SCRUTINY PANEL MEETING 17TH JULY

HOUSE BUILDING PROGRAMME

1.0 INTRODUCTION

1.1 The Council has embarked on a significant programme of developing housing both as a means of fulfilling its objective of providing affordable housing and to realise the value of its land assets to fund the delivery of other essential facilities, such as schools and leisure centres.

1.2 The building and selling of housing is inherently risky, but due to the rapid house price growth in recent years the income that can be achieved from property sales is seen as an opportunity to fund an ambitious capital programme.

1.3 Following a period of house price growth, the market is moving to a period of uncertainty from Government policy/priority and Brexit. Brexit provides additional complexity to the housing market both from the availability of labour to build the houses and the certainty of the financial markets as an investment.

1.4 To illustrate the Council house building risk profile each element of the development has been assessed, and then profiled against the reward/outcome from each scheme to determine if the level of risk (for the reward) is acceptable for the scheme and the spread of risk across each programme is manageable.

2.0 RISKS

2.1 There are 3 stages to the development, each with 2 elements of risk, mainly income and expenditure.

Scheme Risk – Each scheme has an overall risk relating to the cost to develop and the value of property sales. These are assessed as:

- **Cashflow Risk** – The gross expenditure of the scheme which will be the peak borrowing/cashflow position.
- **Sales Risk** – The gross sales forecast of the scheme which is the total amount of income for the scheme

Delivery Risk – Once it is agreed to deliver a scheme, the key risk/decision point is the award on the construction contract, when the Council's exposure to sales is also assessed in:

- **Contract Risk** – The cost of the construction contract accounts for up to 90% of the scheme costs and is dependent on the construction market at that key decision point
- **Sales Exposure Risk** – Assessing the Council's exposure to the housing market at the point of awarding the contract i.e. what future sales is the Council dependant on for the scheme.

Operating Risk – Finally, when the scheme has been developed there may be a surplus, or deficit which will require borrowing and future rental income to support such borrowing. Therefore the risks are:

- **Borrowing Risk** – The open loan of the completed scheme i.e. the surplus or deficit on the development once completed
- **Management Risk** – What is the long term future management risk of the scheme assessed as the Net Present Value. Any scheme with negative value has little opportunity to correct variations and therefore would be of higher risk.

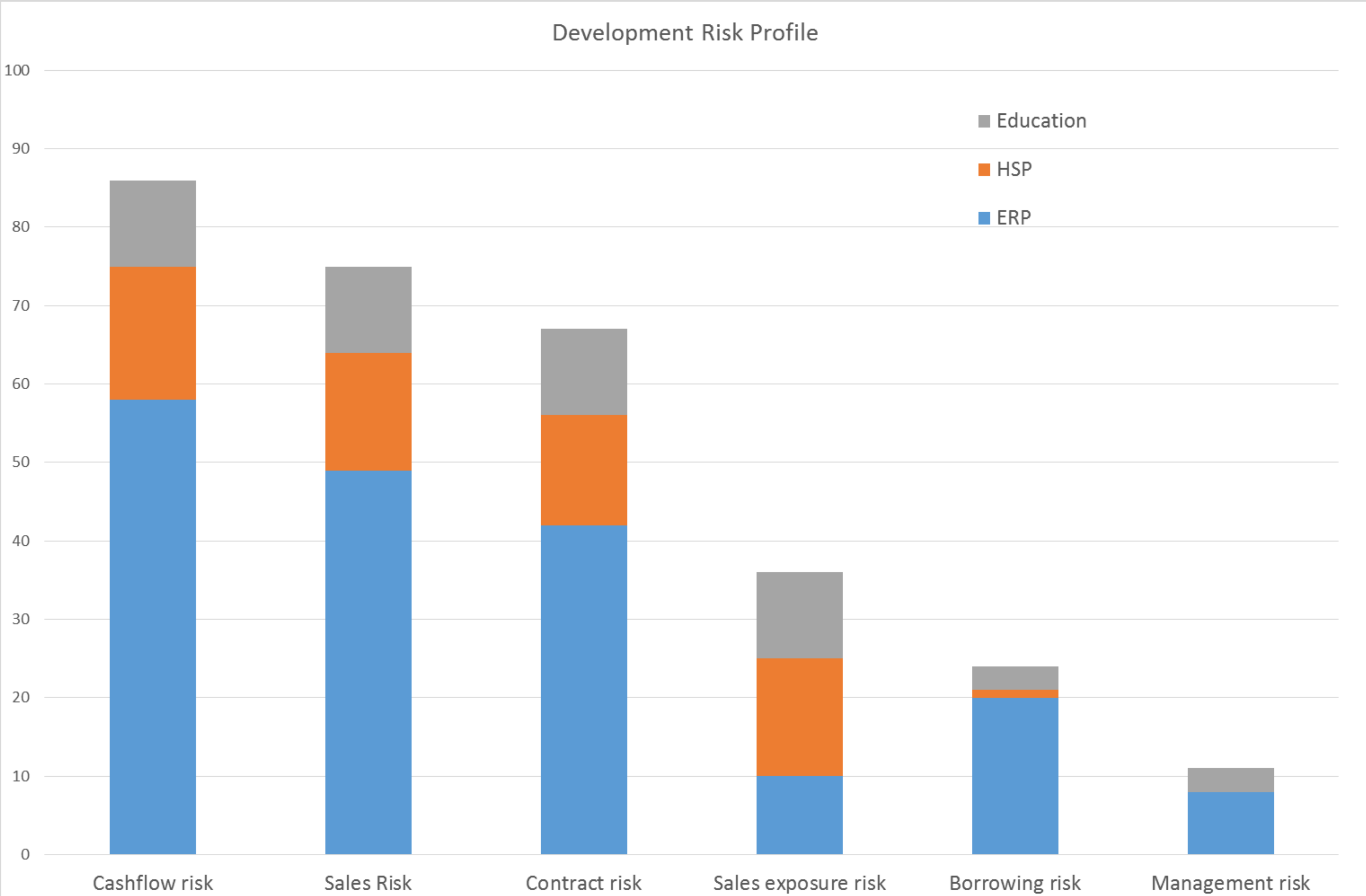
2.2 The risk has been scored (0-6) based on the value of each risk

