CABINET

Chatsworth Gardens - Outcome of Developer Competition and Consideration of the Private Sector Led Proposal

5 November 2013

Report of the Chief Officer (Regeneration and Planning)

PURPOSE OF REPORT					
To consider the outcome of the recent developer competition for Chatsworth Gardens, the PlaceFirst proposal and the draft heads of terms for a detailed agreement. The options for the way forward are compared, including the previously agreed council-led scheme to deliver refurbished homes for sale.					
Key Decision	**X**	**Non-Key Decision**		**Referral from Cabinet Member**	
Date Included in Forthcoming Key decision notice				7 October 2013	
This report is public, with the exception of Appendix 3, which is exempt from publication by virtue of paragraph 3, of Schedule 12a of the Local Government Act 1972.					

RECOMMENDATIONS OF COUNCILLOR JANICE HANSON:

1) **Cabinet approve the preferred Option 2, to secure an agreement with PlaceFirst for refurbishment of council owned properties on Chatsworth Gardens to deliver new homes for market rent.**

2) **The Clusters of Empty Homes Funding is reallocated from the previously approved "council-led" scheme to Phase 1 of preferred Option 2.**

3) **On the basis of the draft heads of terms outlined in this report, and in conjunction with PlaceFirst, officers draw up final contract documentation, consisting of an overarching development agreement, building licence and grant agreement, for delivery of Phase 1.**

4) **Subject to HCA lifting its charge on the properties, authority to sign off the development agreement and building licence be delegated to the Chief Officer (Governance), and authority to sign off the grant agreement be delegated to the Chief Officer (Resources).**

5) **That Cabinet consider whether it is satisfied that disposal of the council's interests in the property will help the authority secure the promotion or improvement of the economic, social or environmental well-being of its area, and, if it is so satisfied, approve the disposal of the Phase 1 property for nil consideration, noting that, subject to the outcome of the current independent property valuation exercise**

confirming that the undervalue is less than £2m, the terms of the General Disposal Consent will apply.

6) **Members agree in principle to the delivery of Phase 2, allowing officers to work with PlaceFirst on detailed proposals to be informed by the experience of Phase 1 delivery. Detailed proposals will be presented to Cabinet for Phase 2 seeking authority to proceed.**

7) **Officers develop and submit a bid to the Department of Energy & Climate Change "Green Deal Communities – Local Authority Fund" for energy efficient measures to i) supplement the energy efficiency proposals specified in the preferred Option 2 and ii) improve and roll out energy efficiency measures to properties in the West End area. Authority to sign off the bid and accept any funding awarded be delegated to the Chief Officer (Resources).**

8) **The Chief Officer (Resources) be authorised to update the General Fund Capital Programme and General Fund Revenue Budget as appropriate, subject to there being no additional call on the council's resources.**

1.0 Introduction

1.1 At April 2013 Cabinet were informed of interest in the Chatsworth Gardens regeneration properties/site from private developer PlaceFirst ltd., and considered the developer's outline proposal for refurbishment through a managed private market rent tenure model. and resolved to (minute reference:144):

- Conduct a new preferred developer competition to test all current private investment interest.
- Agree Heads of Terms on a proposal which secures best consideration with respect to the policy objectives of the council and the Homes and Communities Agency.
- The outcome of the developer competition, the recommended scheme and the initial heads of terms proposed are reported to Cabinet for approval to proceed towards a binding development agreement.

1.2 The renewed private interest emerged after the Cabinet decision at December 2012 Cabinet (minute reference 82) to a city council led contingency proposal for Chatsworth Gardens which itself responded to the withdrawal of the original preferred developer partner, Places for People, and the collapse of their demolition and new build redevelopment scheme. Cabinet had resolved for the council to deliver a substantial refurbishment project, accepting the contingent risks associated with construction, project management and, importantly, end sales. It also allowed the council to use the £1.9M Government Clusters of Empty Homes Funding (CEHF) previously secured for the area which needs to be committed by end of March 2014 and spent by September 2014.

1.3 Without detailed information on the PlaceFirst proposal there was no guarantee their scheme would ultimately be deliverable in the Chatsworth Gardens context. As retaining the ability to spend CEHF resources was important Members also resolved at April 2013 Cabinet that (minute reference: 144).

- Officers continue with eligible preparatory and enabling works on the previously approved council led scheme as a contingency against being unable to secure a viable private developer proposal.

1.4 This report considers the outcome of the recent developer competition and the current options for the regeneration of the Chatsworth Gardens site.

2.0 Background

Site Context and Ownership

2.1 It is useful for Members to be reminded of the site context. The Chatsworth Gardens project objectives are outlined in the Relationship to Policy Framework section of this report. The Chatsworth Gardens site consists of 2 property blocks split by Chatsworth Road:

- Western Block: 4 terraces on Albert Road, Chatsworth Road, Regent Road and Westminster Road.
- Eastern Block: 4 terraces on Albert Road, Balmoral Road. Chatsworth Road and Regent Road.

2.2 The council owns (and currently maintains) 47 properties on the site (Appendix 1) bought with HCA grant. Approximately £7M has been spent to date – around £5M on site acquisitions and £2M on properties acquired elsewhere in the Masterplan area and other associated costs including management and maintenance. Outside of the Chatsworth Gardens area the council also owns a number of "non-project properties"[1] (NPPs) across the West End, also bought with HCA grant. The NPPs are earmarked for sale to provide funding for the main Chatsworth Gardens project and ongoing significant revenue costs associated with holding these properties.

2.3 Acquisition of 2 flats on Albert Road is currently underway and will utilise equal amounts of HCA and CEHF moneys. This reduces the CEHF from just over £1.9M to £1.878M.

Developer Competition and Outcome

2.4 In early June officers issued an invitation to tender, detailed prospectus, scoring criteria and supporting information to the HCA's Developer Procurement Panel and Place First with a deadline for submissions of 5 July. PlaceFirst was the only company to respond with a formal submission. This confirmed officer advice as reported to April Cabinet, that a traditional large scale private housing development on a difficult site in an area of low demand/high risk and where major grant funding (over and above that currently secured) is required was not feasible.

