<u>Purchase of Social Housing units from Brick by Brick</u>

In the February 2021 report on Brick by Brick the Cabinet agreed that the HRA could acquire residential units from Brick by Brick (subject to a review of affordability and HRA revenue implications), the decision had previously been agreed in June 2020 by Cabinet but suspended in November 2020 by Cabinet following both the report in the Public Interest and the initial strategic review of companies undertaken by PwC. The February decision was made following changes to affordability assessments within the HRA and changes in rent policy.

The External Auditor has subsequently, following an email exchange in March 2021, contacted the Director of Finance and made the following observation. "*The circular nature of purchasing properties from Brick by Brick in July 2020 was a concern in the Report in the Public Interest and that decision was paused in November 2020, the paper in February 2021 recommends continuing with the decision however this paper does not set out.*

- *Conflict of interests – the paper needs to set out what is in the interests of the Council and what is in the interests of Brick By Brick and how that conflict of interest has been addressed.*
- *Full financial impact assessment – the revenue implications have been appraised as you note in your response. The part that has not been addressed in the papers I have seen is how the financial assessment considers how much the Council has already spent (in borrowing) to build the properties that the Council is now buying back.*

Given our previous criticism of this decision under the previous leadership my reflection is that the new leadership should consider carefully the transparency of the decision to continue with the July 2020 decision particularly with regard to the legal and financial considerations to purchase properties you have already paid to build."

In addition a further conversation was held between the External Auditor and the Interim Chief Executive recently where this issue was discussed. The External Auditor helpfully explained that the Council needs to fully demonstrate and evidence in any decision on this matter, its consideration of the circular nature of the funding and be clear about the benefits and dis-benefits of this in relation to value for money for tax-payers in the round.

The purpose of this appendix is to enable members to decide whether to continue with the decision to purchase units from Brick by Brick and, if so by what mechanism. It will also address at the outset the observations made by the External Auditor about conflicts of interest.

Financially, the interests of Brick by Brick and the Council are intertwined, as sole shareholder and sole funder.

The Council's overall financial interest is best served by Brick by Brick maximising income to enable it to repay as much of the loans made to it by the Council as is practically possible and to minimise losses to the public purse.

It is therefore in the Council's best financial interest for Brick by Brick to seek alternative purchasers where BBB is of the view that it can increase income from that alternative purchaser over and above any offer from <u>the Council.</u>

The Council made an offer for the 190 units on a site by site basis. BBB has received a superior offer for 86 units from a registered provider for shared ownership use. The Council's offer was accepted for 104 units. This mixed sale gave BBB the best overall return.

It is the Council's contention that acquiring those units are in both the Council's and Brick by Brick's best interests and they are not "double paying" for those units.

The units under construction by Brick by Brick are being funded from loans made by the Council. This funding has in the first instance been raised by the Council from borrowing largely from the Public Works Loan Board (PWLB). The loan is shown in the Council's balance sheet and the revenue cost of the interest is charged to the General Fund. However there is no direct line connection between loans made to Brick by Brick to a particular tranche of borrowing by the Council. When units are sold by Brick by Brick, regardless of who the purchaser is, this should, subject to the Council not agreeing to Brick by Brick retaining the proceeds for working capital, create funds to first pay to the Council the interest accrued on the loans and then repay the debt. The sales proceeds should then extinguish the loan in the Council's accounts.

The apparent double payment which has caused concern for the External Auditor arises from the fact that for the Council to acquire any of the units it needs to enter into a second loan, funded through the HRA to buy the completed units, when it is possible that the first loan funded from the General Fund may not have been fully redeemed as the sale proceeds may still be retained by Brick by Brick to fund working capital.

In that instance the optics are that the Council and the tax payer seems to be paying twice for the units as the Council would in effect have two sets of borrowing against the same properties.

There are alternative ways of dealing with this issue, rather than the Council buying the units at agreed prices.

1. The Council does not purchase any units at all and BBB sells them on the open market.
2. A debt write off or set off arrangement.

These options are explored in terms of impact on the Council and on Brick by Brick both in the narrower and wider sense. However, before this is examined two other issues need to be explored and explained. The case for acquiring social housing units, and the price paid for any units.

The purchase or acquisition of any permanent social housing unit for rent is normally accounted for within the Housing Revenue Account (HRA) by the Council. However, for households whom the Council has a statutory duty to rehouse but who are not in permanent social housing accommodation the costs of housing then fall onto the General Fund. Based on the provisional outturn (2020/21) the average cost of each household of temporary accommodation in the General Fund is £4370 p.a. There were over 2200 Households in temporary accommodation on average in 2020/21. Therefore, an increase in supply to properties in the HRA reduces pressure on General Fund costs by over £450,000.

That pressure can also be reduced by rented accommodation being provided by registered social landlord providers as long as the Council has nomination rights to those properties. It is therefore a legitimate consideration for the Council to consider the costs foregone in the General Fund of providing and paying for temporary accommodation when buying new units of permanent social rented accommodation for the HRA for rent either from Brick by Brick or from any other source.

