Brent	**Audit Advisory Committee** 20 September 2017 **Report from the Board of I4B Holdings Ltd**
For Information	Wards Affected: All
Update on mobilisation and initial operation of I4B Holdings Ltd.	

1.0 Purpose of the Report

1.1 This report provides an update from the Board of I4B Holdings Ltd on the progress it has made in mobilising the company and delivery against its business plan.

2.0 Recommendation(s)

2.1 Audit Advisory Committee is asked to note the updates contained in the report.

3.0 Background

3.1 The Council's Cabinet agreed a Temporary Accommodation Reform Plan in March 2016, which identified a number of new approaches to support homeless families and help reduce the Council's dependence and expenditure on temporary accommodation. One of the key initiatives agreed to was to begin a Private Rented Sector (PRS) programme and incorporate a new wholly owned company for the purpose of delivering PRS housing to residents on the housing needs register who have insufficient means to provide their own private sector housing solution.

3.2 The Temporary Accommodation Reform Plan identified the advantages of establishing a company owned by the Council outside the Housing Revenue Account (HRA) which could let properties within the PRS, while drawing on the Council's borrowing capacity and give the Council greater control of the investment compared to entering into a joint venture or contract with an external organisation, allowing better management of risk and potential reward.

3.3 A PRS portfolio of 300 properties was proposed and an initial budget of £60m, subsequently increased to £100m, was agreed. In Annex 1 of the Temporary Accommodation Reform Plan, a rationale was presented for starting the PRS Acquisition Programme in advance of setting up the Company, stating that the present opportunity to acquire PRS units would narrow in the relatively short-term, and therefore it was in the Council's interest to begin purchases and use purchased units as Temporary Accommodation, with units then switching to PRS lettings on being transferred to the company once established.

3.4 In April 2016, Cabinet approved the Council's investment strategy. The strategy was designed to set the framework through which the capital programme will help to deliver the Council's long-term vision to "make Brent a great place to live and work…" and to help deliver the five Brent 2020 priorities. The strategy signalled a shift away from short-term solutions to long-term public investment, and envisaged the Council embracing more innovative and agile corporate structures to enable a more enterprising culture focused on seizing opportunities and managing rather than eliminating risks. One explicit short-term action of the strategy was to establish a local authority controlled company.

3.5 In November 2016, Cabinet agreed a paper presented by the Council's Chief Finance Officer entitled 'Establishing a Wholly Owned Investment Company'. Cabinet supported the setting up of the wholly owned company and the Company's PRS business plan, reflecting the ownership and management of three hundred properties to support the Council's homelessness agenda.

3.6 The Company, 'Investing 4 Brent' Ltd ("Investing 4 Brent" / "I4B" / the Company) was subsequently set up using the agreed delegated powers and incorporated in December 2016.

3.7 Since its initial establishment, the Company's Board, with the approval of Cabinet as shareholder, has taken the decision to change the name of the Company to I4B Holdings Limited. This decision was recently executed following activation of the Company's bank account.

3.8 The steps that have been taken to establish the Company can broadly be broken down into:

1) The mobilisation of the company – incorporation, governance arrangements, legal contracts, financial support, company policies and other administrative details.
2) The PRS Acquisition programme – purchasing, conveyancing, refurbishment and onward sales.

4.0 Update on Mobilisation

<u>Incorporation of the Company</u>

4.1 Investing 4 Brent Ltd was incorporated on 16th December 2016 (though the Company name has since been changed to I4B Holdings Limited).

4.2 A number of core legal and financial documents were required by Companies House. These are:

- **Articles of Association / Memorandum of Association** – these are the constitution of the Company, as agreed by Cabinet.
- **Business Plan/Financial Plan** – as agreed by Cabinet. See Appendix 1.
- **Shareholder Agreement** – agreed by Cabinet. Sets out the exact nature of the relationship between the Council as the sole shareholder and the Company, and matters on which shareholder consent is required.
- **Loan Agreement** – setting out the terms of the loan facility provided by the Council to the Company.
- **Register of Directors** – details of the four company directors and declarations of interests.

4.3 The Company is overseen by a Board of Directors, chaired by an independent voting Director. This role is fulfilled by Martin Smith, who is the former Chief Executive of Ealing Council.

4.4 The other Company Directors are Cllr George Crane, the Strategic Director of Community Wellbeing (Phil Porter) and the Director of Performance, Policy and Partnerships (Peter Gadsdon).

4.5 The Board of Directors meets on a monthly basis and has overseen the mobilisation of the Company and the execution of its Business Plan. The Board is supported by a team of Council officers who are able to provide expert legal and financial advice.