2.5 Following officer review and scoring of PlaceFirst's initial proposal and, taking into account clarifications received via structured interview, PlaceFirst were invited to work with the council on a sole basis to further develop a proposal for Members' consideration.

3.0 PlaceFirst's Proposal

3.1 A summary document outlining PlaceFirst's proposal is attached in Appendix 2. The core features and principles of the proposal are as follows:

[1] Non-Project Properties were acquired in 2004 when the Masterplan was in an embryonic stage and the HCA and LCC wanted to make early progress with strategic acquisitions. 25 properties were acquired for £2.2M all located in what became the high intervention Masterplan areas that would be brought forward under various projects e.g. Clarendon Road Remodelling, Adactus Live/Work Units, Chatsworth Gardens, Marlborough Road, Bold Street, the ceased Central Park project and the Co-Op Building.

Refurbishment Approach and Tenure Model

3.2 The proposal is for a comprehensive refurbishment approach across the 2 property blocks described in paragraph 2.1. However, the development programme envisages 2 distinct development phases, which is important to the overall financing structure described later in the report:

- Phase 1: PlaceFirst will begin with refurbishment of the Western Block of 4 terraces - where the council has almost complete ownership along Westminster and Albert Road - with 46 units of accommodation due for completion by April 2015.
- Phase 2: Following completion PlaceFirst intends to move on to the Eastern Block of 4 terraces, delivering around 46 units of accommodation by August 2016.

3.3 The council owned properties will be refurbished into a range of energy efficient typologies including townhouses, duplex apartments, and hybrid apartment/maisonettes. The detail for Phase 1 shows the delivery of:

3 x 1 bed homes
20 x 2 bed homes
13 x 3 bed homes
10 x 4 bed homes

The proposal works without the need to acquire any further properties. However, in order to create a cohesive and attractive product a scheme for front and rear facelifts for the properties not acquired is included in the scheme costs.

3.4 Phase 2 is similar in approach and intended to deliver a similar order of units. But, as will be clarified below, more detailed work needs to be undertaken and many other factors taken into consideration before the extent of intervention in Phase 2 can be confirmed and implementation agreed between the parties.

3.5 The proposal is based on private market rental tenure. The market for this product has arisen in response to the difficulties faced by potential home buyers in meeting large deposit requirements of the mortgage market. The success of the proposal depends on PlaceFirst partnering with a housing manager partner to act as landlord to the tenanted properties. In its current schemes/portfolio this role is undertaken on a commercial basis with local (i.e. active in the North West) Registered Providers. Although Placefirst are in discussions with a Registered Provider partner for this proposal, one has not yet been formally appointed/secured.

3.6 Planning permission is required and PlaceFirst are due to submit a planning application for Phase 1, with outline permission for Phase 2, in November.

Financial Model and Funding

3.7 PlaceFirst's financial model for Phase 1 (based on detailed drawings) and anticipated outturn/delivery for Phase 2 (based on more generic assumptions) is attached in Appendix 3 (exempt from publication). It uses the discounted cash flow approach to development appraisal which is suited to consideration of property development outcomes based on a projected rental income stream, and is a standard industry model.

3.8 The delivery of Phase 2 is linked to the successful completion and financial stability achieved following completion of Phase 1. PlaceFirst's financing strategy involves transfer of the council's properties at nil value (refer to paragraph 6.9) and meeting the refurbishment costs of Phase 1 from the following sources:

- The developer's and their investor's own money – the 'equity' on which they expect to secure a reasonable market profit for the risk in undertaking the project.
- Debt finance (secured in-principle) from the HCA's Build to Rent (BTR) scheme – effectively a major loan which would be difficult to otherwise obtain from commercial sources in the current financial climate.
- The council applying its remaining £1.9M secured CEHF resources as grant aid to the developer to deliver Phase 1.

3.9 On completion of Phase 1, ownership of the refurbished properties will be transferred to the developer at nil value and retained by them in perpetuity. Assuming reasonable tenancy levels are secured, Phase 1 will have a substantial asset value based on the potential future income generated from rents over a long term period. This value should allow the company to secure a 'refinancing strategy' with a third party lender, turning the income stream into a capital sum. This can be thought of as being similar in terms to a home owner remortgaging to secure better terms. The refinanced capital sum (representing a proportion of the asset value as the refinance capital loan/value ratio will be less than the full value itself), is then apportioned, in order of priority, for:

I. Meeting the loan financing/repayment obligations to the HCA BTR scheme.
II. Return to the council a proportion of the CEHF grant aid applied to Phase 1.
III. Return of PlaceFirst's equity with required profit.

The intention is then to recycle the Phase 1 capital return into a similar exercise for Phase 2, that is, initial refurbishment (using developer equity, HCA second tranche loan and council grant), completion/letting and refinancing to secure the desired capital return. On completion of Phase 2 the developer profit across the whole scheme is 'redeemed' by the developer.

3.10 PlaceFirst's target development appraisal also shows a projected surplus at the end of Phase 2 - attributable to the input of CEHF 'recycled' grant. This will be available for further housing/regeneration investment. However, until actual performance against the predicted cost variables, asset value and refinancing negotiations are realised at Phase 1 end, the extent of Phase 2 (and any final residual surplus), is uncertain. Following their initial return on Phase 1 the partner investors must also decide whether the outturn has been successful enough to warrant the further equity contribution required for Phase 2.

3.11 All development appraisals depend on the accuracy of the underlying assumptions. The complexity of the model and the market conditions means no analysis of cost/value/return outcome (made at a single point in time), is an exact science - multiple variables impact in many ways. The analysis should be regarded as a reasoned view of the likelihood of achieving the desired outcome at a certain order of cost. However, the sensitivity in key variables is important to understand as these variances will impact on the developer's ability to achieve the desired Phase 1 targets, and by extension, what can be achieved in Phase 2.

