

CABINET
22nd SEPTEMBER 2009

HOUSING PFI – APPROVAL OF FINAL BUSINESS CASE

Executive Summary

The housing private finance initiative (PFI) scheme is approaching the stage where our final business case can be submitted to the government's Homes and Communities Agency seeking agreement on the level of subsidy (PFI credits) to be awarded and to appoint Sarsen Housing Association-led Silbury Housing Ltd as our preferred bidder.

Current financial market conditions have adversely affected the affordability of the project. There is a shortfall in the number of homes for which planning applications have been approved or are currently under consideration. All parties are committed to signing the (first phase of the) PFI contract by the end of December 2009.

The Housing PFI Project Board proposes a reduction in the scope of the scheme from the original 400 homes. This is considered to be a prudent and pragmatic solution that will come close to meeting the original project objective. Further details are set out in the Proposal section, below. If approved these will be developed for the final business case submission.

Proposal

It is proposed that Cabinet agrees for the final business case to be developed and submitted for:

- a scheme of around 350 homes, subject to affordability, with the potential for the homes to be provided on a phased basis, as set out in Appendix 1 of the report;
- provided that the Council's estimated first year revenue contribution remains at approximately £220,000 at current prices, accepting that the Council bears the swap rate risk until financial close; and
- subject to final details being agreed by the Service Director, Housing in conjunction with appropriate councillors and officers.

It is further proposed that Cabinet:

- confirms that all Council owned sites to be included in the project will be provided for nil consideration, subject to obtaining the necessary consents for disposal of land for less than best consideration;

- authorises officers to seek such consents and permissions, and to issue such certificates and notifications as may be required to facilitate the project; and
- requests a further Cabinet report on the details of the final business case, including any phasing proposals.

Reason for Proposal

To ensure that the housing PFI scheme can be delivered in view of current constraints. Submission of our final business case will be a significant milestone in the project programme.

Graham Hogg, Service Director, Housing

CABINET

22 SEPTEMBER 2009

HOUSING PFI SCHEME – APPROVAL OF FINAL BUSINESS CASE

Purpose of Report

1. The purpose of this report is to brief councillors on the proposed details of the scheme and to seek Cabinet's approval to submit our final business case (FBC).

Background

2. The housing private finance initiative (PFI) scheme was started by West Wiltshire District Council (WWDC) in 2003. Its key objective is "to significantly reduce the level of unmet housing need within [West] Wiltshire, by achieving a step-change in the provision of affordable housing..." The specific target was to deliver at least 400 new affordable rented homes by December 2011.
3. One of the actions in Wiltshire Council's first year plan 2009/10 is to "Start building 400 new affordable Private Finance Initiative homes in the Trowbridge area". Provision of new affordable housing is a high priority for Wiltshire Assembly and this is reflected in the Local Area Agreement target to deliver at least 590 new affordable homes per year by 2011.
4. An overview of the project is provided in Appendix 1. We are effectively procuring the supply of nomination rights, for people on the Council's housing register, to good quality affordable rented homes. A small number of units of temporary accommodation are also to be provided for homeless households. The contract's payment mechanism will ensure that our PFI contractor is given an incentive to keep the homes well managed and maintained.
5. The scheme is supported by a maximum PFI credit allocation (i.e. central government subsidy) of £83 million from the Homes and Communities Agency (HCA). The (District) Council has agreed to make a fixed revenue contribution towards the cost of operating the project of £194,000 per annum, index linked to RPI from April 2004, for 30 years. At current prices this stands at approximately £220,000.
6. For historic reasons we are negotiating with a single bidder, Silbury Housing Ltd (previously called SPB Homes), a consortium led by Sarsen Housing Association in partnership with Barclays Private Equity. Persimmon Homes are providing approximately half of the land and its sister company, Westbury Partnerships, will be the building sub-contractor for all of the new homes.

7. The project has been delayed due to various internal and external factors. However, it is now approaching the stage where our FBC can be submitted to HCA in order to seek agreement on the level of PFI credits and to appoint Silbury Housing as our preferred bidder.
8. Strategic direction and governance is provided by a project board made up of the Cabinet Member, EDPH; Portfolio Holder, Housing; Corporate Director, EDPH; Service Director, Housing; and external representation from Local Partnerships (formally known as 4ps, local government specialists in PFI). The board is supported by a cross cutting team of internal officers and external advisers.