4.6 In the November 2016 Cabinet report, 'Establishing a Wholly Owned Company', structures were proposed to enable the Directors of the Company to act with commercial freedom with all the advantages desired in terms of operational flexibility, whilst the Council retains democratic control over all of the key strategic decisions.

4.7 The governance structures are as follows:

- **Company Directors** – operate with commercial freedom in the best interests of the company (as required by the Companies Act).
- **Corporate Management Team** – acts as senior 'client', overseeing the activities of the Company
- **Cabinet** – acts as the strategic supervisory body with ultimate responsibility for ensuring governance of the Company and approval and delivery of its Business Plan. This role is without prejudice to Cabinet's normal decision making powers as set out in the Council's constitution.

<u>Policies and general administration</u>

4.8 The following policies have been written and approved by the Board:

- Health & Safety Policy
- Safeguarding Policy
- Equality Policy
- Assured Shorthold Tenancy Agreement

- Data Protection Policy
- Domestic Abuse Policy
- Anti-social Behaviour Policy
- Complaints Policy
- Freedom of Information Policy
- Procurement Framework

4.9 As the Company contracts out operational activity to either the Council or the housing management agents, these policies explicitly set out the standards it requires its contractors to adhere to.

4.10 The Company does not have an Employment or HR Policy because at present it does not employ any staff.

Service Level Agreement

4.11 The Company has a fixed six month period overarching Service Level Agreement (SLA) with the Council which covers all of its day to day operational activity, including the purchasing and conveyancing process, nominations, lettings and refurbishments, the provision of housing management services and all such other activities as may reasonably be expected to be undertaken. The SLA covers the following services:

- Housing management and responsive repairs
- Buying
- Void management
- Legal support
- Performance monitoring and reporting
- Governance and company support
- Information Governance, FOI, Audit (internal) and Complaints Management
- Financial administration
- Procurement services
- Coordination

4.12 In turn, the Council has contracted three housing management agents to manage properties in the areas in which it has purchased units for PRS letting. Brent Housing Partnership (BHP) (and later the Council once BHP has been brought back in house), Pinnacle Housing Group and Mears Group have been appointed to provide housing management within Brent and Pinnacle Housing Group and Mears Group have been awarded contracts to provide housing management in the Home Counties. Contracts have been signed with BHP (Brent & Greater London), Pinnacle (Home Counties) and Mears (Home Counties).

4.13 To record the Company's assets, the Council (acting on behalf of the Company) is using the existing Northgate housing management system and is preparing to make use of the Council's new Keystone asset management system provided by Civica.

4.14 Through the SLA, the Company purchased a comprehensive range of financial services from the Council including:

- Financial reports to the Board
- Providing an analysis of financial performance against business plan assumptions
- Providing advice to the Company as requested
- Inputting and management of the Company's financial management systems including Oracle
- Managing the Company's accounts
- Invoicing and payments to sub-contractors
- Management and reconciliation of payments to the Company including the four weekly electronic payment of rent and other items to the Company's account from housing management contractors
- Payment of council tax and utilities of void dwellings or any liabilities which fall on the Company
- Service charges and ground rent to freeholder of leased dwellings

Financial delegation and processes

4.15 The Board has a scheme of financial delegation to allow for small payments up to £10,000 to be agreed at officer level. Payments from £10,000 to £49,999 are to be agreed by any one of the Board members, with two Board members to approve all spending over £50,000.

4.16 The Company utilises the Council's Oracle finance system and currently shares a ledger with the Council. The Council plans to introduce a new finance system shortly whereupon the Company will have its own ledger.

5. Delivery against original objectives

PRS Acquisition Performance

5.1 The PRS programme set out to provide 300 units of good quality private sector accommodation for the Council to nominate homeless households to. The programme has been profiled to achieve this target over thirty months instead of twenty-four months and the current programme of acquisitions will be complete by September 2018, with all properties refurbished and let by 31 December 2018.

5.2 Clearly, the programme extension of six months means that opportunities to support homeless families and save revenue costs are delayed, reduced or lost.

5.3 Using a calculation based on the current blend of costs relating to the Council use of temporary accommodation, the annual revenue cost savings to the Council would be circa £900k per annum. The longer delivery date has meant circa £250k of revenue savings benefit to the Council have been delayed.

5.4 As of 16 August 2017, 52 properties have been purchased and there are 75 properties in conveyancing. The current purchase costs and on costs of properties purchased or in conveyancing is higher than set out in the Business Plan at £359k as opposed to £333k. The average Gross Yield is higher than Business Plan at 4.95% as opposed to 4%+. Table one below provides a summary of the purchases and pipeline.