With regard to the price paid for those units there are two considerations, the first is whether the price paid is fundable from the HRA, the second is whether the price paid is the best available price for the units to be purchased (i.e., could the Council acquire more units of an equivalent standard for the same sum of cash) .

The February Cabinet paper established the new principle that the Council would only acquire units in the HRA where the estimated costs of debt, management and maintenance can be covered by rent. Rents would be higher than Council rents for other properties but would be within the limits set by the GLA to enable grant to be received. All of the units proposed to be acquired currently meet that test. The second test is whether any other equivalent units can be purchased by the Council within the borough at the same or similar price. The Council is currently offering to purchase the units at an average price below £300,000 a unit. Details are shown on the restricted paper. All units would be new.

In early April 2021, a search was undertaken using Rightmove to identify new build properties for sale in the borough. Below £280,000 there were 13 1-bedroom units, and no 2- or 3-bedroom units below £300,000.

The 104 units available for purchase from BBB produces 51- 1 bed units, 50-2 bed units and 3-3 bed units. Although older properties could have been purchased these would have had additional costs to modernise and even then, would have been difficult to justify the payment of higher rents which were approved back in February 2021 without which the affordability criteria would be met. The purchase of older properties is therefore discarded as an option as they would not meet the revenue funding criteria due to the lower rents chargeable.

In the light of this it is reasonable for the Council to consider purchasing the Brick by Brick units in that they are affordable within the HRA with the new rental policy set and that there was no other reasonable opportunity to purchase new build units in the borough at or below the prices to be paid to Brick By Brick for the same range of bedrooms to meet the range of housing need the Council faces. Also, the acquisition of 104 units reduces General Fund cost pressures by £450,000 p.a.

Returning to the alternative ways to deal with this situation. The Council could, as referred to above, decide not to acquire the residual 104 units, of that number 67 units could be sold as shared ownership and 37 would, due to planning permissions need to be sold as low-cost rent to either a registered provider or another local authority. The values obtained for shared ownership would be similar to that which the Council would have purchased the units for so in terms of return to the Council from Brick by Brick the difference would be negligible. However, due to the different cash flows between a shared ownership purchase and a low cost rental purchase Brick by Brick would require an enhancement to their working capital facility, thus increasing their level of debt to the Council. This could be as much as an extra £20-£30 million (in FY 2021/22).

If the 37 units were purchased by a registered provider, the Council may be able to acquire the nomination rights. However, there is no guarantee of this. These units could be acquired by another borough who could use Ex Right to Buy receipts to fund the element which would have been funded from Grant then those units and any nomination rights would be lost to the Council as the other borough will acquire them for housing their own residents.

The downside of this option, i.e. not acquiring any of the units, is no additional social housing is provided in Croydon for local residents seeking support from their local council and no ability for Croydon Council to lessen the cost pressure on the General Fund in providing temporary accommodation, the need for additional cash flow support as a further loan to Brick by Brick, and possibly the adverse publicity of 37 units being acquired by another local authority.

The other alternative apart from outright purchase by the Council or non-purchase, would involve a debt swap or a partial debt swap. The Council is only able to offer the average price for the 104 residual units due to the availability of a GLA grant of £100,000 per unit. This is paid as a cash grant to the Council and is then paid to the seller of the units to the Council. Based on the prices being offered to Brick by Brick, the Council would either need to borrow the balance or to write off loan debt to Brick by Brick of the same amount in lieu of sale proceeds.

This would leave the Council and Brick by Brick on par but would mean that the Council would own the properties in the General Fund as this is where the loan swap borrowing is from and not in the HRA. The Council, if it is to use GLA grant, will need to hold those units in the HRA.

This issue could be resolved by immediately appropriating the properties from the General Fund to the HRA. This would not be a straight debt swap as appropriation has to be done at value, so the HRA would effectively pay the revenue cost of debt at the value of the units before grant (i.e. the revenue cost of debt to the HRA would be at the average price per property and not at the amount the Council actually borrowed of the average price less grant per property.)

This impacts the financial viability of the units in the HRA, so that the revenue viability test set in February fails albeit for only for the first 3 years of the business plan. If this was acceptable it would avoid some of the optics of the Council appearing to borrow twice for the same units. However, Brick by Brick lose the cash flow benefit of the units and they would still require further cash flow loans of up to £20 million. In the light of the failure to achieve the full revenue viability test and the likely need for further cash flow loans this option is also rejected.

The final option to consider as an alternative to the buy nothing and debt swap options, is to continue with the existing policy of buying the residual104 units at an agreed price.

This option has the disadvantage of apparently paying twice for the same units, which is in fact only the case if none of the loan advanced to construct the units is not repaid by Brick by Brick. It is the only option that delivers the residual 104 units to the HRA at a pricing model that is revenue positive to the HRA at day 1 and it also, if confirmed quickly, does not require a further cash flow injection to Brick by Brick for working capital purposes.

On the basis of the above the purchase option as set out in this appendix is the option recommended for adoption.