth) the venture is classed as capital expenditure and can therefore be financed from borrowing (whether internal or external) under the PC.

The nature of this venture has characteristics similar to treasury investments. Although not strictly required to do so, given the risk to capital and quasi-investment type structure involving expected returns, this report seeks authority to add this category to the permissible classes of investment set out in the TMS so that the inherent treasury-type risks be managed consistently.

Treasury Management Advice

The council's TM advisors have advised that "*Borrowing to fund any form of capital expenditure is ... permitted under the Prudential Code.*" and "*A [Partnership] is not a company and you cannot purchase shares in it. As a partner you essentially become an owner of the venture and we would therefore link whether expenditure would be classed as capital expenditure or not to what the money put towards the venture is actually doing. If it is going towards the purchase of buildings and land then that is capital expenditure.*"

Conclusion

The proposed cash investment in the fund would be classed as capital expenditure, which could be financed from borrowing (internal or external) in compliance with proper accounting practices.

Oxford City Council

Concern has been expressed at consistency between the approach taken at Oxford City Council and this council toward the funding of proposed participation in the Real lettings scheme. The Chief Finance Officers of the two councils have jointly advised:

The Real Lettings investment proposal secures both service benefits (supply of temporary accommodation) and treasury benefits (revenue income and capital growth). There are some minor differences in the treatment of these types of investment, under the Prudential Code.

Oxford City Council are proposing to treat their investment as a treasury investment, based on their interpretation of the proposal, the Code, and their financial and service-related circumstances.

Milton Keynes Council are proposing to treat their investment as a service investment, based on their interpretation of the proposal, the Code, and their financial and service-related circumstances.

There is no absolute criterion by which either approach could be judged to be correct and the other incorrect. The guiding principal would be that the decision for each council should be one which could be made by a reasonable council, considering all relevant matters and disregarding all irrelevant matters.

The Chief Finance Officer of each council is content that the approach to be adopted by their respective council complies with this principle.

Oxford City Council's statement that "The Council is not legally able to borrow to invest" refers to the principle of borrowing to invest speculatively, or purely to seek a return on investment. It is not intended to mean that borrowing to invest for service delivery purposes is unlawful.

Other measures to reduce B&B usage & costs

The Real Lettings proposal is part of a wide-ranging response to the council's commitment to reduce the use of B&B accommodation, and the costs thereof. This proposal is aimed at one segment of the "demand" side (homeless families with a realistic prospect of being able to sustain non-social tenancies) and one segment of the "supply" side (two-bed flats in the MK area).

Other proposals are also being brought forward to address the various supply-side and demand-side problems, including:

- Leasing additional temporary accommodation units in Bedford
- Building new council housing to provide permanent rehousing capacity
- Conversion of vacant commercial properties into temporary/permanent housing
- Improving on the existing HIP scheme to encourage private-sector landlords to house homeless families and others in receipt of Housing Benefit

Property market issues

Market capacity

Resonance, the proposed fund manager, have been following the MK property market and have expressed confidence in being able to acquire sufficient properties in adequate condition at appropriate price points.

Each property will be refurbished to the agreed specification between the Fund and SMB and this has been factored into the financial projections, and the capital appreciation assumptions for each area have been taken from the projections from a national property valuer (Jones Lang La Salle)

The council's own modelling indicates that there are sufficient properties on the market, and coming onto the market, to be able to meet the proposed acquisition strategy.

The council will only pay into the fund in relation to properties acquired; the fund will not hold the council's money other than as necessary to meet imminent expenditure

Potential impact on market

The property market in MK included 547 sales of flats in the last year. The proposed acquisitions represent approximately only 12% of this market. It is likely, therefore, that any impact on the overall market will be small.

Robustness of partnership

The council would be entering into a three-way partnership with St Mungo's Broadway (who will manage the properties and support the tenants) and Resonance (who will manage the investment fund). Information as to the robustness of these organisations as potential partners is set out below.

St Mungo's Broadway

St Mungo's Broadway was formed in April 2014 by the merger of two homelessness charities; St Mungo's and Broadway. St Mungo's began helping people sleeping rough off the streets in 1969. Broadway was created on 1 April 2002 from the merger of two London charities that, between them, had been supporting homeless people for more than 20 years.

St Mungo's Broadway, officially registered as St Mungo Community Housing Association, is:

- a limited company registered in England and Wales under company number 8225808
- a charity registered with the Charities Commission under number 1149085 since September 2012
- a housing association registered with the Homes & Communities Agency (HCA) under number LH0279.
- Broadway Homelessness and Support Ltd is a wholly owned subsidiary of St Mungo Community Housing Association. Together, both organisations are known as St Mungo's Broadway.

Both St Mungo's and Broadway produced unqualified accounts for the year 2013/14.

The combined St Mungo's Broadway has a turnover of approximately £70m, 1,250 employees, and works with over 20,000 clients. They work in partnership with many local authorities nationally.

St Mungo Community Housing Association is currently rated G2 (*"The provider meets our governance requirements but needs to improve some aspects of its governance arrangements to support continued compliance"*) and V2 (*"The provider meets our viability requirements. It has the financial capacity to deal with a reasonable range of adverse scenarios but needs to manage material risks to ensure continued compliance"*) by the HCA.

The Charities Commission records St Mungo Community Housing Association as being up-to-date with its statutory returns.

