Agenda Item No:	**5**	Fenland CAMBRIDGESHIRE
Committee:	Investment Board	
Date:	21 October 2020	
Report Title:	Consideration of investment in Residential Housing	

1.1. Purpose

- To provide the Investment Board with an opportunity to consider investing in residential property as part of the Commercial and Investment Strategy.

1.2. Key issues

- Type and location of any such investment;
- Portfolio management of such assets;
- Initial funding proposals and Return on investment;
- Business arrangements and delivery methodology;
- Risk assessment and resourcing

1.3. Recommendations

- It is requested that the Investment Board:-
    - Provide a steer on the key issues as outlined in the report and the direction to be taken;
    - Request a full business case when direction is agreed;

Wards Affected	All
Portfolio Holder(s)	Cllr Chris Boden, Leader and Portfolio Holder, Finance
Report Originator(s)	Paul Medd, Chief Executive Officer Peter Catchpole, Chief Finance Officer and Corporate Director Carol Pilson, Corporate Director and Monitoring Officer Amy Brown, Deputy Monitoring Officer
Contact Officer(s)	Paul Medd, Chief Executive Officer Peter Catchpole, Chief Finance Officer and Corporate Director Carol Pilson, Corporate Director and Monitoring Officer Amy Brown, Deputy Monitoring Officer
Background Paper(s)	Cabinet Report 9th June 2020 Approval of the Business Case to set up a Local Authority Trading Company (LATCo)

Fenland District Council

Investing in Residential Property

October 2020

Contents

1. Summary

The LATCO business case presented to and approved by Cabinet on 9th June 2020 included a potential scenario for investing in residential property for a rental return.
This paper seeks to build on this initial scenario and ascertain further steers from the Investment Board on how this option can be developed. There are many ways in which this can be approached and some of the options to be discussed include but are not limited to the following:-

- Buying new properties in bulk off plan potentially at a discount.
- Are there particular segments of the market that we would want to target i.e. sheltered housing, supported living etc. as tenancies could be seen as potentially longer?
- Are there particular areas of Fenland that we may wish to target as they potentially offer better returns on investment?
- If not new, then what is our minimum standard of property to invest in? Ready to let, refurb needed etc.?
- Retaining new properties from our own development schemes?
- Others?

2. Background

In view of the reduction in central government support the Council has a responsibility to consider smarter ways of working and providing additional income. It is therefore undertaking a review of how it manages property investment to generate income to continue to maintain services and to live within its means.

The Commercial and Investment Strategy which was approved by Full Council in January 2020 identified the need for the creation of one or more residential and commercial property companies to engage in property investment at arm's length from the Council for a commercial purpose. Further advice has been received which enables both residential and commercial activities to be undertaken by one arm's length company which will be solely owned by the Council.

The Council's business plan 2020/21 shows that improving infrastructure and housing growth is a priority and the establishment of a separate property company will provide the means to proactively explore new methods of property investment and housing delivery across the district.

In the Business case to establish the company presented to Cabinet on 9th June 2020 the objectives for Fenland Future Ltd ("FFL") were agreed as follows:-

(a) Maximise the return to the Council as shareholder from its asset portfolio and exploit opportunities for acquisitions, development and commercial return from assets;

(b) Create a delivery model that operates with a degree of commerciality in line with aspirations that mirror the Council's Corporate Plans;

(c) Hold, manage and operate private lettings directly or via procuring landlord services to the tenants of any rented housing;

(d) Act as a responsible and equitable landlord;

(e) Deliver capital appreciation;

(f) Generate income from commercial investments;

(g) Always seek to obtain the lowest price for purchases and best consideration on sales.

This paper builds on these objectives with a particular focus on acquiring property for rental purposes. For the purposes of this discussion paper it is assumed that FFL will be the acquiring organisation and will therefore hold the assets on its Balance Sheet.
Although this is only the first stage of the process it might be worth noting that a Local Authority can own up to 199 residential properties before a Housing Revenue Account (HRA) is required and further legal advice would be sought well before this trigger point is reached.

3. Business Arrangements

Private residential properties will initially be let on assured shorthold or non-secure tenancies to provide the Company with the greatest flexibility with the long-term management arrangement of the properties.

It is proposed that the management, maintenance and statutory compliance services will be acquired either through the Fenland Future Ltd or an external provider depending on the volume and nature of the tenancies. It is envisaged that this would be outsourced initially until there is sufficient critical mass to manage directly through FFL.

4. Financial Analysis

Detailed financial modelling on more specific and targeted investments would need to be carried out to assess the potential viability of acquiring properties for rental in the District. For illustrative purposes the general scenario as presented in the original business case is again included with this paper.

<u>Property purchase</u> <u>(Appendix 1)</u>
A scenario where the FPC purchases 15 housing properties at the beginning of each year, spending approximately £1.5m per annum on investment properties in the Fenland District for the first 5 years of operation. The proposed portfolio of properties is based on purchasing properties in the Fenland area with an average price of £100k including Stamp Duty Land Tax, fees and an allowance for refurbishment.

The properties would be acquired through the purchase of existing properties including new builds or potentially off-plan as reasonable discounts may be secured. When selecting the properties, the key criteria applied will be to achieve a minimum 6% or higher ratio of capital cost to annual rent. When modelling the first phase the key aim would be to select properties that offer the greatest return.