5.5 The Company's business model is highly sensitive to rental yield. A change in yield of 0.25% is equivalent to an increase in equity funding and a reduction in debt funding of £9.7m (circa 10%).

5.6 To manage risks, the Company is working towards achieving an average 5%+ gross yield to ensure risks are managed. The Company has introduced a lower gross yield rate of 4.45% for Brent properties and a higher rate for non-Brent properties to ensure the Business Plan achieves its required average and the minimum target of 120 homes in Brent.

Table One – PRS Purchases and Pipeline at 16/08/2017

Purchase & Pipeline summary				
	No	Value £000s (pipeline & acquisitions)	Average purchase price (target ave. £333,000)	True Gross Yield (target 4%+)
Purchased PRS Units 2016/2017	52	£18,716,091	£359,924.83	4.86%
Pipeline PRS Units 2016/2017 (under offer and in conveyancing)	75	£26,931,210	£359,082.80	5.02%
Totals	**127**	**£45,647,301**	**£359,427.57**	**4.95%**
Other pipeline properties (not in conveyancing)	15	N/A	N/A	N/A
Remaining PRS Acquisition Budget (£100,000,000)	**173**	**£54,352,699**	**£314,177**	**5.04%**

5.7. To date, the Council has purchased properties on behalf of the Company to ensure that momentum was generated whilst the Company was being set up. The Company now has a bank account and is able to pay purchase and refurbishment costs directly.

5.8. The 52 properties purchased to date are not representative of properties within Brent and deviate from the business plan assumption which is: Brent: 120

(40%), Greater London: 30 (10%) and Home Counties: 150 (50%). This imbalance is primarily owing to a parallel Council acquisition programme which purchased 40 Brent properties for the Housing Revenue Account.

5.9. Nonetheless, if the 127 properties purchased, or in conveyancing, are considered the proportions closely match the business plan with Brent: 46 (36%), Greater London: 13 (10%) and Home Counties: 68 (54%).

5.10. External buying agents have been appointed to complement the Council's property buyers and these agents will initially concentrate on lower value properties in the Home Counties with yields in excess of 5.5%. The impact of this will be to bring in line the average property purchase price and allow greater flexibility to achieve a greater share of portfolio properties in Brent than business plan expectations.

5.11. The performance of the Company's management agents is untested until properties are placed into management. The time it has taken to set up a Company bank account has created this delay. There are 15 properties ready to let once the Council sells the properties to I4B. Delegated authority was provided on 21st August 2017 and the Company now has access to the loan. It is expected that the first 15 properties will be transferred to the Company on Monday 11 September.

5.12. There are a number of actions underway to strengthen the core business model. However, some of the actions will require a variation from the current Business Plan and these proposals will come forward to the Cabinet in due course.

5.13. Actions to improve the performance of the acquisition strategy include:

- The acquisitions team has improved yields, as can be seen in table one, of this report, and should the team continue on its current trajectory significant improvement will be seen.
- The acquisitions team has been tasked with buying properties with greater economic benefit than those bought so far, with a view to improving the financial performance of the entire 300 unit portfolio (once fully purchased).
    - The acquisition team will focus on smaller dwellings, primarily two and three bedroom properties however a yield in excess of 5% will still be required.
    - The acquisitions team will continue to purchase properties in Brent at a lower minimum gross yield of 4.45% however a limited number of one bedroom properties (up to 15) will be purchased.
- Up to 15 one bedroom units purchased in Brent will be in demand and the company will let the properties. The Council can nominate sufficient customers in line with the Borough's homelessness pressures and housing demand.
- External buyers have been identified and the award has been made to purchase and initial 50 units through external buying agents. A minimum

gross yield of 5.5% has been set and a purchase value less than £250k per property is anticipated. These properties will be in the northern towns of the Home Counties.

- Should a noticeable difference in performance of internal and external buyers be identified additional commissions can be made based on performance.
- The Company has the ability to use market rent for a proportion of its portfolio, in some circumstances, if it provides financial stability to the company.

The dashboard showing the position in August 2017 is attached at Appendix 3.

Implications for the financial model

5.14. The financial implications of the original objectives were reflected in a financial planning and forecasting tool which detailed (among other things), for the three discrete property location categories (Brent & Greater London; Home Counties (low LHA); Home Counties (medium LHA)) Projections and Forecasts of:

- Property Purchase & Acquisition Costs
- Rental Yield
- Loan to Equity Ratio
- Debt Financing Costs
- Operational Management & Repair Costs

5.15. It should be noted that the financial projection extrapolates real data on acquisitions to date, whereas the forecast layers originally forecast data (for yet-to-be purchased properties) on top of actual data to date.

