Executive Summary

Monmouthshire now finds itself in an unprecedented position. The removal of the tolls has led to increased levels of inward migration, which in turn has resulted in an escalation in house price with the average house price standing at £307,600 and a 9:1 average earnings to house prices. The median working age of a Monmouthshire resident is 48 compared to 34 in Cardiff and current predictions suggest that we will continue to see an increase in our older populations and the outward migration of our younger populations. Whilst it is impossible to predict all of the reasons behind the loss of our younger generations, it is reasonable to assume that a lack of affordable housing and employment opportunities are significant contributory factors. A separate report has been commissioned on the economies of the future, which is due to report shortly and form part of the evidence foundation for the preparation for the next Local Development Plan.

Acknowledging the significant role of providing an adequate housing supply chain, County Council tasked officers with undertaking an initial feasibility exercise to establish the potential to create an arm's length Housing Development Company (HDC) in common with other Councils in both England and Wales. In particular, officers were tasked with defining the potential opportunities and resulting risks, potential trading structures and initial guidance on the next steps.

A small officer group was established to undertake this review and their initial findings form the basis of this report. In summary it has been concluded that the creation of an arm's length company is a credible option to disrupt the housing market, in terms of the supply chain, development methodologies, tenure of occupiers, carbon footprint and both social and financial value. Critical to the success of the company will be the trading format, supply pipeline, capacity and clearly defined values and outcomes. Detailed work needs to be undertaken to define the preferred structure of the HDC, a pipeline of sites, potential development options including Joint Ventures (JV), alignment and delivery of Council's policies, social justice, financial viability, carbon neutrality and social outcomes. Initial work has considered broadening the scope so that instead of limiting the development to housing, commercial opportunities that align with our Investment policy should also form part of the Development Company (DC)

1. Strategic Case - Evidence of Need.

1.1 National Position

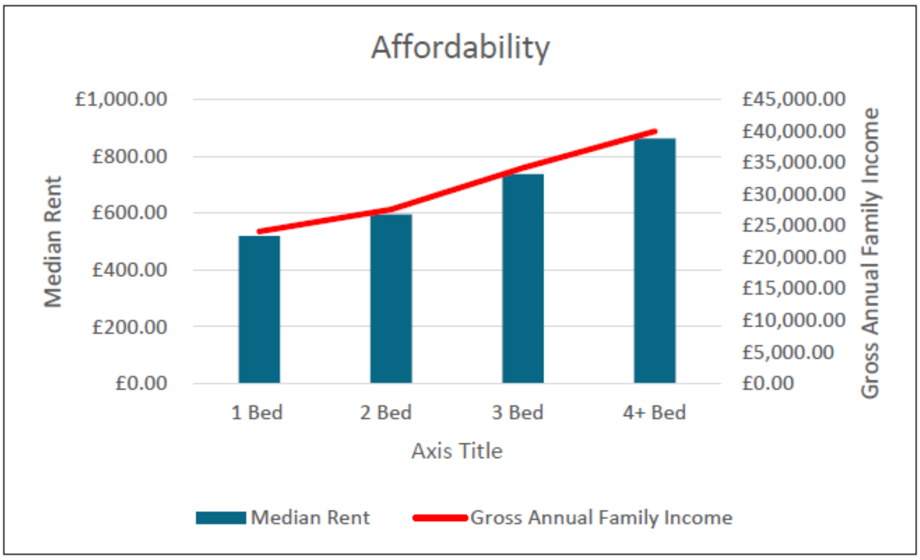
Nationally it is recognised that there is a housing shortage as demand continues to outstrip supply. Welsh Governments "Prosperity for All" national strategy seeks to build 20,000 affordable homes within its current term and low carbon homes underpins their newly launched Low Carbon Delivery Plan where energy efficient homes can tackle both fuel poverty and meet carbon neutral aspirations and align with the Well-being of Future Generations legislation. National policies have been implemented to support the housing market such as the removal of Land Transaction Tax on properties under £300,000 and Welsh Government's Help to Buy Wales, which helps buyers purchase new build homes up to the value of £300,000 with only a 5% deposit.