Base Financial Assumptions

In calculating the viability model, the following assumptions have been included:

- Inflation 3% per annum;
- Borrowing costs 5% per annum on a 50-year annuity basis;
- Management costs per unit £500 per annum;
- Responsive maintenance costs per unit £400 per annum;
- Major repairs provision 0.5% per annum from year 5;
- Occupancy level 96%.

For the property purchase scenario, a 50-year cash flow has been used for the business plan of the FPC. On the basis that assets are well-designed, planned and maintained and suitable provision is made for capital repairs during the lives of the assets housing asset lives typically extend up to 100 years. On this basis, assets should remain in a good condition at the end of the 50-year cash flow and, therefore, have a residual value. The business plan has excluded increases in house prices however it is anticipated that this is an area where additional returns on investments can be made in the medium to long term.

The assumption in preparing the profit and loss account and balance sheet is that the housing stock acquired would be held as investment property, as determined under IAS40 (property held for capital appreciation or to earn rentals). There would therefore be no depreciation charge on the assets. However, falls in the asset valuations would be charged to the profit & loss account.

The financial cash flow forecast at Appendix 1 shows the potential property purchase impact and further detail would be required to present in a full business plan.

Other considerations would include agreeing exit strategies and holding periods. It may be beneficial to strike a balance between acquisitions, holdings and sales at any given time which is in essence an effective asset management process. This would need to allow for disposal of troublesome/void properties and continual refinement of the asset base.

Capital appreciation would also be a key factor in this strategy and will be considered when looking at any property acquisition.

5. Financing

Potential Funding Sources

It has been assumed that the Council will make loan finance available to FFL through the use of prudential borrowing. This would be based on a secured loan at market rates including a margin which will provide FDC a return on the funds invested.

Funding initial schemes

It is envisaged that the Council will need to loan FFL sufficient sums to enable the purchase of the first properties including all acquisition expenses.

Stamp Duty Land Tax (SDLT)

SDLT is a charge on property transactions. The sale of land and / or property from a third party to FFL has the potential to incur an SDLT charge. This will be allowed for in the calculation of the initial purchase cost of the properties.

6. Risk Management

The key delivery risks and their likely impact are summarised below along with mitigating actions. A robust risk management plan will be developed as part of the business plan.

In undertaking acquisitions, the Council will need to consider the capacity of FFL to deliver and manage these investments and to ensure statutory compliance and financial sustainability in the future.

In practice this will require it being able to evidence that it has:

- Assets it can use as security;
- Managed operational properties effectively, with good void and bad debt performance;
- Met debt servicing requirements of loans from the Council; and
- Managed the business of the FFL effectively from corporate governance and reporting perspective.

7. Resources

Further consideration around resources needed to deliver this strategy will need to be taken into account. These include but are limited to: -

- Day to day management
- Lettings management

- Repairs and maintenance
- Financial management
- Debt control and enforcement
- Statutory testing and compliance
- Sales and purchases management
- Legal advice and leasing

As referenced above under 3. Business Arrangements, it will almost certainly be necessary to “buy in” these skills in the first instance until such time that “critical mass” is achieved.

Appendix 1 – Example Financial Modelling (property purchase only)

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 20	Year 30	Year 40	Year 50
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
Income														
Private Rental Income	104	207	311	415	518	534	550	566	583	601	808	1,085	1,459	1,960
Total Income	**104**	**207**	**311**	**415**	**518**	**534**	**550**	**566**	**583**	**601**	**808**	**1,085**	**1,459**	**1,960**
Costs														
Management Costs	-8	-15	-23	-30	-38	-39	-40	-41	-42	-43	-47	-63	-85	-114
Repairs and Maintenance	-6	-12	-18	-24	-30	-31	-32	-33	-34	-35	-58	-78	-104	-140
Allowance for Major Repairs and Maintenance	0	0	0	0	0	-7	-14	-22	-29	-39	-72	-129	-263	-353
Company running costs	-20	-21	-21	-22	-23	-23	-24	-25	-25	-26	-35	-47	-63	-85
Total Costs	**-34**	**-48**	**-62**	**-76**	**-90.5**	**-100**	**-110**	**-121**	**-130**	**-143**	**-212**	**-317**	**-515**	**-692**
Financing Costs														
Interest	-75	-150	-225	-300	-375	-373	-371	-369	-367	-364	-332	-280	-195	-55
Total Financing	**-75**	**-150**	**-225**	**-300**	**-375**	**-373**	**-371**	**-369**	**-367**	**-364**	**-332**	**-280**	**-195**	**-55**
Grand Total Costs	**-109**	**-198**	**-287**	**-376**	**-466**	**-473**	**-481**	**-490**	**-497**	**-507**	**-544**	**-597**	**-710**	**-747**
Profit / (Loss)	**-5**	**9**	**25**	**39**	**53**	**61**	**69**	**77**	**86**	**94**	**264**	**489**	**748**	**1,213**
Corporation Tax	0	0	0	7	10	12	13	15	16	18	50	93	142	230
Profit / (Loss) after tax	**-5**	**9**	**25**	**31**	**43**	**50**	**56**	**62**	**70**	**76**	**214**	**396**	**606**	**983**