Risk Value	Risk Score
Less than 0	0
Up to £5,000,000	1
Up to £10,000,000	2
Up to £25,000,000	3
Up to £50,000,000	4
Up to£100,000,000	5
Up to £ 250,000,000	6

2.3 Please note that the risk profile does not include the development of over 5,000 properties at Woodberry Down, which is being developed in partnership with Berkeley Homes. The Woodberry Down contract structure and delivery is very different from the Education, Estate Regeneration Programme and Housing Supply Programme with the development risk taken by Berkeley Homes, the only risk to the Council is the viability risk (Management Risk) which is agreed before each phase. In addition, Berkeley Homes does not bid for and of the Council's other tenders.

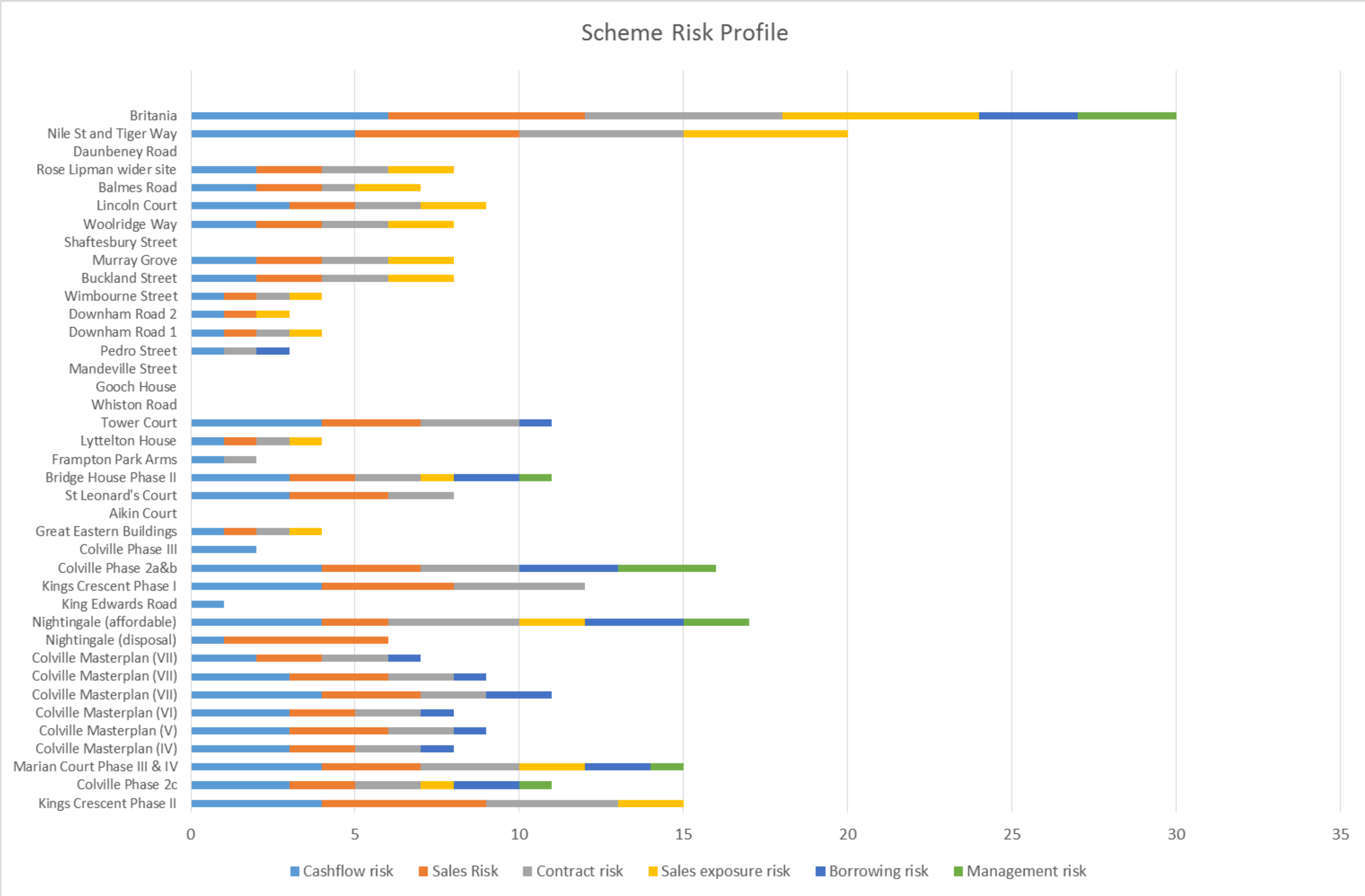
2.4 Chart 1 below, shows the total for each type of risk by programme. It is expected that the cashflow and sales risk would be the greatest and the Council demonstrates how it manages this risk by the reduction during the delivery and management of the scheme, in the remaining risk profiles. For the Education and Housing Supply programmes the total development and sales risk is being borne by the Council, whereas the Estate Regeneration Programme has passed a significant amount of the sales risk to the contractor/developer, therefore the Sales Exposure Risk is significantly less for this programme.

2.5 The portfolio approach taken for the ERP means that some schemes make surpluses to fund schemes that produce a deficit, so whilst the overall programme produces a positive NPV, the risk assesses each scheme independently and therefore produces a management risk for these schemes.