3.12 Appendix 3, and the summary under Financial Implications (exempt from publication) reviews:

I. The extent to which the developer has employed reasonable and prudent benchmarks, value assessments, profit/return assumptions particularly around:

- Refurbishment costs / tendering benchmarks
- Rental pricing strategy and allowance for letting / voids /bad debts
- Appropriateness of developer profit requirement and applied appraisal discount

rate

- Apportionment of risk/reward at refinancing if return is less/more than anticipated (and the impact on Phase 2 and final completion)

II. The company's underlying financial strength and ability to deliver their proposal

3.13 The protection of the council's interests and mitigation of the risks associated with the above issues are to be managed through a suite of detailed contractual agreements. The proposed structure of which is described below.

Proposed Legal Framework

3.14 As the phasing of the scheme is critical it has been proposed that the legal structure should be based on the following principles:

I A contractual agreement for delivery and completion of Phase 1 (with a commitment to undertake further detailed work under an 'in principle' agreement to deliver Phase 2).

II On Phase 1 completion, and following a reasonable period for letting, undertake a joint review/assessment of the viability of proceeding with Phase 2.

III Following the review, and If acceptable to all parties, the relevant authority to enter into a further agreement for delivery and completion of Phase 2 is sought.

3.15 The contractual framework for each separate Phase will involve the following :

- *Development Agreement*
  Providing the Overarching Agreement to establish arrangements between the developer and council for carrying out the development scheme and the ongoing management of the development area. The draft Heads of Terms forming the basis, structure and shape of the Agreement are attached in Appendix 4.

- *Building Licence*
  A supplemental document to be entered into in accordance with the terms of the Overarching Agreement. Properties will not be transferred in title to the developer until refurbishment is complete. In order for both the council's and developer's interests to be protected the Building Licence sets out the parties obligations and responsibilities over the site, providing rights of entry and authority to carry out works in accordance with an approved scheme and providing a basis for certification of completion and transfer.

- *Grant Agreement*
  The council intends to use £1.9M CEHF funds in Phase 1 of the project. The investment will be in the form of a grant and the conditions of the award will be enshrined within a document with conditions to protect the council's interests in its eligible use. A mechanism will need to be defined by which the anticipated amount of grant funding is returned at the point of refinancing at the end of Phase 1, recycled into Phase 2, with a the final anticipated return due against grant (which can be recycled into further housing/regeneration work). This will be achieved by inclusion of an overage clause.

3.16 The council has experience of delivering complex development agreements with third party developers and, in general, the provisions and clauses are standard industry formulations. The fitness of the heads of terms and legal framework are further discussed in Legal Implications section.

4.0 Details of Consultation

4.1 Extensive consultation established the project objectives and principles. However, since the collapse of the original Places for People scheme due the recession there has been too much uncertainty on the way forward to make detailed consultation meaningful. Following a decision at this Cabinet meeting it is intended to undertake further community engagement and consultation on the practical details of project delivery with local residents and property owners.

5.0 Options and Options Analysis (including risk assessment)

5.1 A 'do nothing' option is not included within this report. Disposal of all properties with sales receipts covering disposal fees was discounted due to Members' consistent support for finding a positive solution to Chatsworth Gardens. The option of 'pulling out' of the project presents considerable risk in every way other than financial. It declines to use approximately £1.9M CEHF funding currently secured and may also damage future council HCA resource bids and partnership working. This option is therefore not considered in this report. The viable options are detailed in the table overleaf.

6.0 Officer Preferred Option (and comments)

6.1 **Option 1** is the 'council-led' scheme previously agreed by Members following December 2012 Cabinet (minute reference 82) and officers have continued work on this as a contingency (see para 1.3 of this report). The proposal is detailed in a previous report, listed as a Background Paper

6.2 As noted in previous reports the basis of the intervention strategy in Option 1, and the ultimate underlying risk, lies is in securing sales for the houses remodeled. As refurbishments are completed in particular terraces, ongoing sales are required to generate further income to continue with further phases of intervention otherwise the project will stall. The mortgage market is still difficult for first-time buyers, although the introduction of a local mortgage assistance scheme and the recent launched new phase of the Government's Help to Buy policy may partially improve this situation. Members should be under no illusion about the challenge of securing rolling house sales in the West End of Morecambe in the current economic climate, and the very real risks this presents to delivering a project with this tenure model.

6.3 Given the general risks attached to Option 1 the Place First proposal as described in **Option 2** merits serious consideration. The introduction of a market rent model allows a much more flexible and potentially more extensive approach to be taken. According to the council's own market intelligence and discussion with local agents, refurbished maisonette/apartment property is difficult to sell on the open market – the council's scheme did not therefore consider these house types. However, renting this type of property is less of an issue for prospective tenants who are generally more concerned with overall design/quality, management/landlord relations and security of tenure.