Resonance

Resonance is a social impact investment company with over a decade of experience of working closely with social enterprises throughout the UK, with particular expertise in community-led projects, homelessness, education and social care and working closely with investors whose values and ethics closely align with these sectors.

The Resonance Group also includes two subsidiaries; Resonance Impact Investment Limited (RIIL), a deal arranger and fund manager authorized by the Financial Conduct Authority (FCA) and Community Land & Finance CIC, a community development finance institution and accredited Social Enterprise.

As well as the Real Lettings Property Fund, Resonance currently manages two debt funds lending to community-led organisations to develop assets that serve local need and/or make the most of local opportunities. These funds help the development of resilient, powerful, inclusive communities mobilising both financial and social capital for the long-term benefit of communities around the country.

Resonance Limited is a company incorporated on 17 April 2002 registered in England and Wales, number 04418625. Resonance Impact Investment Limited (company number 07349971) is authorised and regulated by the Financial Conduct Authority (FCA), number 588462.

Reference sites

These organisations are already working in partnership with the London Borough of Croydon (LBC) in a London investment fund. LBC have recently decided to increase their investment in the fund.

Social Impact & Equalities Impact Assessment

The council's Comprehensive Equality Scheme 2012-2016 contains an objective to reduce the number of households in temporary accommodation

and find appropriate accommodation for them. Consequently an Equalities Impact Assessment has been prepared.

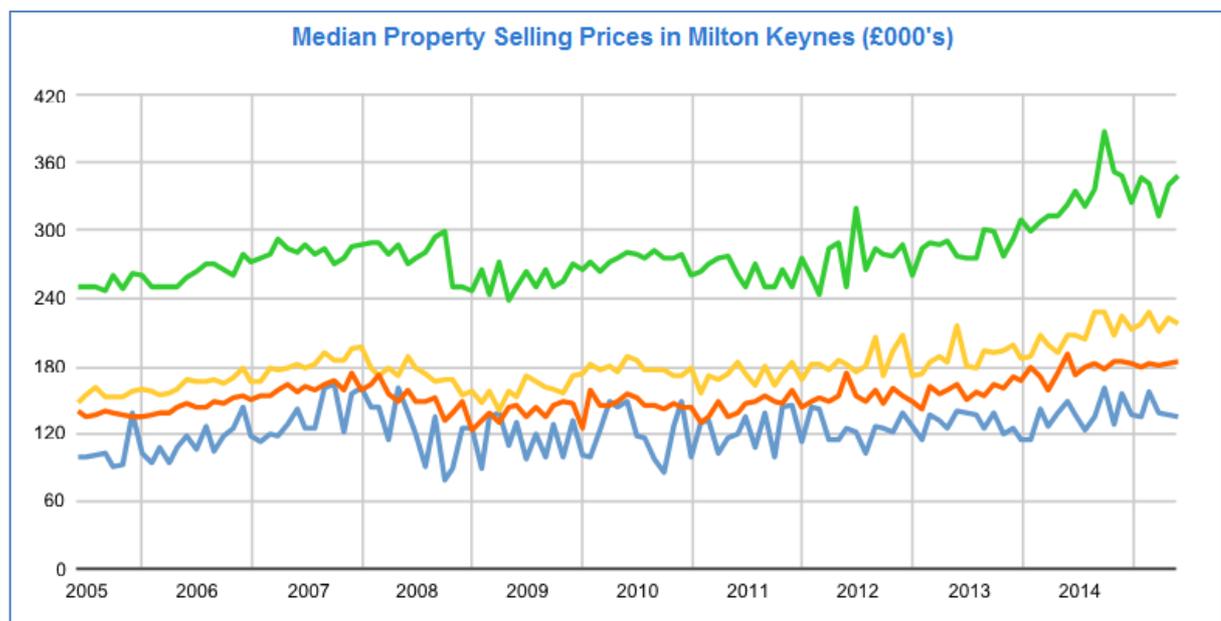
On the social impact of the second year of the London scheme, St Mungo's Broadway reported:

- Most of the tenants have been in Real Lettings accommodation for a short period of time with only 20 tenants housed for more than one year. These 20 tenants are nearing two years sustained tenancy, which is a significant achievement.
- 98% of tenants sustain their tenancies for more than six months
- 39% of tenants are in employment, 25% in training/education, 25% actively looking for work
- 87% of tenants say the property has had a positive impact on their support networks and relationships
- 27% of tenants save for a deposit so they can move from real lettings into the private market
- 84% of tenants are not in rent arrears, rising to 96% after 6 months
- Five tenants have moved on, of which four are positive and one is negative. This exceeds expectations in the sense that it happened before the second or third year of their time with Real Lettings.

Market History

The following graph illustrates property market movements in Milton Keynes over the last ten years:

(— Detached, — semi-detached, — terraced, — flats)



Source: www.home.co.uk

This data shows that over the last ten years, flats have increased by an average of **4.5%**; over the last four years, by an average of **7.1%**.

No quantitative forecasts for the Milton Keynes market are available, though Milton Keynes is often quoted as an area offering above-average potential for growth. Nationally, growth is forecast variously at around 6% per annum (Capital Economics), 19% over 5 years (Savills), or 34.1% by the first quarter of 2021 (OBR).

Modelling at 3% (compound 15.9% over 5 years) therefore represents a prudent view.

Market research (although admittedly based on a small sample) suggests that the increase in value of flats in Netherfield to have been 3.07% in the last 12 months, and 17.39% (annual 3.26%) over the last 5 years.