

	Audit Advisory Committee 20 March 2018
	Report from the Board of i4B Holdings Ltd
Update on the operation of i4B Holdings Ltd	

Wards Affected:	All
Key or Non-Key Decision:	Non-key
Open or Part/Fully Exempt: <small>(If exempt, please highlight relevant paragraph of Part 1, Schedule 12A of 1972 Local Government Act)</small>	Open
No. of Appendices:	Four: <ul style="list-style-type: none"> • i4B Business Plan 2018-2021 • i4B Internal Audit Report 2017/2018: Governance, Risk Management, and Financial Management • i4B Internal Audit Report 2017/2018: Benefits realisation, Management Information and Reporting • Council Management Team (CMT) response to the i4B's second report to CMT
Background Papers:	N/A
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1.0 Purpose of the Report

- 1.1 To provide an update on the performance, future plans and audit arrangements of the Council's wholly owned company, i4B Holdings Ltd.

2.0 Recommendation(s)

- 2.1 The Audit Advisory Committee is asked to note:
- The update on Company performance;

- i4B's future plans as set out in its second Business Plan;
- Key risks and mitigations;
- i4B's completed internal audit reports and future audit arrangements;
- A brief update on First Wave Housing.

3.0 Company Performance Update

3.1 As of 1 March 2018, i4B had purchased 123 PRS units with a total value of £43,810,081 (including works, fees and tax). The average purchase price was slightly above target (£345,000) at £356,180, however, taking into account the properties currently in conveyancing, the total portfolio looks likely to achieve target. The average true gross yield was above target (4%+) at 4.92%. See Table 1.

3.2 Table 1 – Purchasing and Conveyancing summary, 1 March 2018.

Purchase & Conveyancing summary - 01/03/2018							
	No	Value £000s (purchased & in conveyancing, including in negotiation)	Average purchase price (target average £345,000)	True Gross Yield (target 4%+)	Location		
					Brent	Other Greater London Boroughs	Home Counties
Purchased PRS units – 1 March 2018	123	£43,810,081	£356,180	4.92%	48	9	66
Properties in conveyancing (including in negotiation)	128	£44,148,273	£344,908	5.12%	106	7	15
Total purchased and in conveyancing	251	£87,958,354	£344,908	5.02%	154	16	81
Remaining PRS Acquisition Budget (total £103.5m)	49	£15,541,646	£317,176	4.89%	10		39

3.3 The Council's Purchasing Team has been successful at purchasing properties at increasingly high yields and within Brent. As of 1 March 2018, 170 of the 251 properties purchased and in conveyancing are located in Brent or Greater London. This is a higher proportion (61%) within the initial Business Plan Period than originally planned (40%).

3.3 In addition to this, a growing understanding of the customer base that the Council is seeking to nominate for Private Rented Sector (PRS) housing and analysis of the market which shows that net and gross yield margins are very close regardless of location has led i4B to request an additional £3.5m to be

spent acquiring more properties in Brent. This has amended the weighting of properties to 180 units (60%) in Brent or Greater London and 120 units (40%) in the Home Counties. The additional funding was made available following agreement of the Shareholder on 12 February 2018.

- 3.4 Although the average price of purchased properties is above target, the remaining purchases are predicted to bring the average cost back within target. This prediction is based on the fact that a high proportion of properties yet to be identified are in the lower-cost Home Counties region. The difference between a three-bed Home Counties property and a three-bed Brent property is c. £153,000 (including on-costs). The difference between a two-bed Brent property and a three-bed Home Counties property is £87,000. The remaining uncommitted PRS acquisition budget stands at £15,514,646.
- 3.5 The Shareholder has agreed a target of 300 PRS units to be purchased by 30 September 2018. It is predicted circa 140 units will be purchased by 31 March with the 300 being purchased by 31 December. This slippage does impact on the ability of the Council to generate the revenue savings anticipated (£900k per year). However, a more granular analysis of the cost benefits is taking place and, the current estimated saving is based on an assumption of a revenue saving of £25 per unit per week. However, the savings on two lettings relating to extremely large savings both already contributed over £1000 per week in revenue saving. As i4B and the Council become more sophisticated in how we measure achieved savings a truer picture will emerge.
- 3.6 As of 1 March 2018, 37 properties purchased by i4B have been let through the Council's Housing Needs service. Based on the current pipeline of properties in refurbishment we are expecting 205 properties to be let by 30 September 2018.
- 3.7 i4B has a service level agreement (SLA) with the Council to provide services for the end-to-end process from property search through to lettings. However, performance against the key performance indicators (KPIs) outlined in the SLA have not been meeting targets in some areas. In particular, the length of time properties have spent in conveyancing has been far longer than anticipated, and similarly the extent, cost and length of time for refurbishment has been more than anticipated.
- 3.8 A number of measures have been put in place to address this. These include streamlining the conveyancing, refurbishment and out of borough lettings processes.
- 3.9 To monitor SLA performance, monthly client meetings have been set up between i4B and the Council, to allow the company to monitor Council performance against the SLA.
- 3.10 In addition the Shareholder has also set up monitoring meetings held between the Chief Executive, on behalf of the Council, and i4B which occur once every six months. These meetings are used by the Council as shareholder to hold i4B to account against the objectives set out in the i4B business plan.