	Option 1: Implement previously approved city council led scheme for refurbishment of council owned properties on Chatsworth Gardens to deliver homes for sale	Option 2: Secure an agreement with PlaceFirst for refurbishment of council owned properties on Chatsworth Gardens to deliver homes for market rent (Preferred Option)
ADVANTAGES	Provides a positive and quality solution to the desired Chatsworth Gardens regeneration objectives / outcomes. Utilises existing Clusters of Empty Homes Funding (CEHF). Brings empty homes back into use. Clearly sets out council's commitment to local residents and owners in the area. Demonstrates delivery to HCA boosting chances for future funding.	Provides all advantages of Option 1 with a number of additional benefits: Funding model and tenure allows greater capital investment/value to be generated out of almost double the individual housing unit outcome. Current appraisal, even with high level of sensitivity applied, appears to give a greater certainty on the extent of intervention. At the current assessment all the council's empty properties on Chatsworth Gardens are refurbished (in 2 phases) and a surplus is generated on the initial public grant investment which can be recycled back into the project or further housing/regeneration investment. In terms of architectural approach the scheme provides a greater impact – moves the project more towards 'exemplar' features originally envisaged in West End Masterplan. Developer has specialism in, and seeks to deliver, higher environmental standards. Developer has commitment to, and a commercial interest in good long term management of the development and improving the wider area and context for their investment. Place First see themselves as a potential council partner on future projects/developments. "Open book" accounting allows council to accurately assess reasonableness of the developer's costs, returns etc. Transfers construction and delivery risk to private sector. Moves from sales risk to a relatively less risky rental model. More control over and greater amount of private sector investment to enable draw down of all CEHF.
DISADVANTAGES	Ideally requires co-operation from owner occupiers & landlords to implement facelift element and deliver a cohesive scheme Uncertainty of delivery outcome for Regent Road and extent of progress is subject to the achievement of projected sales values Misses out on potential to transfer development risk away from the council. Tenure model of sales to owner occupiers is high risk in current market and location, even with the new Government Help to Buy scheme. Ongoing increasing management costs of properties as scheme progresses, particularly council tax liabilities as majority empty for more than 2 years	Ideally requires co-operation from owner occupiers and landlords to implement facelift element and deliver a cohesive scheme. Phasing of scheme and dependence on market conditions before Phase 2 can be committed means the council is still liable for management costs associated with those empty properties, although there is a similar burden for Option 1 (refer to Financial Implications). Under adverse market conditions and performance Phase 2 may be less extensive and/or lower surplus return on public grant and may even prove unviable. However, similar market risks are attached to Option 1 in terms of potential extent of intervention

	Option 1: Implement previously approved city council led scheme for refurbishment of council owned properties on Chatsworth Gardens to deliver homes for sale	Option 2: Secure an agreement with PlaceFirst for refurbishment of council owned properties on Chatsworth Gardens to deliver homes for market rent (Preferred Option)
RISKS	Involves the council taking on the delivery risks on a capital housing development project. The council will face a sales risk on the direct refurbishment properties that needs to be mitigated by some form of mortgage assistance scheme. Limited control over private sector match required to access part of CEHF grant. Build costs and sales date/value can adversely impact project (although a reasonable contingency is built in). Failure to achieve sales rates/values adversely effects ability to achieve full extent of project and could lead to an underachievement of CEHF outputs and issues with the funder.	Uncertainty of delivery until development agreement is finalised and impact on deadlines for meeting CEHF obligations. Similarly, the Developer not completing Phase 1 for reasons beyond their control. Reversion to the council-led scheme as a contingency is not practical after January 2014. However, the risk of not achieving agreement or completion is considered low. Securing tenants still represents a challenge and the developer has not formally secured a Registered Provider as a managing partner at the time of writing. The proposal is based on untested private tenure/management models and the developer is a relatively young and rapidly expanding company, i.e. currently undertaking two other similar schemes, one due to complete November 2014. Failure to complete and/or achieve projected outturn from Phase 1 adversely effects ability to achieve Phase 2 and could lead to an underachievement of CEHF outputs and issues with the funder.

6.4 The costs of creating an individual refurbished house in Option 1 are high due to the necessity for heavy intervention in the fabric of the large former guesthouses and HMOs. There is still a need for expensive intervention in Option 2, but the costs of creating 2 or 3 individual dwelling units out of one property are not especially different from creating a single unit. PlaceFirst can therefore create more outturn value for the cost of refurbishment. The development appraisal for Option 2 shows that all the council owned properties are addressed with a projected surplus, part of which will be available to be recycled back into the project or further housing/regeneration schemes. By contrast, there is uncertainty in the extent to which the council-led scheme would generate enough capital / resource to enable a comprehensive approach to be undertaken. Option 1 does not, for example, provide a solution to all of the largest and most difficult Regent Road properties.

6.5 There are market risks within Option 2, and the sensitivity in the appraisal figures (refer to Financial Implications) reveal how the movement in key variables could impact on the extent of / ability to deliver Phase 2 and the level of outturn surplus the council could expect to receive. However, Option 1 is also significantly subject to market factors - perhaps more so given the rental market is generally accepted to be more stable in terms of demand than the sales market. There is current debate by industry commentators that the Government's proposals to underwrite first time buyer deposits through Help to Buy could lead to increased volatility in house prices in the short / medium term. The proposed break following delivery of Phase 1 in Option 2 will also allow both parties to take stock. Within pragmatic cost/outturn sensitivities applied to the appraisal figures an extensive intervention in Phase 2 is still possible and probably has more certainty of outcome than Option 1.

6.6 The transfer of development risk, additional physical outcomes, and security of private investment are the clearest benefits of Option 2 over Option 1. In terms of potential regeneration impact/outcome the PlaceFirst scheme fundamentals bear comparison with the council-led scheme, and in most areas represent a significant improvement. The particular risks/mitigation attached to the PlaceFirst proposal centre on:

- *Critical path to agreeing the detailed legal framework with PlaceFirst:* The £1.9M CEHF needs to be committed by end of March 2014 and spent by September 2014. However, if contracts cannot be exchanged by the end of March the ability to use CEHF (and deliver the project) will be lost unless an extension to the CEHF commitment deadline is agreed with the Government. In addition, should PlaceFirst and the council fail to agree detailed terms after January 2014 the council will lose the comfort of being able to deliver Option1 as a contingency project, again unless an extension to the CEHF commitment deadline is agreed. This is because it is not practical to complete and commit CEHF resources by the end of March 2014 if tendering on the council-led project starts after January 2014. However, officers consider the risk of being unable to sign an agreement with PlaceFirst by the end of March 2014 to be low. PlaceFirst's team has been working closely with officers for a number of months, and both joint-working arrangements and detailed contract negotiations have been proceeding well. There are no anticipated issues to agreeing the detailed contracts in good time – officers advise that the documents' content will be of a standard form to be completed under the heads of terms (Appendix 4) which are considered acceptable. In order for the council to contract with PlaceFirst the Homes and communities Agency (HCA) must also agree to lift their charge on the properties imposed on the basis of their previous grant funding sunk into the project for acquisitions. This is also considered to be a low risk (refer to Legal Implications)