1.2 Monmouthshire Picture

Data provided by Hometrack indicates that average house prices in Monmouthshire have increased by 22.8% since November 2010, equating to an increase of £56,173 and in September 2018, the average house price was £307,600. There are local variations in growth between the towns, with not surprisingly highest increases being achieved in the south of the County. Severnside experienced a growth of 18.6% between June 2017 and June 2018, coinciding with the UK's government announcement of their intention to remove tolls on the Severn Bridges. Conversely, Chepstow saw a rise of 4.2% over the same period, but an increase of 33.4% since 2009. [1] The recent differential is explained by the lack of new housing supply in Chepstow with only 8 new builds during 2016 and 17, which pushed buyers further down the M4 corridor to Caldicot and Newport. Due to the average earnings to house price ration, Hometrack data indicates that 51% of 21-39 year olds living in Monmouthshire will be unable to purchase a property.[2]

The current Local Development Plan allocated sites capable of delivering 4,500 units by 2021. A report to Council in February 2019 identified a forecast shortfall of 504 properties, 38 off which are affordable. The forecast shortfall equates to 11.2% of the total planned delivery and approximately 2 years build out assuming current delivery rates.[3] In addition, the current available housing land supply stands at 3.9 years rather than the prescribed 5 years. As a result, the LPA adopted a new policy in September 2018, which was further revised in February 2019, which enabled the consideration of "windfall" sites that would assist in recovering the shortfall so long as the sites meet 11 prescribed ground rules. This has resulted in the consenting of 130 units at Church Road in Caldicot and 111 in Raglan[4], all of which are required to provide 35% affordable housing

An analysis of the Council's housing register indicates that there are currently 2,071 households in bands 1 -4 in need of housing. The current LDP has a target of 960 affordable homes and in March 2018 only 374 of these had been constructed. The Head of Planning Housing & Place Shaping indicates that development is now increasing at pace as consented sites commence on site, however the shortfall remains. Even if the LDP were to meet its target, there would still be in excess of 1,500 households remaining on the waiting list. Further research needs to be undertaken to establish the level and type of demand for both private rented and market housing to define the extent and nature of the current latent demand which in term can be used to inform the delivery model of the proposed DC. In addition, research is needed to identify the need for policies such as key worker rented homes, where rentals are capped at below market value for those workers within the targeted industries, a policy that could align with the future economies proposals.



The Local Housing Market Assessment also considered the availability and financial viability of the private rented sector in Monmouthshire.

[1] Local Housing Market Assessment 2018
[2] Local Housing Market Assessment September 2018
[3] Addressing our lack of 5 year land supply, 21.02.19 report author Head of Planning Housing & Place Shaping
[4] This application has been called in by Welsh Government and the outcome is awaited

It looked at marketed properties between September 2016 and September 2017 and identified 249 properties. It then considered number of bedrooms and rental levels and concluded that the majority of properties would be unaffordable for households earning either the Monmouthshire average of £32,416 (out commute) or £25,360 (working in Monmouthshire). The average rental level for two bedroom houses was £375 to £1,175 per calendar month and three bedrooms £550 to £1,095. Of the 249 properties, advertised only seven of them fell within the Local Housing Allowance rates, which in turn influences the available housing benefit and increasing the gap in affordability.

The evidence seems to support the need to intervene in the housing supply in the form of market housing and private rented and intermediate stock. Bringing forward market housing sites in compliance with the LDP would also facilitate the development of affordable housing. It is not proposed that the DC compete or replicate the role of the local registered social landlords (RSLs) as they are well established and have significant structures in place to manage the social housing stock. The DC would however compete with the trading arms that have been established by the RSLs, or could work with them in the form of Joint Ventures on a site-by-site basis.

2. Opportunities

2.1 Financial

2.1.1 Capital

Currently the Council disposes of its residential land on the basis of freehold disposals in compliance with S123 of the Local Government Act 1972. Whilst we would always undertake to de-risk the site by undertaking due diligence and where appropriate obtaining a planning consent, any sale will inevitably result in the developer factoring a developer's profit before determining how much they are prepared to pay for the land. This is typically in the region of 20 - 25% of the gross development value of the completed site and reduces the capital receipt.

RSL's are able to operate on a lower profit margin, but ultimately still need to realise a return. In the event that a DC is established, the developer's profit will be retained by the trading company and subject to the company structure and profitability will be pass ported back to the Council. Developer's profit in the form of capital will only be realised on those properties that are sold. Those that are let will instead realise a rental income and provide a guaranteed rent roll. Alternatively, a blended financial return could be adopted where market housing for sale is used to subsidise private rented or intermediate housing.

2.1.2 Revenue

The DC has the ability to retain completed residential or commercial properties to generate a revenue stream. Given that, this will involve the long-term management of residential rental properties it will need to consider establishing a separate wholly owned trading entity or provide these services through a JV or a private company. Commercial properties could be managed through the company or transferred back to the Council to be managed as part of its commercial portfolio. The rent received will need to meet the costs of borrowing, managing the assets including repairs and maintenance and generate a net profit. The standard tenancy agreement for the private rented sector are assured short holds which do not provide security of tenure beyond the length of the agreement which are typically between 6 and 12 months. Adopting a blended approach to ownership will enable the DC to have flexibility around either capital or revenue generation depended on the financial need. Holding rental stock will also allow the DC to benefit from a revenue stream and potential capital appreciation, which would be realised in the event that the stock were subsequently sold.