Main Considerations for the Council

Affordability

9. The annual cost of providing the required homes and services, once tenants' rents have been netted off, (known as the Unitary Charge) will be largely covered by the PFI credits (paid on an annuity basis), with the balance being met through an annual revenue contribution from Wiltshire Council. Allowing for inflation, the Council's current annual contribution is approximately £220,000. As with any PFI scheme, Silbury Housing needs to raise the initial cost of providing the homes through bank loans.
10. Based on the maximum allocation of PFI credits and the Council's agreed revenue contribution, a 400 home project has become unaffordable. The difference between the estimated annual cost of the original (400 home) project and the level at which it would be affordable to the Council (i.e. the affordability gap) appears to be due to adverse funding terms arising from the credit crunch. In other words a 400 home project would be affordable were it not for the lack of liquidity in financial markets and the increased pricing of debt.
11. While the Bank of England base rate is at an all-time low, the net cost of fixed long-term borrowing (known as swap rates) is at a similar level to two years ago and increasing, but funder's margins (i.e. percentage points added by banks to the swap rate in order to arrive at the overall loan rate) have increased significantly during this period.
12. To illustrate this point, Silbury Housing's 400 home bid had a first year Unitary Charge of £8 million. The project would be affordable to the Council at £6 million. Some £1 million per annum has been removed from the Unitary Charge through negotiations (i.e. it has been reduced to £7 million), but the remaining £1 million affordability gap appears to be due to adverse funding terms.
13. In order for the project to be affordable at 400 units it will be necessary to either:
 - secure additional PFI credits from central government;
 - increase the Council's financial contributions;
 - reduce the scope of the scheme, in quality and/or quantity;

- further negotiate with the bidder around the pricing of their bid; or
 - any combination of the above.
14. The default position in PFI projects is for the procuring authority to meet any affordability gap through increased financial contributions i.e. additional revenue funding. Councillors may wish to consider this option. However, given the Council's budgetary situation and following discussions with the Chief Finance Officer, it is recommended that the project should be re-scoped, so that an affordable solution can be delivered within the agreed revenue contribution.
 15. After consideration of the above factors, the Housing PFI Project Board proposes that the FBC should be developed and submitted for a reduced scheme of around 350 homes, with the potential for the homes to be provided on a phased basis.
- Land and planning**
16. The proposed location and number of homes is shown in Appendix 2. To date full planning permission has been secured for 106 homes. Six planning applications are currently pending for a total of 246 homes. These are due to be considered by Western Area Planning Committee on 16 September 2009 and the outcome will be reported verbally to Cabinet.
 17. Assuming that all current applications obtain planning permission, there will be 352 homes, a shortfall of 48 units on the original 400 homes, due to one site (Vivash Park, Westbury) where, to date, the developer has been unable to overcome the reservations of planning officers.
- Homes and Communities Agency funding**
18. The government have agreed to an outline business case that provided a maximum of £83 million of PFI credits in support of a project to deliver 400 homes. Discussions have taken place with HCA to ascertain the level of funding that may be available in response to increased funding costs. We have been advised that all PFI funding is fully committed and no additional credits are available. However, the indications are that a reduced scheme of around 350 homes would still be capable of drawing down the full £83m in PFI credits.
 19. Authorities are expected to provide their land to PFI schemes for nil consideration. It was previously agreed for all (former) District Council sites included in the project to be provided for nil consideration, subject to obtaining the necessary consents for disposal of land for less than best consideration.
 20. However, the County Council previously required a capital receipt for its land. This may be financially inefficient for the project because the Unitary Charge will include an element to repay the value of any capital receipt with interest. It could also reduce the total number of number of homes that can be delivered through the project.

21. HCA has reiterated in recent discussions that all Council land should be provided for nil consideration as part of a solution to deliver the maximum number of homes within the project's overall affordability envelope. Equally, the Council should not seek to reduce its agreed revenue contribution. Nil consideration Council land and a current revenue contribution of approximately £220,000 should therefore be seen as pre-requisites for the maximum level of PFI credits remaining unchanged.

Timescales

22. The scheme has been delayed for a variety of reasons, but it has gathered momentum over recent months and all parties are now committed to reaching financial close, on the whole project or first phase of the project, by the end of December 2009. This is currently an achievable, but very challenging timescale.

Value for money

23. In addition to providing an affordable solution, it will be necessary to demonstrate to HCA's satisfaction that the project provides value for money. A value for money assessment has been largely completed, subject to HCA's final agreement. Any further efficiency measures will have only a modest impact on closing the affordability gap.
24. The objective of this assessment it is to ensure that the project provides overall value for money and it is therefore appropriate to consider project costs 'in the round' as well as on a 'line by line' basis. For the sake of transparency, councillors' attention is drawn to Persimmon's land price, requirement which is at a level below the peak of the market, but above current depressed prices.
25. A significant price reduction has been achieved though negotiations, but we are now at a point where there is no further scope for reductions if Persimmon's land is to be included for affordable housing as opposed to being built out for open market sale.
26. The alternative to including Persimmon's land would be for councillors to accept a greatly reduced scheme of, say, 200 homes. However, this would raise other value for money and procurement issues, and the project target (to provide at least 400 new affordable homes) would be missed by a significant margin.
27. A comparison between the anticipated average dwelling cost (i.e. total land, build and on-costs divided by the total number of homes) of PFI homes and those included in the recent successful bid to provide additional local authority (LA) housing (as approved by Cabinet on 15 July 2009) is shown in Appendix 3. When looked at on a like for like basis i.e. excluding land, the PFI scheme provides good value for money. The average cost of PFI homes, including land, will depend on which sites obtain planning permission and this is therefore subject to change.