- *Housing Manager Partner:* The introduction of privately rented stock, if marketed and managed correctly, is compatible with the overall regeneration objectives for Chatsworth Gardens (see Relationship to Policy Framework) and is consistent with trends in the housing market. However, Members will be alive to the need to secure tenants, ensure robust management protocols and enforceable legal agreements to prevent reversion of properties to uncontrolled market rent in a regeneration area. At the time of writing PlaceFirst have not formally secured a named partner Registered Provider for this particular project. While it is still possible to develop strong agreements on the managing agent protocols / underwriting of occupancy/voids it is better for a named partner to be involved at the earliest opportunity to ensure the controls enshrined in the agreement are practical for the particular context.

- *Capacity / Track Record*: PlaceFirst is a young company and has been trading since November 2009 operating in a relatively immature market for delivering large scale, comprehensively managed private rent tenure. PlaceFirst has current working agreements with other public authorities, and are on-site delivering a number of similar projects. But the financial model is untested in the sense that no similar project by the developer has reached a level of rental maturity or confirmed sustainability in financial terms. While the financial/project structure could be considered innovative, it is only novel in the context of a UK institutional finance market wholly dominated by "building for sale". Officers consider the quality of PlaceFirst's development proposals to be high and, due to the developer's associated specialism in energy efficiency/sustainable development solutions, there are interesting features / opportunities which the council would struggle to match within the resources available in its own Option 1 scheme.

6.7 It is considered the council's interests can be protected through detailed legal agreements and the above issues resolved to secure CEHF commitment in good time. The model has real regeneration potential and brings many advantages in terms of the transfer of the majority of the Chatsworth Gardens development risk to the private sector. The developer has sound financial structure, a long term approach to investment/return; a high degree of competency and talent in design/delivery; a relatively simple investment model; and enthusiasm for Morecambe/West End as a place. Their detailed proposition is a compelling one, presenting a situation where the council is able to meet its regeneration objectives without needing either to take on project/sales risk or bring additional public investment over that currently secured via CEHF.

6.8 **Option 2 is therefore the preferred option:** Officers work towards securing an agreement with PlaceFirst for refurbishment of council owned properties on Chatsworth Gardens to deliver new homes for market rent. The agreement will be structured on the basis outlined in paragraph 3.14 above.

6.9 Members should note that it is proposed to transfer the properties to PlaceFirst at nil value, therefore the disposal means approving an 'undervalue'. This is because the council's requirements remove the value which could hypothetically be achieved from selling the former multi-occupied HMO property on the open market with no restrictions on future use. Disposals for a consideration that is less than the best that can reasonably be obtained normally require the specific consent of the Secretary of State (SoS) However, the Secretary of State has given a general consent which applies where the difference between the unrestricted value of the interests to be disposed of and the consideration accepted ("the undervalue") is £2M or less, and the authority considers that the disposal will help it to secure the promotion or improvement of the economic, social or environmental well-being of its area The outcome of the independent valuation exercise is pending and will be known prior to Cabinet, thereby determining the scale of undervalue. However, it is anticipated that the valuations over the projected phases of the PlaceFirst proposal will show that the undervalue is less than £2M. Furthermore given the projected surplus (for recycling back into the project or other housing/regeneration work), it could be considered the council has potential to recoup the undervalue to some extent in due course, although there are no guarantees.

Supplementary Funding Opportunity

6.10 In July the Department of Energy & Climate Change (DECC) launched a "Green Deal Communities – Local Authority Fund", a capital based fund for delivery of energy efficient measures. Funding is also only available to support work where the occupant or owner makes a financial contribution to the costs of installing the measures, either through Green Deal Finance or by meeting these costs upfront. Key fund parameters are:

- principal funding is for projects only, with a minimum threshold of £1m (and flexible cap up to £3m);
- projects must deliver significant retrofits across whole streets/areas;
- bids must set out how energy bill payers will be engaged with and encouraged to sign up to Green Deal Plans;
- bids must include evidence that Energy Company Obligation (ECO) funding will be available to support the bid. ECO funding is required to be provided by the 'big six' suppliers – British Gas, EDF, E.ON, Npower, Scottish Power and SSE – to assist 'hard to treat' houses and vulnerable households access and implement energy efficiency measures.
- funding is only to support work where a contribution to measures is made either through using Green Deal finance or by self-funding measures;
- bids must demonstrate that strong partnerships have been established to support delivery, including local community partners;
- bids should address potential local barriers, e.g. how have planning issues been addressed to support the bid and avoid delays;
- bids must demonstrate strong value for money;
- bids build in monitoring (including data collection) from the outset and commit to working with DECC's overall Green Deal evaluation and sharing learning including case studies and open homes;
- comply with all state aid rule:

6.11 Bids are invited from local authorities by 31 December 2013 and must be from a minimum of £1m up to £3m. The full criteria are provided in Appendix 5 for Members' consideration.

6.12 Given the funding/eligibility criteria, officers think there is potential to secure additional substantial funding for improvements in the energy efficiency measures proposed in the preferred Option 2. In addition, there is potential to roll out the energy efficiency agenda and practical approaches using Chatsworth Gardens as an 'exemplar' of local housing types to owners across the West End. As previously mentioned, PlaceFirst's work in energy efficiency/sustainable development solutions, and the transfer of properties into their private ownership makes an ideal opportunity to add value to the Chatsworth Gardens project and assist in contributing towards the council's sustainability agenda.

6.13 Members are asked to allow officers to investigate and develop a bid to "Green Deal Communities – Local Authority Fund" for energy efficient measures to i) supplement the energy proposals for the Preferred Option 2 and ii) improve properties in the immediate West End area. The bid is currently anticipated to be of the order of £1.5M to £2.0M.