As the DC would need to be established and provided with an initial funding stream, the Council would need to generate a return on any borrowing to ensure compliance with state aid rules. From discussions with advisors and those operating HDC's it would appear that the Council in on lending will need to charge a premium in the region of 2% or higher above borrowing costs, which will realise an additional revenue return to the Council.

2.2 Social

In accordance with its Social Justice Agenda, the DC should be aligned to the Council's wellbeing plan and carbon neutrality policies. Beyond policy delivery, the plan has the opportunity to deliver wider ambitions:

2.2.1 Supply Chain – The DC will work with SME's and RSL's to develop a robust local supply chain to enable the construction of the properties and the development of apprentiships within the construction industry.

2.2.2 Energy - The provision of energy and broadband infrastructure can be tackled at source ensuring that the properties are future proofed with renewable technologies and appropriate electrical infrastructure to enable EV charging. Our ambition will be beyond carbon neutrality with carbon positive the standard where the grid permits.

2.2.3 Housing – The provision of affordable market homes available for sale or rent that are more affordable and reflect the latent demand that exists within our indigenous communities. We will have the ability to consider initiatives such as shared ownership, key workers that support the wider economic growth and sustainable development of our communities.

2.2.4 Construction Methods – The company will have the ability to explore alternatives to traditional construction techniques including modular build, turning homes into power stations and passive houses.

Clearly all of these aspirations will come at a cost and the detailed business case alongside the proposed articles of association, values, company objectives and target financial return will need to be determined. The DC will provide the Council with an opportunity to deliver its social justice agenda and define a delivery model that will ensure a higher standard of home, which places social value in alignment with financial returns and fully embodies the principles of the Well-being agenda.

3. Risks

In our due diligence to date, the following have been identified:

Lack of capacity or experience to develop viable trading model	There are many examples of HDC's established by Councils and we have already engaged with some of these. We would need to ensure that we appoint appropriate advisors with a proven track record, continue to talk to other HDC's and develop internal expertise.

The Development Company will not generate any income in its initial trading period and will therefore generate an additional revenue burden to the Council	In order to make the company viable a payment holiday will be necessary, however the debt will need to be serviced – placing a short term financial burden on the Council. This could be mitigated by placing the servicing debt on the commercial property estate – if capacity exists. Alternatively, the borrowing costs will be built into the MTFP and subsequently fully recovered from the company.
Reputational risk of non-delivery	In the event that a DC is established a pipeline of sites would need to have been identified and site appraisals etc. commenced to ensure that they are financial viable and meet the social goals. In addition, discussions with potential construction/development partners would need to be undertaken to ensure that there is construction capacity and the financial consequences were understood.
Lack of supply pipeline	Two possible sites have been identified. In addition candidate sites have been submitted to the LDP process and the DC would have the capability to acquire additional land holdings
Change in local authority financial regulations	Funding could be secured through private investors. This would need to be assessed on a site by site basis to maintain financial viability
Trading structure	The detailed work has yet to commence, however it is anticipated that there will be a holding structure with the ability to expand with the creation of JV's or single purpose vehicles such as a housing management company
Delayed or Lack of financial return	There will inevitably be a time lag between forward funding, build out and the realisation of either capital or revenue return. Repayments for on lending could be staged to align with development programmes. Business cases will need to be prepared on each site and monitored through the build out face to monitor sale and rental values as well as construction costs and professional fees.
Failure of development partners	A robust evaluation procedure will be adopted which will consider track record, financial standing and capacity. In addition, safeguards will be built into legal agreements and retentions, but it must be accepted this cannot be completely eliminated.
Fail to meet social agenda	A basket of options will need to be developed which consider energy, technologies, construction methods, supply chain development, up skilling of communities.

Lack of expertise to run the company	The structure and format has yet to be determined but is likely to be made up of a blend of secondments and external appointments. Attractive packages will be needed to attract individuals with the appropriate values and skill sets.
Lack of demand for products completed	Further research is needed on market demand, alongside alternative construction methods and morgageability of products – particularly those that will be power generators (through renewable technologies), three phase electricity supplies and combined heat and power opportunities. Alongside discussions will be needed with network providers, planners and technology providers
Lack of profitability due to external factors such as brexit, recession etc.	Whilst these can never be eliminated, the market cycle and governmental policy can be monitored. There can be flexibility built in as market housing can instead become rented and any commercial developments will not have been undertaken without a secure occupier with cap and collar leases.

