

Item No. <b>22</b>	Classification: Open	Date: October 16 2007	Meeting Name: Executive
Report title:		Elephant & Castle - Financial Implications Report	
Wards or groups affected:		Cathedrals, Chaucer, East Walworth and Newington	
From:		Finance Director	

## RECOMMENDATIONS

1. The Executive approve remaining leasehold acquisition capital costs of up to £23.5m for the Heygate Estate. This is to be included in the capital programme and financed as part of a receipt arising from the final contract to be agreed with the preferred development partner and expected to be received upon the transfer of vacant possession and the completion of the demolitions on the estate.
2. The Executive approve that interim funding gap for the buybacks be funded through the re-profiling of the existing Housing Investment Programme.
3. The Executive note that the demolition of the Heygate Estate will be managed and funded by the preferred development partner, subject to contract.
4. The Executive approve the provision of a dedicated Major Projects rehousing team for the provision of coordinated project delivery of estate and case management under the control of the interim Strategic Director for Major Projects to be funded through the existing departmental budgets for 2007/08.
5. The Executive note that work will be completed on assessing the new cost of the Major Projects rehousing team and that any new commitment be included within the 2008/09 Policy and Resources Strategy to be presented to Council assembly in February 2008.
6. The Executive to approve that the Strategic Director for Environment & Housing (Home Ownership Unit) to financially test all leaseholders affected by regeneration schemes and applying for rehousing assistance from the council by using the systems most appropriate to the financial market at the time, as outlined in paragraphs 19 to 21.

## BACKGROUND INFORMATION

7. The Executive requested, on 19<sup>th</sup> June 2007, a full report on the financial implications for the Heygate Action Plan implementation and future implications for the Aylesbury estate regeneration.
8. The details in this report are reserved for the implications on the Heygate Estate and do not cover related implications for the Aylesbury programme. These will be subject to future reports to the Executive once there is a clearer view of both timing and phasing of the project.



9. Subsequent to the 19<sup>th</sup> June 2007 report to Executive, final bids were received from the short listed tenderers to become the preferred development partner for the Elephant and Castle. This was reported to Executive on 24<sup>th</sup> July 2007 and Lend Lease was selected as the preferred development partner.

10. On 30<sup>th</sup> July 2007, the major projects board (executive committee) considered a report on the "Elephant and Castle Regeneration - Approval of preparation, seeking authorisation and use of compulsory purchase powers in the Elephant and Castle Core Area/Appropriation of land within Elephant and Castle Core Area for planning purposes". As part of this report the board considered the funding for the acquisition of leasehold third party interests where the council was the freeholder. The board recommended the following for ratification by the full executive:

That the council make available the necessary funds to complete the acquisition of all third party interests where the council is freeholder, currently estimated at £23.5m, of which £5m should be made available immediately (i.e. within financial year 2007/08).

The estimated capital cost and method of funding is recommended in paragraph 1 of this report and the profile across the years outlined in paragraph 31.

11. The final negotiations with preferred development partner are continuing and currently and are expected to be concluded early in 2008.
12. The figures in this report are based on the detailed proposal from the preferred development partner and are subject to contract. Further analysis for the revenue costs of the multi-disciplinary team are on the basis of initial analysis by PWC on behalf of the interim Strategic Director of Major Projects and are subject to review as part of the Policy and Resources Strategy.
13. The council has supported a regeneration programme at the Elephant and Castle for a number of years alongside the support of central government grant. Currently the revenue budget to support these aims stands at £2.238m. The status of this budget will be reviewed as the project moves to the delivery phase and if appropriate may be reallocated to other major projects, subject to Executive agreement.

#### KEY ISSUES FOR CONSIDERATION

14. **Capital Leasehold Acquisitions and Demolition:** In the 19<sup>th</sup> June report to Executive the expected capital requirement was £49.7m. This report details a capital requirement of £23.5m for leasehold acquisitions and associated costs (including home loss payments previously estimated at £4.3m). The final bid from the preferred development partner included the transfer of risk for the first £20m demolition costs to the preferred development partner, subject to contract.
15. A separate provision for shared equity of £0.6m was made in the 19<sup>th</sup> June report. Whilst no separate provision has been made in this report, the option to assist existing leaseholders with a shared equity purchase does however remain.