6.14 It must be stressed that progression and implementation of the preferred Option 2 is **not dependent on securing this DECC funding**. Any award received will enable wholly additional improvements to the Chatsworth Gardens specification and practical incentives/approaches for private owners in the West End to implement energy efficiency measures.

7.0 Conclusion

7.1 Officers have conducted a developer competition to test all current private investment interest in the Chatsworth Gardens development opportunity. PlaceFirst have provided a proposal which, if supported by the council's exercise of its powers under the Local Government Act 1972 general disposal consent, will help the council to secure the promotion or improvement of the economic, social or environmental well being of its area by the refurbishment of council owned properties on Chatsworth Gardens to deliver new homes for market rent.

7.2 Members are advised to allow officers to secure an agreement with PlaceFirst based on their proposal which both reduces the council's risk burden and secures a better and more certain outcome against its regeneration objectives.

Appendices:

Appendix 1 - Council Ownership on Chatsworth Gardens
Appendix 2 - Place First Proposal Summary Plans / Document
Appendix 3 – Review of PlaceFirst Financial Model/Appraisal (exempt from publication)
Appendix 4 - Heads of Terms
Appendix 5 - Green Deal Communities – Local Authority Fund Application Pack

RELATIONSHIP TO POLICY FRAMEWORK

In January 2011 council resolved that housing regeneration be included as a theme in its corporate priorities. This was reaffirmed in the 2012-2015 Corporate Plan.

The Chatsworth Gardens Project is a key element of the West End Masterplan and was ranked as a high priority by Cabinet as part of review and refresh exercise carried out on the Masterplan in 2009. The council has been working with the Homes and Communities Agency (HCA), formerly known (prior to December 2008) as English Partnerships, to deliver the Chatsworth Gardens Housing Exemplar scheme. The objectives of the proposal are as follows:

- Attract families and long-term residents to live and work in and near the town
- Create a more balanced community
- Reverse the negative perception of Morecambe's West End as a place to live
- Reduce the number of HMOs (Houses in Multiple Occupation)
- Kick-starting public/private investment in the area;
- Creating confidence in the market – to show that family housing is possible and have a catalytic effect (along with the other interventions)
- Deliver quality housing stock
- Address crime and social conditions in the area
- Act as a demonstration to the market in terms of the standard and quality of housing that should be delivered in the Masterplan area

As 40% of the districts homelessness derives from failed private sector tenancies in the West End, these schemes will help reduce homelessness, enable housing supply imbalances to be corrected and help stabilise a transient community

There is a relationship between bringing empty homes back into use and the allocation of proposed sites for housing in the Local Plan. Empty property reuse is a significant element of providing for the District's housing needs.

CONCLUSION OF IMPACT ASSESSMENT
(including Diversity, Human Rights, Community Safety, Sustainability and Rural Proofing)

The West End Masterplan has carefully considered issues of sustainability and is based on sustainable principles. Any proposal received will need to be designed and built in accordance with specifications/standards which ensure high quality urban design, including safer by design and life time homes standards as well as high environmental standards.

LEGAL IMPLICATIONS

Legal Services have been consulted and their comments inserted within the body of the report where appropriate.

The legal implications of progressing with **Option 1** are fully discussed in the report/recommendations of 4th December 2012 Cabinet (Minute 82).

The legal implications of progressing with **Option 2** are as follows:

General Disposal considerations

The agreement between the developer and the council is effectively a disposal of land. Legal Services officers confirm that the terms of the developer competition have been conducted within, and the disposal will be taken forward under, the terms of the council's disposal procedures.

The proposal in Option 2 is to dispose of the council's holdings at nil value.

Section 123 of the Local Government Act 1972 provides that authorities may not, without the consent of the Secretary of State sell land for "a consideration less than the best that can reasonably be obtained".

However, the General Disposal Consent issued by the Secretary of State in 2003 provides that the Secretary of State's consent is not required for the disposal of an interest of land which the authority considers will help it to secure the promotion or improvement of the economic, social or environmental well-being of its area, where the difference between the unrestricted value of the interests to be disposed and the consideration accepted ("the undervalue") is £2M or less. The council is currently revaluing the relevant properties to confirm the amount of the undervalue, but the current assumption is that the undervalue is unlikely to be more than £2M, and this will be confirmed at the meeting. Accordingly, the council could dispose of the land without the specific consent of the Secretary of State, provided that members are satisfied that the disposal will help to secure the promotion or improvement of the economic, social or environmental well-being of the area.

Legal Framework

The basis of the legal framework is to ensure the council retains control over this major scheme and ensure that maximum consideration in terms of well-being benefits is received. The agreement will be required to incorporate provisions for monitoring the performance of the developer and the ability to grant disposals initially across Phase 1.

As the phasing of the scheme is critical it has been proposed that the legal structure should be based on the following principles:

- A contractual agreement for delivery and completion of Phase 1 (with a commitment to undertake further detailed work under an ‘in principle’ agreement to deliver Phase 2).
- On Phase 1 completion, and following a reasonable period for letting, undertake a joint review/assessment of the viability of proceeding with Phase 2.
- Following the review, and if acceptable to all parties, the relevant authority to enter into a further agreement for delivery and completion of Phase 2 is sought.

The contractual framework for each separate Phase will involve the following :

- *Development Agreement*
  Providing the Overarching Agreement to establish arrangements between the developer and council for carrying out the development scheme and the ongoing management of the development area. The Agreement will cover: initial conditions / events to be achieved prior to start on site; individual organisational and mutual obligations; timing considerations and the rights of parties/investors. The final agreement will be a complex contractual document with all necessary detail. The draft Heads of Terms forming the basis, structure and shape of the Agreement are attached in Appendix 4.