5.16. The financial model is updated to reflect real data as new properties are acquired allowing the ongoing financial performance to be tracked and new projections/forecasts derived.

5.17. Using the latest data (acquisition of 52 units) the financial model predicts that, should the current acquisition pattern continue (i.e. a financial **projection**):

5.18.1 Property purchase and acquisition costs for a 300 unit portfolio will exceed the £100m agreed funding limit by £7.5m.

5.18.2 The 300 units acquired will not be in locations reflected in original assumptions (critically, there will be an underachievement of the number of units purchased in Brent and Greater London (139 compared with 150 in original plans)).

5.18.3 A marginal and favourable variance in the Rental Yield will result in approximately £10K more than **forecast** being available every year to fund operational debt and/or financing costs.

5.18. Performance against this threshold will be reported to Cabinet at regular intervals to ensure there is clarity about its direction of travel and further, to provide certainty that the Company limits its reliance on Council equity.

6. Challenges and how these are being addressed

Property acquisition process and key to key performance

6.1 A number of challenges have arisen during the set up and mobilisation of the Company and the acquisition programme, many of which have been resolved or are currently being addressed.

6.2 The time between property identification and purchase is an average of fifteen weeks and the average number of days between purchase and refurbishment completion (key to key) is 160 days. The Business Plan target for purchase to letting is 90 days. Plans are in place to improve performance, especially relating to refurbishment timescales to ensure that performance relating to the remaining 248 properties compensates for performance at the commencement of the programme.

6.3 The target of 300 properties purchased by April 2018 has been extended by six months to September 2018. The impact of these late purchases is primarily a delay in provision of revenue savings to the Council. Risks to the Company's Business Plan are limited. As the market has been much flatter than initially predicted, the price the Company is likely to pay for delayed purchases may well not be disadvantageous and the risk of the portfolio achieving gross yield because of market conditions is limited.

6.4 The programme has now established a track record of acquisitions and property refurbishment and has contractors ready to manage the properties and collect rent on behalf of the Company.

6.5 The Company has raised issues with the use of Council services via the SLA which have not been as flexible and agile as required. This was discussed at the 24 August 2017 meeting of the Council Management Team and measures have been agreed to ensure the support being provided is able to meet the Company's requirements. However, it is important to note that this has been a new way of working and learning from the establishment of I4B is being used to improve ways of working as well as to inform future projects. In addition, had the Company opted to obtain external support, this would not have resulted in mobilisation being undertaken more quickly.

6.6 In advance of the work on the SLA, CMT has agreed a number of measures to strengthen the level of support for the Company and to ensure improvements in business processes e.g. the acquisitions prcess.

7. Further Business Opportunities

7.1 The Company has explored a number of opportunities which could complement its landlord role, strengthen its Business Plan and deliver more benefits for Brent. The Company and the Council's Housing & Community Investment Board (HCIB) are working together to explore the best fit of opportunities to deliver affordable housing and new housing supply.

7.2 The types of schemes being considered include block acquisitions, joint ventures with Registered Providers (RPs), roof top modular new build, taking over assets currently owned by Brent Housing Partnership (BHP) and supporting Council new build schemes through risk sharing and property purchase. The Company and the Council's Housing Partnerships team are looking at a number of current schemes and opportunities.

7.3 Examples of specific schemes include:

- A £7m scheme consisting of 30 new homes of modular construction within Brent. The properties would be built in partnership with the Council and have affordable, social and intermediate I4B tenancies. The scheme has been provided with an initial grant allocation from the GLA.

- The Company may become a suitable recipient for the assets currently owned by BHP, if a decision is made to transfer assets once BHP comes back into the Council. BHP has circa 300 properties let at market and intermediate rents. Any transfer of assets would strengthen the Company and provide benefits from shared costs and economies of scale.

- Joint venture opportunities provide the Council, the Company and partner RPs the opportunity to purchase potential housing sites in Brent and develop affordable, intermediate and if desired, market rent. One example of a joint venture would be to develop 80 flats at a cost of £25m within Brent. The scheme development could be delivered by the RP but 50% of the properties would be owned by the Company at the build cost price, as opposed to the market price.

- The purchase of ten new build leasehold units within Brent. The scheme could enable the Council to avoid losing the freehold of the site and increase the affordable (intermediate) units from 30% to 100% and enable the provision of a new community facility.

7.4 The Company will ask Cabinet, as part of its business planning, to consider a paper exploring freedoms and flexibilities in relation to the Company and the opportunities that could result.