16. Furthermore, the 19<sup>th</sup> June report had a capital estimate of £1.6m for security of the Heygate estate. This report deals with the security issues by the provision of additional Community Wardens, dedicated police support and night time patrols. These costs are included in the total revenue operating costs detailed in paragraph below for the Major Projects rehousing team.
17. **Major Projects Rehousing Team:** The following table shows the estimated gross running costs of implementing the Heygate Action Plan with respect to the approved bid from the preferred development partner as major development partners.

**LB Southwark Heygate Action Plan: Estimated Operating Budget**

	2007/8 £	2008/9 £	2009/10 £
Staffing costs	450,000	1,700,000	850,000
Operational costs	487,000	525,000	401,000
<b>Total Estimated Costs</b>	<b>937,000</b>	<b>2,225,000</b>	<b>1,251,000</b>

18. Further work will be completed to verify existing resources available to be reallocated to the dedicated team and the allocation of costs between the Housing Revenue Account and the General Fund. It is expected that there will be £583,000 p.a. revenue contribution available from the preferred development partner, although this is to be finalised during the current negotiations.
19. **Leaseholder Buyback Policy:** The Elephant & Castle Leaseholder Policy, approved at Executive on 8th February 2005, set out the various options for leaseholders whose properties are being acquired by the Council to facilitate the regeneration of the estate. Due to Heygate property values being lower than other properties in the Borough, the policy included options for leaseholders unable to afford to buy another property. To assess for which option leaseholders are eligible, the Home Ownership Unit (HOU) will undertake a financial assessment of the leaseholder, including their mortgage borrowing capability, based on a multiple of the household income. The HOU has now identified that this method is unrealistic, out of date and inappropriate in comparison to actual circumstance and how this is currently quantified in the marketplace. There is inconsistency when compared with how HOU carries out affordability testing in the other schemes it runs, i.e. Social Homebuy, Hardship Repurchase and in the near future Cash Incentive.
20. The multiplier approach takes gross annual income and multiplies it by a set figure resulting in the maximum borrowing ability. The previous report proposed a figure of 3.7 times the principle income or 3.1 times the joint income where there is more than one potential mortgagor in qualifying employment. The affordability approach is a residual method which takes income and expenditure to result in a figure which gives the amount of disposable income a household has based on concrete evidence. This figure can then be translated into a maximum borrowing ability.



21. The advantages of the affordability approach over the multiplier approach are clear.

- It is evident that income in itself does not dictate actual affordability. Two households with an identical income will not necessarily have the same demands on their income depending on personal circumstance, the household make up and the property which is to be purchased.
- The affordability approach is fairer and more robust and has already proved effective in the existing hardship repurchase and social homebuy schemes already run by HOU.
- This approach is more realistic in comparison to the open market. Mortgage providers have been moving away from the multiplier approach for the last few years and continue to do so. Leaseholders who will need to seek another mortgage are likely to be tested using an affordability approach.
- The transparency of this approach provides fewer grounds for appeal by making clear to any applicant the financial reasons why a certain rehousing option is applicable and others inappropriate.
- This approach maximises the borrowing ability for households with few costs so allowing them to stay in home ownership whilst more financially vulnerable leaseholders and their families are protected and assisted.

#### **Policy implications**

22. The implications of the change in current policy for mortgage affordability are outlined in paragraph 21 above.
23. The implementation of the Heygate Action Plan was agreed at Executive on 19th June 2007.

#### **Community Impact Statement**

24. This was considered fully in the reports to executive for the Heygate Action Plan on 19th June 2007 and the Elephant & Castle Stage 3 Master Development Partner Selection on 24th July 2007.

#### **Resource implications**

25. The approval of the policy to change the way in which mortgage borrowing ability is estimated will require an additional 1.5 members of HOU staff due to the additional analysis required. Resources will need to be reviewed in HOU in context of the Major Projects' Rehousing Team.
26. Staffing numbers for the Major Projects rehousing team are estimated to be 45. This includes existing staff currently employed by different departments and also a requirement for new staff to address the increased workloads. The full year staffing costs are estimated to be £1.7m. The staffing costs for 2007/08 will be met from existing resources. It is expected that the team will have transferable skills which will be useful for other housing regeneration schemes like the Aylesbury.