- *Building Licence*
  A supplemental document to be entered into in accordance with the terms of the Overarching Agreement. Properties will not be transferred in title to the developer until refurbishment is complete. In order for both the council’s and developer’s interests to be protected the Building Licence sets out the parties obligations and responsibilities over the site, providing rights of entry and authority to carry out works in accordance with an approved scheme and providing a basis for certification of completion and transfer.

- *Grant Agreement*
  The council intends to use £1.9M CEHF funds in Phase 1 of the project. The investment will be in the form of a grant and the conditions of the award will be enshrined within a document with conditions to protect the council’s interests in its eligible use. A mechanism is defined by which the anticipated amount of grant funding is returned at the point of refinancing at the end of Phase 1, recycled into Phase 2, with a the final anticipated return due against grant (which can be recycled into further housing/regeneration work). An overage clause and formula represents the mechanism to apportion any reward surplus / risk deficit against anticipated figures at the defined particular Phase completion, valuation and refinancing events.

<u>Statutory Approvals / Partner Funding Agreements</u>

Planning approval is required for the implementation of Phase 1 and Phase 2. While a risk to timing of implementation there are no major issues anticipated or which have been highlighted in detailed discussions with the city council’s planning officers. Similarly the relevant statutory interventions (e,g in the highway and to utilities), are not expected to cause major delays. Resolution of all statutory approvals will be made conditional on starting on-site in the Development agreement.

The council was in default of the current HCA funding agreement for Chatsworth Gardens dated 21/12/2005 when its original private developer partner Places for People withdrew. Schedule 2, Part 1 of the agreement states that the council will provide the Agency with its detailed written proposals for the future management development and disposal of the council site. In February 2011 a high level meeting with the HCA indicated that they will support the council's preferred approach if they consider it to be a viable and positive regeneration solution, but at that time had no funding to support the council achieving this. In February 2012 the HCA encouraged the council to apply for the Cluster of Empty Homes Funding opportunity as a solution to Chatsworth Gardens.

In order for the council to contract with PlaceFirst the Homes and Communities Agency (HCA) must agree to lift the charge on the properties imposed on the basis of their previous grant funding sunk into the project for acquisitions. To lift the charge on the properties the HCA need to agree to the disposal and this requires both a local and a national approval. The 'local' approval is handled by the North West HCA office and could be achieved in November with approval by the HCA Project Executive in London the following month. This presents an overall scheme risk to implementation (and the potential for sign off to the development agreement and by extension the commitment of CEHF funding). However, officers anticipate this risk to be low as:

- The HCA have been kept informed of the council's efforts to secure a contingency solution. Officers followed the HCA's advice in presenting the opportunity to the open market before agreeing to work with PlaceFirst on the basis of their submission.
- The HCA has a separate interest in the project via its Build to Rent scheme. PlaceFirst have secured finance partly on the basis of delivery on Chatsworth Gardens. The HCA is fully aware of the merits of the scheme and have approved funding after undertaking their own due diligence on the company. In order for this finance to be released to PlaceFirst the HCA will need to place a new charge on the properties, reinforcing the need/desirability of lifting the current charge.
- The HCA has an interest in progressing CEHF spend as administrators to the DCLG for the scheme and are fully committed to the objectives.

There is a great deal of support for the proposal from various sections within the HCA so it is expected that HCA will agree to the lifting of the charge.

The acceptance of the Clusters of Empty Homes Funding (CEHF) offer is under a separate agreement to the 2005 funding agreement. The CEHF needs to be committed by end of March 2014 and spent by September 2014. However, if contracts cannot be exchanged by the end of March the ability to use CEHF (and deliver the project) will be lost unless an extension to the CEHF commitment deadline is agreed with the Government. In addition, should PlaceFirst and the council fail to agree detailed terms after January 2014 the council will lose the comfort of being able to deliver Option1 as a contingency project, again unless an extension to the CEHF commitment deadline is agreed. This is because it is not practical to complete and commit CEHF resources by the end of March 2014 if tendering on the council-led project starts after January 2014. However, officers consider the risk of being unable to sign an agreement with PlaceFirst by the end of March 2014 to be low. PlaceFirst's team has been working closely with officers for a number of months, and both joint-working arrangements and detailed contract negotiations have been proceeding well. There are no anticipated issues to agreeing the detailed contracts in good time – officers advise that the documents' content will be of a standard form to be completed under the heads of terms (Appendix 4) which are considered acceptable.

The CEHF resources will be applied to eligible works on empty properties and public realm as required by the terms of the fund. The spend will monitored and secured by provisions in the Grant Agreement between PlaceFirst and the council.

Supplementary Funding Opportunity

The report notes an intention for officers to develop and submit a bid for DECC funding under the Green Deal Communities – Local Authority Fund. Should a funding offer be made on the basis of this bid the delivery of any proposals will involve a formal grant agreement to be made between the city council and the funder/accountable body. The outline terms and conditions of the funding stream have been reviewed by legal services and the terms appear standard for Government sponsored external funding streams. Any particular conflict in final grant award terms with council policies/procedures raised in development of the more detailed proposals or under any offer will be considered and reported to Cabinet as necessary.

FINANCIAL IMPLICATIONS

The Financial Implications of progressing with **Option 1** are fully discussed in the report/recommendations of 4th December 2012 Cabinet (Minute 82).

In terms of the Financial Implications of progressing with the Developer's proposal as outlined in **Option 2**, these should be read in conjunction with the legal implications and the figures and assumptions which are detailed in Appendix 3. It should be noted that development appraisals depend on the accuracy of the underlying variables and as well as experience on current ongoing schemes elsewhere, the Developer has employed reasonable and prudent cost benchmarks and market value assessment informed by the views of a leading construction consultant, published statistics on private rent, bespoke market research and local agents, etc. Officers within Financial Services (Resources) and Regeneration & Planning have also reviewed the assumptions contained within the financial model upon which the Developer has based its proposal for Phase 1 and are comfortable with the competency of the underlying data.