4 Constraints

4.1 Legislative Framework

Wellbeing Powers are provided through Section 2 of the Local Government Act 2000, gives local authorities the power to do:

1) Anything which they consider is likely to achieve any one of the following objects:
(a) The promotion or improvement of the economic well-being of their area,
(b) The promotion or improvement of the social well-being of their area, and
(c) The promotion or improvement of the environmental well-being of their area

Section 2 (4), of the act provides local authorities with the ability to incur expenditure, give financial assistance, enter into arrangements or agreements and provide goods services and accommodation.

Power to trade - Alongside its wellbeing powers, the Council has the ability to establish trading companies via S 95 the 2003 Local Government Act. Subsequent legislation in the form of regulation 2 of the Local Government (Best Value Authorities) (Power to Trade) (Wales) 2006, requires local authorities to have regard to their fiduciary duty to council taxpayers if undertaking trading activities. We would expect any development company to be financially viable in addition to yielding a social return and this will be tested in the development of the detailed business case.

The power to borrow is provided via S1 of the 2003 Local Government Act. This determines that borrowing may be undertaken:

(b) For the purposes of prudent management of its financial affairs provided it does not exceed its affordable borrowing limit under s.3 Local Government Act 2003 (s.2 (1) and 2(4))

4.2 State Aid

If the preferred model is a wholly owned fully commercial company, any on funding by the Council to the DC will need to be at a commercial rate to ensure compliance with state aid. From work undertaken to date, current on-lending rates are circa 2% above Council PWLB rates, which ensure compliance and create a revenue profit. In adopting this model, the DV would need to bid for any services that it wished to provide the Council, however given the model is designed to undertake development contracts on land within its control this is not considered a significant issue.

4.3 Funding

It is anticipated that the DC will be established utilising funding from the Council, which in turn will be realised through prudential borrowing. In the initial set up and trading period, the company will not be returning a profit and therefore unable to service the initial borrowing costs which will increase the revenue burden for the Council. The implications of this will need to be considered within the detailed business case.

4.4 Land Supply

The land supply will be provided in the first instance from assets held by the Council. These will need to be transferred to the DC at market value to ensure compliance with S123 of the LGA and State Aid rules. It is anticipated that the Council may wish to phase the release of assets to the company to mitigate risk, ascertain evidence of successful delivery and mitigate the borrowing costs to the DC. As the DC establishes land may be acquired from third party owners dependent on availability and the outcome of the submitted Council sites through the current LDP process.

4.5 Capacity and Expertise

In order to progress into a detailed business case, additional external expertise will be required. It is anticipated that advisors will consider the legal trading structure, the financial viability of the proposition and an analysis of the initial pipeline to determine viability. Funding will need to be approved to enable this to be progressed and is included within the Council report.

5. Trading Format

There are a number of options available that would deliver the Council's aspirations to increase house building whilst realising a financial and social return. These can be summarised as follows

5.1 Disposal of land with contractual obligations

The Council could continue to dispose of its land albeit with development constraints that could be built into the contractual documentation. We would however need to consider the impact of the Faraday case law[5], which confirmed that the sale of land with any positive development considerations is to be treated as a procurement for a public works contract, which falls within OJEU procurement regulations. This has the potential to delay developments rather than accelerate them.

5.2 Joint Ventures

The procurement of a JV between the Council and a private sector partner could be undertaken and may be subject to an OJEU procurement dependent on the nature and value of any positive obligations imposed on the partner and the level of co-investment. Where a co-investment model is

[5] Faraday Developments Ltd v West Berkshire Council (2018) EWCA Civ 2532

adopted without any positive obligations in line with the MEOP[6] approach, no OJEU procurement would be necessary, however the Council would need to rely on control mechanisms through the appointment of Directors and Articles of Association. If however the DC were established as a fully commercial entity, they would be in a position to enter into a JV without being subject to the procurement regulations.

5.3 Wholly Owned Development Company

This is method largely adopted by other Councils. It is envisaged that the Council would establish a holding structure, which would enable it to flex as opportunities arise. There are different trading models including companies limited by guarantee or shares and Limited Liability partnerships (LLP). The preferred delivery mechanism will need to be established following due diligence alongside professional advisors. Crucial to these deliberations will be the ability to pass port profits from the company to the Council, the management of risk, tax considerations, Articles of Association and flexibility.

6. Next Steps

It is proposed that the Council progresses into the development of a detailed business case that considers the following;

- Outcomes and Values
- Preferred trading format and legal structures
- Articles of Association
- Success Factors
- Minimum required social return for each development – this needs to consider carbon neutrality, construction methods and supply chain.
- Minimum required financial return
- Supply pipeline
- Demand analysis

[6] Market Economy Operator Principle – commercial vehicle with equal equity and control between both investors