27. The funding of the leasehold buybacks can be met in the short term by re-profiling the expenditure within the Housing Investment Programme. This is subject to the reimbursement of leasehold costs by the preferred development partner, subject to contract, for an earmarked receipt of up to £20m. The majority of the leasehold costs will be incurred in the financial years 2008/09 and 2009/10 and the capital receipt is expected after demolitions have taken place in January 2010. A further £10m fixed land payment is expected to be paid at the beginning of phase 1 in January 2010.
28. The overall Housing Investment Programme will be re-profiled to accommodate the timing difference between the expenditure for the leasehold buybacks and the receipts from the preferred development partner, subject to contract. Should there be a short term funding gap it may be necessary to undertake prudential borrowing to enable the continuation of both the Housing Investment Programme and delivery of the vacated Heygate estate.
29. The requirement of any prudential borrowing would be subject to the appropriate approval procedures in effect at that time.

#### Financial Implications

30. £9.44m has already been approved for leasehold acquisitions including £6.44m funding from the re-profiled housing investment programme. The full amount has been fully committed up to the current financial year.
31. A further £23.5m is estimated to be required to complete the remaining leasehold repurchases. This is profiled as follows:

	£
2007/08	3,286,000
2008/09	7,770,000
2009/10	12,444,000
<b>Total Capital funding required</b>	<b>£23,500,000</b>

32. The profile of the acquisitions will be subject to change depending on the implementation date of the compulsory purchase orders and the timing preferred by individual leaseholders. It is likely that costs will still be incurred after the date of expected vacant possession (September 2009) since final payments may be made after vacant possession and following negotiation and the due course of the legal processes.
33. Current negotiations for the final contract with the preferred development partner could include £750k costs of resiting a church to be financed by the preferred development partner, subject to contract. This would be likely to result in a reduced capital receipt on hand over of vacant possession and completed demolitions.



34. The preferred development partner's bid includes a capital receipt for the council of up to £20m for the reimbursement of leasehold acquisition costs and a fixed land payment of £10m upon the completion of demolition works, subject to contract. This is estimated to be received in January 2010. The financing of the leasehold acquisitions within the HRA will be an issue for 2008/9 and the re-profiling of the existing Housing Investment Programme will be able to accommodate the timing differences.

## **SUPPLEMENTARY ADVICE FROM OTHER OFFICERS**

### **Strategic Director for Regeneration & Neighbourhoods**

35. There is currently resource capacity within the Housing Investment Programme which can be used in the short term to finance the leaseholder buybacks without impacting on the delivery of our other investment priorities. It is anticipated that the use of this housing investment funding will avoid the use of prudential borrowing or a call on general fund capital. The housing programme will be re-profiled to allow for the spend levels identified in paragraph 31. If however, prior to the repayment of the funding by the development partner (paragraph 27); the capacity of the housing programme to deliver can be increased, other resources may have to be identified to bridge the funding requirements. The proposal will enable the rehousing of Heygate estate residents to continue according to plan without constraining the borough-wide housing investment programme.

### **Strategic Director for Major Projects**

36. The bringing together of the multi-disciplinary team will help to improve the service offered to tenants and leaseholders of the Heygate estate. The resident's concerns about their rehousing needs and lease buybacks to a challenging timescale will be assuaged by having a dedicated case office with a supporting team back up. In this way, the tenant's concerns will be addressed in a holistic way and on a timely basis. The visible presence of community wardens and night time patrols will help to ensure that public order is maintained as flats and blocks are vacated. The accelerated timescale for transferring vacant possession will spur confidence in the regeneration programme, avoid the social problems of partially cleared estates and provide a sound commercial basis for regeneration.
37. The terms of the bid from the preferred development partner are welcomed and support the council's overall regeneration aims. The terms provide for the preferred development partner to manage the timely demolition process and to underwrite demolition costs of up to £20m, subject to contract. Upon the completed demolition the Council will receive reimbursement of its leasehold costs of up to £20m, subject to contract. The provision for sharing future gains from the development of the Elephant and Castle area could provide further capital receipts to fund future regeneration programmes.

### **Strategic Director for Environment and Housing**

38. The change in policy for assessing the affordability of mortgages is necessary to ensure that a fair and more realistic approach is taken when considering the facts for each individual concerned. This will enable fair and consistent decisions to be made, and if challenged clear reasons can be put forward that are meaningful to the individual concerned. The proposed change will bring the council in line with best practice expected from the lending institutions.