In comparison with Option 1, although Option 2 is the more expensive of the two to refurbish, it is important to note that the Developer's scheme is based on current prices, whereas the council's is based on prices over a year old, it includes the large 'difficult to deal with' properties on Regent Road, which the council's scheme is unable to afford in the short to medium term and is based on a much higher environmental specification. In addition, it removes the council from the burden of contingent risks in respect of construction, refurbishment, VAT partial exemption liabilities, project management and future property rental management or end sales and will further assist in reducing ongoing revenue management costs associated with holding Chatsworth Gardens, e.g. significant council tax liabilities for Phase 1 initially and ultimately Phase 2, subject to a viable business plan for implementation of this next phase.

The Developer intends to form a specific Special Purpose Vehicle company (SPV) for this proposal to meet funder's requirements and provide transparency. This will also enable the council to monitor scheme costs, cashflow and ongoing viability, etc. The refurbishment will be delivered through a fixed price design and build contract through which costs will be controlled. The main risk therefore arises through the future management of the property portfolio and its ongoing viability, which will be shaped in the main by levels of rent that can be achieved and overall levels of voids. It should be noted that at this stage although the Developer is in discussions with a Registered Provider partner for Phase 1, one has not yet been formally appointed.

Prior to entering into further contractual commitment with the Developer for Phase 2, it would be necessary for both parties to review the relative success or failure of Phase 1 to meet the forecast costs, net rental income and ability to 're-finance' based on future rental values to inform the viability of the next phase of the project. This is not too dissimilar to what would be required under Option 1, the main difference being that Option 2 in all likelihood has more certainty of achieving a comprehensive approach compared with Option 1.

It is re-iterated that the principal financial risk arising under both options continues to be the ability of the council to secure Clusters of Empty Homes spend, which needs to be committed by end of March 2014 and spent by end of September 2014 and although not without its risks, it is felt that Option 2 provides the most realistic solution in meeting these deadlines.

The final position regarding total number of properties and actual CEHF to be included under Option 2 will be reflected in the legal agreements should any further property sales be actioned prior to commencement of the proposal, therefore based of the Heads of Terms outlined in this report, it is proposed that final associated legal documentation, i.e. the overarching Development Agreement, Building Licence and Grant Agreement continue to be drawn up by Officers in conjunction with the Developer and that subject to HCA lifting its charge on the properties, authority to sign off and enter into a formal contract be delegated to the Chief Officer (Governance) and Chief Officer (Resources).

In disposing of the council's property holding at nil value, it needs to be determined whether or not there is an 'undervalue', therefore the council is currently in the process of having its properties independently valued prior to commencement of the scheme. Although the Capital Programme does not currently include a budgeted capital receipt for this scheme and so there will be no bottom line impact upon transfer, regardless of whether or not the Developer led scheme is approved, it is likely that the current carrying value (based on original acquisition costs) on the council's balance sheet (£2.7M for Phase 1 properties) will need to be reduced in line with the expected revaluation. Further impairment / write off would be required at the end of Phase 1 upon transfer to the Developer.

Supplementary Funding Opportunity

As outlined in the report the proposal to develop and submit a capital bid to the Department of Energy & Climate Change "Green Deal Communities – Local Authority Fund" is for energy efficient measures to i) supplement the energy efficiency proposals specified in the preferred Option 2 and ii) improve and roll out energy efficiency measures to properties in the West End area. Any funding award is wholly additional to the progression of the preferred Option 2. It is anticipated that much of the implementation arising from any funding award will be undertaken by PlaceFirst as the council's delivery partner and involve officer resources, principally from Regeneration and Planning, Partnership and Accountancy sections.

It is recommended that authority to sign off the bid and accept any funding awarded be delegated to the Chief Officer (Resources).

The General Fund Capital Programme and Revenue Budget will need to be updated as appropriate to reflect the financial implications of those recommendations approved (in part or whole), subject to there being a nil impact on the council's resources.

The progression of this scheme will impact to some degree on the council tax yield and New Homes Bonus funding, although it is impossible to forecast this at present because of the many variables and uncertainties. The impact is not considered a material consideration however, and it would be picked up as future monitoring develops.

OTHER RESOURCE IMPLICATIONS

Human Resources:
The human resources required to deliver Option 1 are fully discussed in the report/ 4th December 2012 Cabinet (Minute 82) report - these are principally from Regeneration and Planning, although other services support is required, including Financial, Property and Legal. Progressing with the Place First proposal in Option 2 will require input from Legal, Financial and Property Services officers' time in negotiating and drafting the detailed terms of the underlying legal documentation. Ongoing input will be required over the lifetime of the project managing properties prior to implementation of Phase 2, principally from Regeneration and Planning although other services support will be required including Financial, Property and Legal.

Information Services:

No Information Service implications.

Property:

The major implications for the involvement of Property Services are discussed in the body of the report and Legal Implications section. The developer competition involves the disposal and future development/management of refurbished residential and some commercial property to the terms of the council's Corporate Property and Disposal Strategies. The progression of the project requires input from the council's property services staff in conjunction with Regeneration & Planning staff leading the project.

Open Spaces:

No Open Space implications.

SECTION 151 OFFICER'S COMMENTS

The Section 151 Officer has been consulted and has no further comments.

MONITORING OFFICER'S COMMENTS

The Monitoring Officer has been consulted and has no further comments.

BACKGROUND PAPERS	**Contact Officer:** Paul Rogers / Tom Brown
Cabinet Report 4th December 2012, minute ref: no.82: Agenda for Cabinet on Tuesday, 4th December 2012, 10.00 a.m. Cabinet Report 23rd April 2013, minute ref: no.144: Agenda for Cabinet on Tuesday, 23rd April 2013, 10.00 a.m. Winning Back Morecambe's West End Masterplan - available on Lancaster City Council Website: http://www.lancaster.gov.uk/planning/regeneration/morecambe-s-west-end/	**Telephone**: 01524 582326 / 01524 582334 **E-mail:** progers@lancaster.gov.uk tbrown@lancaster.gov.uk **Ref:**