8 Financial Implications

8.1 The financial model is regularly updated to reflect the latest property acquisitions and is designed to assist the Board's decision-making, with respect to the potential to flex the parameters (e.g. size, location) of properties yet to be purchased.

8.2 The funding arrangement for the purchase of properties assumed within the financial model is:

Borrowing: the maximum loan that the rental income (net of costs) is able to support

Equity Investment: a dividend-free capital contribution from the Council which funds the difference between borrowing undertaken and total property acquisition costs

8.3 The Council equity stake calculated in the updated financial model Forecast (as opposed to the Projection) is estimated at 14.6% of total capital outlay of £99.3m (£14.5m). This is the minimum Council investment requirement to maintain viable financial model.

8.4 Table Two below shows how the financial model would perform for varying levels of equity investment:

Table Two

Equity Requirement as per latest financial model (%)	Proposed Equity (%)	Equity Stake Excess (%)	Capital Shortfall (equivalent to Equity Excess in cash terms) (£000's)	Annual Revenue Headroom (£000's)
14.60	5.00	(9.60)	9,100	267
14.60	10.00	(4.60)	4,100	121
14.60	15.00	0.4	(400)	(12)
14.60	20.00	5.4	(5,400)	(158)
14.60	25.00	10.4	(10,300)	(300)

8.5 At 5% equity, the programme suffers a £9.1m capital shortfall which would require 267k additional revenue income to be generated each year (£267k would support 95% of £9.1m of additional borrowing (95% only, is required to maintain the 95:5 borrowing to equity ratio)). Five percent is the level of equity investment that was envisaged when the original business plan was put together.

8.6 At 25% equity investment, there is £300k of revenue headroom in the model, this being the maximum amount of revenue income the programme could forgo while remaining viable.

8.7 Officers are currently working through various operational scenarios to determine the extent to which equity investment is likely to be needed and how this level of support can be provided from within Council resources.

8.8 Performance against the anticipated equity requirement will be reported to Cabinet at regular intervals to ensure there is clarity about its direction of travel and further, to provide comfort that all opportunities to reduce the Company's reliance on Council equity are thoroughly investigated.

8.9 Current outputs from the financial model suggest that there has been significant movement from the originally anticipated cost of property acquisitions previously estimated at £85.6m to £99.3m for the latest forecast (and £107.5m for the latest projection).

8.10 With property acquisition costs now forecast at £99.3m, there is a risk that the next update of the financial model will forecast a breach of the £100m capital expenditure limit.

8.11 Property acquisition strategies are constantly reviewed in order to bring financial performance back in line with either the original predictions or failing that, the current forecast.

8.12 Paragraphs 5.18.1 and 5.18.2 considered together indicate that, if maintained, the current purchasing pattern would result in the £100m capital expenditure fund being exhausted before all 300 units were bought.

8.13 Officers have also carried out stress-tests of the Company financial model to determine the extent to which outputs are influenced when base assumptions are flexed.

8.14 Each of the key risks to the Company Business Plan was scenario-tested. Included at Appendix 2 provides a table illustrating the impact of each scenario with a [low/medium/high] risk rating and suggested offsetting mitigations available to the Board.

8.15 The Board will be routinely monitoring the risk profile of the company and reporting regularly to the Council as shareholder.

9.0 Legal Implications

9.1 The Company has been established as a trading company in accordance with the approvals of Cabinet of 15 November 2016 and in compliance with relevant legislation to include section 95 of the Local Government Act 2003 and the Local Government (Best Value Authorities) (power to Trade) (England) Order 2009.

9.2 The report to Cabinet of 15 November 2016, indicated that the Company's initial principal aim was to assist in the delivery of the Council's regeneration plans and housing development objectives, but it was envisaged that the aim will be developed over time. In Section 7 of the report it appear that the Company has explored a number of opportunities which could complement its landlord role, strengthen its business plan and deliver more benefits for Brent. Pursuant to the general power of competence under section 1 of the Localism Act 2011, the Council is able to agree to the extension of the commercial purpose for which the Company has been established subject to exercising such power in accordance with its general duties, to include its fiduciary duties.

9.3 The Financial Implications section of the report details steps to realign performance and the business plan and address risks. Cabinet approval in

relation to the various options set out in the Financial Implication Section would be required which in turn would require amendment of various documents referred to in paragraph 4.2, in particular the Shareholders Agreement and the Business Plan.

10.0 Equality Implications

10.1 The proposals in this report have been reviewed and found to have a neutral impact on equality in relation to all of the protected characteristics.

Background Papers

1. I4B Business Plan
2. Scenario test of Business Plan risks and mitigations
3. PRS dashboard – August 2017

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