- 3.11 Despite performance in terms of acquisitions and number of tenants to date being behind target the Council is still realising benefit in terms of reduced temporary accommodation (TA) costs. The projected saving in TA costs for the council is £324,323 over the first 12 months (based on the 41 properties let to date). This is an average of £7,092 per let during the first 12 months.

4.0 The Second Company Business Plan

- 4.1 On 12 February 2018, Brent Council's Cabinet approved i4B's second Business Plan, which included a number of options which are under consideration by the Board as potential opportunities for the Company. These are:

- Private Rented Sector (PRS) - Continuation and expansion of the PRS landlord business, purchasing a further 300 units between September 2018 and April 2021 (creating a total of 600 PRS properties by April 2021).
- Properties for Intermediate Rent – Creating an Intermediate rent portfolio of 100 properties by April 2020 through the purchase of specific blocks or street properties and through flexible tenure management of PRS stock.
- Strategic Investments – The Company is exploring opportunities to benefit from the Quintain intermediary housing market investment opportunity, as well as empty homes projects and land purchases able to provide a meanwhile site use.
- New build Partnership with the Council (on Council owned sites) – The Company is exploring the opportunity of a partnership with the Council to maximise the opportunity to invest in Council land and assets to deliver housing and investment return. Immediate opportunities exist to deliver new Housing Revenue Account (HRA) and PRS homes.
- New Build Partnership with the council and Registered Providers (RPs) on commercial sites – the Company may create Joint Venture partnerships with the council and RPs to purchase commercial sites within Brent for affordable and PRS housing. Immediate opportunities exist with a number of RPs and on a number of sites.

- 4.2 i4B does not, however, intend to move forward with any of these opportunities until it has firmly established its phase 1 operation (the 1st 300 properties) and it is delivering against its intended financial and non-financial objectives.

- 4.3 For further details of the above proposals, please see the full Business Plan, in Appendix 1.

5.0 Summary of Key Risks

- 5.1 Please see table on the next page for a summary of key risks and mitigations.

Risk	Business Plan Assumption	Risk Type	Mitigation
Company cash flow (capital & revenue) is insufficient to manage expenditure	i4B has commenced a large acquisition and refurbishment programme. The period between purchase and letting requires significant financial resources. The business plan assumes an average of 90 days for property refurbishment and letting from the point of purchase. i4B's revenue account also requires an element of cash flow support to manage expenditure until it creates a surplus through rent.	Financial	i4B is monitoring SLA performance to deliver capital works and refurbishments within business plan requirements. i4B is focusing on reducing the amount of time taken during refurbishment and letting to maximise rental income. The council has approved a cash flow facility of up to £3.5m and current modelling indicates this will be sufficient to meet i4B working capital requirements. i4B will monitor cash flow requirements at its monthly meetings and with the shareholder at client/company meetings.
Business plan rent collection rates are not achieved. Introduction of universal credit adversely affects rent collection	The business plan assumes a rent collection rate of 98.5%.	Financial	The Board is investing in additional monitoring of rent and arrears performance of housing management subcontractors. It is funding (through the SLA) a weekly monitoring of rent performance data of subcontractors to check contractors' data, identify variations and request information from subcontractors on actions being taken.