39. It is envisaged that some existing leaseholders will not be in a position to continue to afford outright ownership and will be assisted with an offer of more affordable intermediate tenure (shared ownership). Lending institutions current practice in this scenario is to ensure affordability of the share purchased by full means testing examining income and expenditure in detail to determine a surplus amount available to fund a mortgage, rather than a simple multiplier.
40. The policy recognises that there will inevitably be an increase in the number of secure tenants because there will be a proportion of existing leaseholders that will not be able to fund any type of intermediate ownership. Until the means testing is underway the numbers cannot be ascertained.

#### **Strategic Director for Legal and Democratic Services**

41. The recommendation proposed sets out the proposed changes to the financial parameters within which the Elephant & Castle Major Project operates. If the Executive approves this report, the Major Projects Board will, under the authorisation given to it under the Council's Constitution (section 3E), have the ability to make decisions in this area of spend.

#### **Comments of the Deputy Chief Executive**

42. The Rehousing Programme for Heygate Tenants and Leaseholders will have an impact on the distribution of stock allocations through Homesearch. Currently some 15% of all allocations are to the Band One category, and it is expected that the proportion of lets to Band One Tenants (including Heygate Tenants) will increase. Nevertheless, the number of lets overall will remain high relative to most London boroughs, a fact augmented by projected high numbers of new Housing Association units coming on-stream over the next two years. We therefore expect that all urgent housing needs will continue to be met in reasonable timescales whilst rehousing is in progress.
43. The Community Housing Service currently manages some 400 Heygate Estate properties, which are used to meet the Council's strict statutory duty to accommodate homeless families. We expect that the number of voids available for use as Temporary Accommodation (TA) will diminish as each phase completes. CHS expects that the additional demand created by the Heygate rehousing process will be met through commissioning of additional TA units through Private Sector Leasing agreements (PSL).
44. The cost of PSL agreements fall to the General Fund, so this process involves a transfer of financial risk from the HRA to the General Fund, at a time when the DWP has stated that Benefit Subsidy levels will reduce until 2010. This risk will be mitigated by the more favourable contracting arrangements currently under discussion. At present, we believe that new commissioning will deliver an additional £120k to supplement Homeless Prevention in the General Fund in 2008/2009, on the basis of a 5% reduction in Benefit Subsidy. A wider procurement exercise is planned following the lapse of two further PSL management agreements in the next financial year, which will further mitigate any medium term risk to the General Fund caused by the demolition of the Heygate Estate.



45. CHS is working toward a medium term Government target to reduce the number of households in temporary accommodation by 50% by 2010, thus it is possible that TA demand will reduce in the longer term. Once contracts for PSL supply are entered, the allocations priority within TA will change toward favouring PSL supply over regeneration voids. It is possible therefore that CHS will not be able to fill all voids generated in future schemes with homeless households. Project governance structures now in place will ensure that the use of regeneration voids as short life is closely monitored, and alternative uses be explored should TA demand prove insufficient to meet housing management requirements.
46. Detailed monthly reports are prepared to monitor the overall TA position. These reports feed into the budget monitoring reports provided to the Finance Director. The effects of the new contracting arrangements will be reviewed and any resulting financial variations will be reported through the normal budget monitoring process.

#### Finance Director

47. The vacation of the Heygate estate requires the council to undertake a number of leasehold buybacks and to re-house council tenants to other properties. Relocation of existing tenants can be achieved using current arrangements and related costs can be contained within the existing Housing Revenue Account budget.
48. The council needs to fund leasehold buybacks to secure vacant possession. In accordance with the Best and Final Offer from the preferred development partner these costs up to the value of £20m will be reimbursed, subject to the terms of the final contract. The buybacks require initial funding in advance of this receipt. This will be provided from within the housing investment programme before the council is reimbursed once vacant possession has been granted. This funding source has been agreed with the Strategic Director of Regeneration & Neighbourhoods and will be phased over the period 2007/08 to 2009/10.
49. In the event of a short term funding gap, then prudential borrowing may need to be considered. Should this be the case this would be subject to the appropriate approval procedures in effect at that time.
50. In addition, demolition costs of up to £20m will be underwritten by the preferred development partner who will also manage the demolition on behalf of the Council, subject to contract. Should total demolition costs fall below an estimated sum, then the savings will be shared between the council and the preferred development partner, again subject to the terms of the final contract.
51. In the event of the failure of a third party to deliver on the overall programme, the council will retain full possession of the sites. Once vacant possession had been achieved, the plots would be available for the council to sell and the receipt would be recycled to reimburse the costs of leaseholder buybacks and fund further regeneration projects.
52. The Major Projects Board have proposed that a special team be created to specifically support the Heygate residents during the period of rehousing. The total costs for the period 2007/08 to 2009/10 are currently estimated to be approximately £4.4m. The whole team will be located within the Major Projects department. The creation of the Major Projects rehousing team will fundamentally enhance the rehousing project for all the tenants affected.