Final business case

28. This is a complex project and there are inevitably limitations on the amount of information that can be presented to Cabinet. Negotiations are also ongoing with Silbury Housing Ltd and HCA to reach an agreed commercial solution.
29. It is therefore proposed that Cabinet agrees for the FBC to be developed and submitted, in accordance with the parameters set out in the Proposal section of this report, subject to the final details being agreed by the Service Director, Housing in conjunction with appropriate councillors and officers. A further Cabinet decision will be required prior to entering into the PFI contract.

Environmental Impact of the Proposal

30. The provision of around 350 new homes will inevitably have an environmental impact on individual localities. However, approximately half of the homes will be located on previously developed 'brown field' land and increased densities on Persimmon's sites will result in more sustainable land use of 'green field' sites.
31. All PFI units will meet Level 3 of the Code for Sustainable Homes, meaning that they achieve 25% reduction in energy consumption from Building Regulations standards. A number of environmentally sustainable features will be incorporated into the homes including low water consumption fittings, energy efficient lighting and photovoltaic (PV) roof tiles. PV tiles generate electricity from daylight and the technology allows any unused electricity to be sold into the national grid.

Equalities Impact of the Proposal

32. All general needs homes will be allocated through the Homes4Wiltshire choice based lettings (CBL) system. The CBL policy ensures that nominations are made in a fair and transparent way. Allocations to the temporary accommodation units will be managed outside of CBL.
33. The homes will also be built to Lifetime Home standards meaning that they are suitable for a wide range of tenants and are capable of adaptation to meet the changing needs of residents due to age and disability etc.

Risk Assessment

34. The model PFI contract provides for a standard risk sharing profile between the Council and our PFI contractor. There is limited scope for changing that profile and any significant changes (so called derogations) need to be signed-off by HCA. The following paragraphs highlight project specific (i.e. non-standard) risks for Cabinet's attention.
35. There is a risk of planning delay on one or more site. Persimmon's offer to provide land for the PFI scheme is due for review at the end of 2009. Both of these factors can be accommodated within the phasing proposal.

36. Submission of the FBC will be a significant milestone in the project programme. Any delay in approving submission of the FBC would be likely to delay the project.
37. The project is included in the corporate risk register. At the time of writing it was shown as high risk due to the status of planning applications and the need to obtain HCA's formal agreement to proceed with a reduced scheme at the full level of PFI credits.

Financial Implications

38. This project's affordability has been adversely affected by current financial market conditions. We have been advised by HCA that additional PFI credits are not available. In view of the tough economic and budget climate facing all councils across the Country, it is not recommended that the Council increases the annual revenue contribution. Instead it is proposed to reduce the scope of the scheme.
39. The proposed reduction in scheme size from 400 homes to around 350 units indicates the severity of increased funding terms compared to the position two years ago (when 400 units would have been affordable). Indications are that the reduced scheme should be capable of taking up the full £83m PFI credits. However, this still has to be formally agreed by HCA.
40. It is important to point out that the Council bears the risk of changes in swap rates until financial close. We have therefore asked the bidder to include a swap rate buffer in its financial model. Our intention is to ensure that the Council's agreed revenue contribution remains at the agreed level (currently £220,000 per annum), but there is scope for the contribution to change depending on the actual swap rate at financial close.
41. On a positive note, the rules on refinancing have changed, so that 70% of any future benefits will accrue to the Council i.e. the project could be refinanced when loan terms are more favourable.
42. As discussed above, it is proposed that all Council owned sites to be included in the project are provided for nil consideration. This is a financially efficient use of Council resources.
43. The Council's total set up costs could potentially amount to £2m depending on the extent of final negotiations with Silbury Housing and HCA, together with the number of phases of homes and the construction phase contract management role. The estimated cost of reaching financial close in December 2009 is approximately £1.6m, of which £1.1m has been spent to date and is irrecoverable regardless of whether the project proceeds. Approximately £1.5m has been provided by WWDC including from identified reserves.
44. In terms of the set up costs, approximately £500,000 revenue funding will need to be identified from existing resources, in addition to the annual

contribution of £220,000 (index-linked). However, a significant proportion of the additional £500,000 would only be required if there was more than one phase of housing.