<p>The appeals court cannot distinguish between i4B as a private sector landlord and the council as a landlord</p>	<p>The i4B business model is based on the wholly owned council company being a private landlord. i4B must retain its autonomy in granting and ending tenancies. As a private landlord i4B will use its assured shorthold tenancy as the primary tenancy offered to tenants. The Directors must strictly adhere to the requirement to 'act in the interest of the company'. The council as shareholder and funder must act in accordance with these roles.</p>	<p>Financial & Reputational</p>	<p>i4B will use its assured shorthold tenancy agreement to let PRS properties. Licences and other forms of tenancy terms will be exceptional. i4B will make all decisions in relation to granting/ending tenancies and may delegate some responsibility to its management agents through approval of procedural documents. Management agents will act in the name of i4B when progressing legal/court action. The Board will approve court action which could result in a tenant losing their home. i4B will use its logo on literature, though management agents will also use their own brand when communicating with tenants. The Board, council Members and senior officers will be briefed on i4B's positive contribution towards achieving council objectives, and on the role of the Board of Directors and the Shareholder. i4B will work with the council's press office to ensure press releases contain appropriate descriptions.</p>
<p>Property portfolio does not achieve the target Gross Yield margin</p>	<p>5% average gross yield (true).</p>	<p>Financial</p>	<p>The Board, in consultation with the requirements of the council, has some flexibility to amend the bedroom size and location of property acquisitions to maintain gross yield averages. The business plan has increased the number of properties in high LHA locations (e.g. Brent), creating a larger cash margin per property and helping i4B manage fixed costs such as insurance and housing management fees. The programme could be spread over more years to prevent artificial house price inflation due to i4B's intense programme. i4B could diversify its products introducing intermediate renting and potentially shared ownership into its portfolio to support the overall strength of the business plan. i4B is seeking to work with the council and Registered Providers to purchase new build homes. With the support of the council, i4B could generate higher yields with some partnerships and introduce new products.</p>

Void periods exceed business plan	The business plan assumes 1.5% void loss. The business provides an additional allowance of 90 days for refurbishment following the purchase of a property.	Financial & Operational	i4B has built the requirement to cooperate to ensure void periods are minimised into the contracts with housing management and void contractors. i4B has weekly meetings with the council's housing needs team who are responsible for nominating tenants. i4B is working with the council to ensure purchases are in line with the council's customer profile and sustainable tenancy requirements. i4B will review the nominations agreement at client/company meetings. i4B could approach the shareholder to dispose of properties in locations consistently failing to attract customers.
Interest rates increase	30 year loan facility for up to £103.5m at a fixed interest rate of 2.87%. Short term working capital loan facility for up to £3.5m at a fixed interest rate of 3%.	Financial	The current facilities are for fixed terms and fixed interest rates therefore i4B is not currently exposed to any interest rate risk. i4B will seek to arrange future loan facilities on the same terms whilst interest rates remain low. Should base rates significantly change, i4B will review and revise its growth and financing strategy appropriately having taken the necessary professional advice.

- 5.2 For a full risk register, including risk scores and mitigations, please see Appendix 1 of the company Business Plan (attached as Appendix 1 of this report).

6.0 Internal Audits

6.1 Background

- 6.1.1 In September 2017, the i4B Board agreed that the Company's internal audit function be delivered by the Council's co-sourced provider, PricewaterhouseCoopers LLP (PwC), as an extension to the co-sourced services currently provided to the Council.
- 6.1.2 In November 2017, i4B agreed a programme of four internal audits for 2017/18. The scope of these audits was also agreed. The four audits are:
- Governance, Risk & Financial Management;
 - Benefits Realisation, Management Information and Reporting;
 - Financial Model Review; and
 - Fraud Risk Assessment.
- 6.1.3 The first two audits have been completed and final reports agreed with i4B. Please see appendices 2 and 3 for the reports relating to these audits.
- 6.1.4 The second two audits have not yet commenced. i4B agreed the Fraud Risk Assessment Terms of Reference at its February 2018 Board meeting and this will comments shortly. PwC will share timescales and Terms of Reference for the Financial Model Review with i4B shortly.

6.2 Audit findings – Governance, Risk & Financial Management

- 6.2.1 PwC gave this audit the judgement of Reasonable Assurance.
- 6.2.2 The purpose of this audit was to undertake an initial review of the design and effectiveness of the controls currently in operation at i4B in relation to governance, risk management and financial management.
- 6.2.3 Good practice was noted in relation to the current approach to governance whereby i4B is governed by a single four-member board containing an independent chair, two Strategic Directors of London Borough of Brent, and one Councillor. The Board meets on a monthly basis which enables it to maintain a detailed oversight of ongoing operations and ensure that decisions are well-informed.
- 6.2.4 Although the governance fundamentals were considered to be in place, some areas of further improvement, (particularly relevant as i4B continues to expand and diversify its operations) have been identified. PwC noted three medium and four low risk findings as part of this review. The key areas of improvement relate to the development of a risk management framework, the development and maintenance of policies governing i4B's operations, and ongoing review of the

SLA with Brent Council. Two further advisory findings were also identified. Please see Appendix 2 for full findings.