Continued work will be required over the coming months with other Strategic Directors to pool HR and financial resources to maintain the programme through to completion. It is anticipated that the experience and skills required will be readily transferable to future programmes including the Aylesbury programme.

53. For 2007/08, costs will initially be contained within existing departmental budgets (e.g. Environment & Housing (including Community Safety); Community Housing; etc.). Where appropriate, these costs will continue to be charged to the Housing Revenue Account where they support landlord functions.
54. Precise details are still being agreed but any shortfall from existing provisions will be reported through the forthcoming budget process. The final figures are still to be agreed with the Strategic Directors for these budgets but are expected to be completed by the end of November 2007.
55. Every effort will be made to maximise the use of existing resources and budget provision to minimise the amount of budget growth. Due consideration will need to be given to the structure of the final contract with the preferred development partner to ensure that the costs of demolition are fully borne by preferred development partner.
56. The additional pressure on the housing investment programme is recognised, but the reimbursement of £20m to the programme on the granting of vacant possession together with carefully re-profiling of the current programme will mitigate against any disruption to that programme.
57. It must be appreciated that this project is extremely complex and all financial implications are based on the best information available at any point in time. The council reserve the right to use all funding mechanisms such as prudential borrowing in order to mitigate any short term cash flow shortfalls on any of the capital investment as outlined in this report. Any such decision would be subject to all the normal approval processes and would need to be incorporated into the revised Policy and Resources Strategy.

#### REASONS FOR URGENCY

58. It is essential that the programme of leasehold acquisitions and the establishment of the Major Projects Rehousing Team be progressed as quickly as possible to ensure the success of the Elephant and Castle redevelopment. Any delay to this programme would have adverse financial and reputational consequences.

#### REASONS FOR LATENESS

59. The finalising of the cost implications, phasing and funding sources of the proposals has required extensive internal consultation and amendment.



## BACKGROUND DOCUMENTS

Background Papers	Held At	Contact
Heygate Action Plan – report to Executive 19 <sup>th</sup> June 2007	Constitutional Team, Town Hall, Peckham Road	Everton Roberts
Elephant & Castle Stage 3 Master Development Partner Selection report to Executive 24 <sup>th</sup> July 2007	Constitutional Team, Town Hall, Peckham Road	Everton Roberts
Elephant & Castle Leaseholder Policy report to Executive 8 <sup>th</sup> February 2005	Constitutional Team, Town Hall, Peckham Road	Everton Roberts

## AUDIT TRAIL

Lead Officer	Duncan Whitfield	
Report Author	Brian Smith	
Version	Final	
Dated	5 <sup>th</sup> October 2007	
Key Decision?	Yes	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES /		
Officer Title	Comments Sought	Comments included
Strategic Director for Legal and Democratic Services	Yes	Yes
Finance Director	Yes	Yes
Strategic Director for Regeneration & Neighbourhoods	Yes	Yes
Strategic Director for Major Projects	Yes	Yes
Strategic Director for Environment and Housing	Yes	Yes
Deputy Chief Executive	Yes	Yes
Executive Members (Major Project Board)	Yes	No
Date final report sent to Constitutional/Community Council/Scrutiny Team		12 <sup>th</sup> October 2007

## BACKGROUND INFORMATION

The Executive requested, on 12<sup>th</sup> June 2007, a full report on the financial implications for the Heygate Action Plan implementation and future implications for the Aylesbury estate regeneration.

The details in this report are reserved for the implications on the Heygate Estate and do not cover related implications for the Aylesbury programme. These will be subject to future reports to the Executive once there is a clearer view of both timing and phasing of the project.