Legal Implications

45. The PFI contract (known as the Project Agreement) is still being agreed between Silbury Housing, its sub-contractors and the Council. This needs to be submitted for approval by HCA at the same time as our FBC. There is a risk that HCA may not agree our proposed changes to the standard contract and this could delay financial close. Likewise the comments of the new consortium of funders and their respective professional advisers are still awaited on the Project Agreement. If significant issues are raised this could further affect the timetable.
46. The Council has received external legal advice that considers the risk of a legal challenge to the existing procurement process, owing to a reduction in the proposed scheme size. To summarise briefly, the advice concludes that provided no other material changes are introduced to the scheme, the risk of a legal challenge is not significant. If the assumptions on which this advice is given are changed in the future, the advice will need to be reviewed.

Options Considered

47. The original options appraisal from our outline business case has been revisited. This included the following four options:
 - 'Do minimum'.
 - Large-scale Housing Corporation (now HCA) funded development programme.
 - Large-scale Council funded development programme.
 - Large-scale PFI funded development programme.
48. PFI is still the preferred and most realistic way of (coming close to) meeting the project objective.

Conclusions

49. The housing PFI scheme has suffered a number of delays, but it is now approaching the stage where our FBC can be submitted. This will represent a significant milestone in the project programme.
50. Officers are satisfied that Silbury Housing's offer will provide overall value for money. However, adverse financial market conditions have affected the affordability of the scheme. It is therefore proposed to submit the FBC on the basis of a reduced scheme, with the potential for the homes to be provided on a phased basis. This is considered to be a prudent and pragmatic solution that, given the global financial situation, will come as close as practicably possible to meeting the original project target.

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22 September 2009

Background Papers

None.

Appendices

Appendix 1 – Project overview

Appendix 2 – Proposed location and number of homes

Appendix 3 – Comparison between anticipated average dwelling cost of PFI homes and LA housing bid

APPENDIX 1 – PROJECT OVERVIEW

Heading	Detail
Number of homes	A scheme of around 350 homes, subject to affordability, with the potential for the homes to be provided on a phased basis. Homes owned by the PFI contractor during and after the contract.
Contract period	30 years from contract close, including a three year construction period. PFI contractor required to provide housing management and maintenance services in accordance with specified performance standards.
Estimated capital cost	Approx. £56m.
PFI credits	A maximum of £83m.
Annual revenue contribution	£194,000 index linked to RPI from April 2004 for operational period. Approx. £220,000 at current prices.
Capital contribution – nil consideration land	Former District Council land – approx. £3.2m. Former County Council land – approx. £1.5m.
Capital receipt	None, subject to Cabinet's agreement.
Set up costs	Estimated £1.6m to reach financial close in December 2009 and up to £2m through to full service commencement in 2012. Approx. £1.5m funded by WWDC.
Nomination rights	100% for contract period. At least 50% post-contract nomination rights. All general needs allocations through Homes4Wiltshire choice based lettings system. 15 no. dwellings to be used as temporary accommodation.
Rents	Housing Corporation target rents for general needs units. Tenants' rents paid directly to the PFI contractor.
Council provided development sites	For approx. 169 homes.
Bidder provided development sites	For approx. 183 homes.
Development standards	Housing Corporation (now HCA) Design and Quality Standards, including: <ul style="list-style-type: none"> • enhanced Housing Quality Indicators; • Code for Sustainable Homes Level 3; • Secured by Design compliance; • Lifetime Homes standards; and • Building for Life standards.

Target programme

Milestone	Target date
Final business case submitted	October 2009
Preferred bidder confirmed	November 2009
Financial close	December 2009
Start on site	Spring 2010
Full service commencement	Summer 2012

APPENDIX 2 – PROPOSED LOCATION AND NUMBER OF HOMES

Site name/location	Number of homes	Planning status
Hornchurch Road, Bowerhill	27	Deferred
Broad Street, Trowbridge	31	Approved
Hillside, Warminster	33	Approved
Leigh Park Area R1D, Westbury	28	Pending
Leigh Park Area R11, Westbury	28	Pending
Manor School, Melksham	63	Pending
New Terrace, Staverton	62	Pending
Paxcroft Mead, Hilperton	18	Approved
Victoria Road, Warminster	38	Pending
York Buildings, Trowbridge	24	Approved
Total	352	

APPENDIX 3 – COMPARISON BETWEEN ANTICIPATED AVERAGE DWELLING COST OF PFI SCHEME AND LA HOUSING BID

	PFI scheme	LA housing bid
Total land cost	£15,400,000	Nil
Total build cost	£35,734,000	£5,455,584
Total on-costs	£1,091,000	£1,213,630
Total scheme costs	£52,225,000	£6,669,214
Total number of dwellings	325*	47
Average dwelling cost including land	£160,692	£141,898
Average dwelling cost excluding land	£113,308	£141,898

* Excluding Hornchurch Road, Bowerhill