6.3 Audit findings – Benefits Realisation, Management Information and Reporting

6.3.1 PwC gave this audit the judgement of Reasonable Assurance.

6.3.2 The objective of this review was to consider the design and operating effectiveness (where implemented) of controls relating to Benefits Realisation, Management Information and Reporting for i4B.

6.3.3 PwC noted a number of areas of good practice, including:

- The overall purpose of the company and the goals it seeks to achieve are laid out within the business plan. These have been revised appropriately to include a high level of detail within the current draft business plan that is to be presented to the January 2018 board;
- Although no non-Financial KPIs were included in the original business plan and this is highlighted as part of this review, work has already been put in place to address this and a significant number of non-Financial KPIs have been included in the new draft business plan that includes details of the measures used to derive them;
- KPIs have been written into the Service Level Agreement with the Council and the Housing Management Contracts which should ensure management reporting is given appropriate attention by other stakeholders and provide i4B with a mechanism to hold contractors accountable.

6.3.4 Although examples of good practice have been noted, areas for further improvement have also been identified. PwC noted three medium and three low risk findings as part of this review. However, following a meeting with i4B representatives, PwC reviewed and revised the wording of the high risk recommendation. The key areas of improvement relate to improving the reporting of benefits realisation regarding homelessness, the absence of non-financial KPIs in the original Business Plan and management of data in the PRS project tracker. The other findings relate to areas where procedures could be improved to make the control environment more efficient and effective. Please see Appendix 3 for full findings.

7.0 External Audits

7.1 At the i4B Board meeting on 21 February 2018, the Board agreed to appoint KPMG as the external auditor for i4B.

7.2 The timetable for audit of i4B's accounts will be as follows:

- May/June = fieldwork carried out;
- End of June = draft set of accounts prepared;
- August/September = sign-off.

8.0 First Wave Housing

- 8.1 First Wave Housing Ltd is another housing company which is wholly owned by the Council. Previously part of Brent Housing Partnership (BHP), the company was set up in October 2017 when BHP was brought back in house. The board membership for First Wave Housing is the same as the i4B board, and board meetings for both companies occur consecutively. Advice is being sought by the Council on the benefits or otherwise in relation to bringing the two companies together in future.
- 8.2 First Wave Housing Ltd has 329 tenanted properties, of which 170 are at Local Housing Allowance (LHA) rates, 89 are at social rent rate, 25 are at intermediate rent and 45 are at market rent. The annual rent roll is £4.2million. There are also two commercial properties within the portfolio.
- 8.3 A meeting has taken place with the Council's Head of Audit and Investigation and representatives of PwC to provide a background briefing on First Wave Housing which will be used to develop a proposal for internal audit arrangements to be considered by the i4B board in March 2018. Given the similarities between First Wave Housing and i4B, the recommendations of the i4B audits, where applicable, will also be carried out for First Wave Housing.
- 8.4 It is proposed that a report on First Wave Housing, including agreed audit arrangements, will be brought to the next meeting of the Audit Advisory Committee.

9.0 Legal Implications

- 9.1 The recommendations in this report are for noting and, as a result, there are limited legal implications directly arising from the report.
- 9.2 The two internal audits undertaken in relation to i4B have identified a number of findings. Officers at i4B will need to ensure that prompt and effective steps are taken to implement such findings.
- 9.3 As detailed in paragraph 8.1, consideration is given to bringing First Wave Housing Limited and i4B together. This will have significant implications for the Council and both organisations if implemented and such change will require Cabinet approval.

10.0 Financial Implications

- 10.1 The forecast income and expenditure statement for the current year indicates a net loss of circa £1.4m. This is consistent with the original Business Case which assumed a net loss in the first two years as i4B acquired properties and incurred significant up-front expense in advance of rental revenues reaching maximum levels.

10.2 The original Business Case assumption was that a net profit would be achieved annually from year 3 onwards and there is no reason at the moment to revise that assumption. Drawing on the experience of First Wave Housing (especially with regards to rent collection and void rates), the Board is confident that once i4B is established and its properties are at maximum occupancy, the original Business Case financial outcomes will be achieved.

11.0 Equality Implications

11.1 No equality implications have been identified.

Report sign off:

MARTIN SMITH

Chair, i4B Holdings Ltd