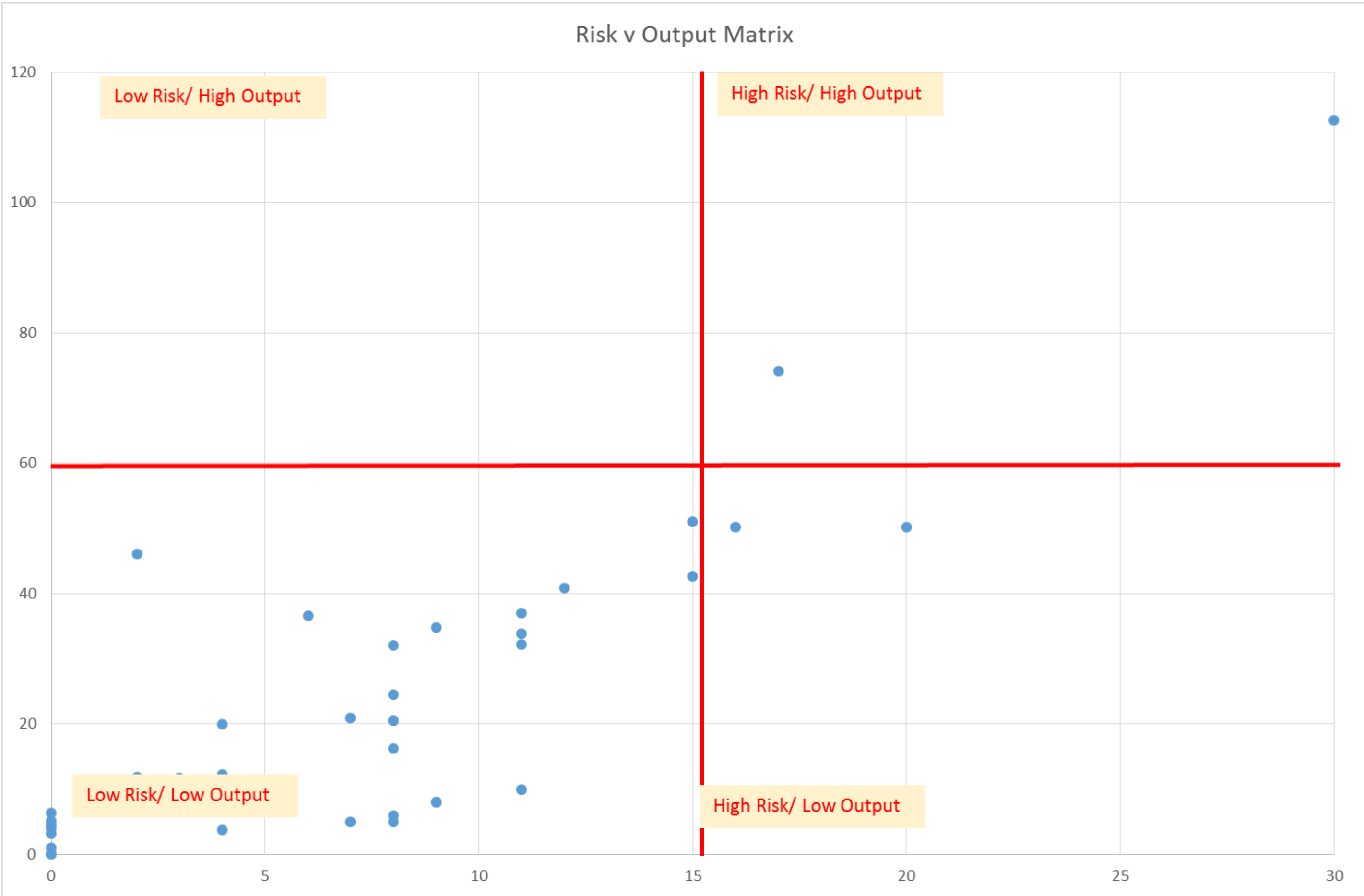


Development Risk Profile
100
90
80
70
60
50
40
30
20
10
0
Education
HSP
ERP
Cashflow risk
Sales Risk
Contract risk
Sales exposure risk
Borrowing risk
Management risk

2.6 Chart 2 illustrates the risk per scheme, accumulating all the risk elements in to a total risk score. The larger scheme and therefore larger values generate a larger risk, whereas some of the smaller HSP schemes have a zero risk score. Chart 2 also illustrates that only 5 schemes have an ongoing management risk (-ve NPV). Whilst Nightingale (affordable) has a borrowing and management risk, this scheme is dependent on the sale of the Nightingale (disposal) scheme.



2.7 Chart 3 plots the total risk (from chart 2) against the outcome that is being delivered for the scheme. For ERP and HSP this is measured by the value of the affordable housing delivered, whereas for the Education programme this is the construction value of the school and leisure centre.



3.0 SUMMARY

3.1 The Council's development programme (cashflow) totals £1.5bn, however the charts show how the this is being mitigated, managed and spread so that the resultant management risk over the longer term only applies to 5 schemes and is managed with the surplus generated from other schemes. The transfer of the sale risk to the contractor/developer in the ERP may have reduced the value of the potential output for the scheme but reduces the Council's sales expose fluctuations in the housing market.

3.2 The charts don't plot the timeline which would illustrate the risks are not all accumulated at a point in time, but are also spread over a 5 year period. Each scheme is appraised and approved at points throughout the development with the cost and borrowing profiles reviewed and risks assessed, and only proceed if they are affordable within the parameters of the programme's financial measures.

3.3 The majority of the schemes fit into the low risk low output quadrant and there may be opportunity to take on a greater level of sales exposure in the ERP subject to the financial/borrowing profile of the programme. Alternatively a greater management risk may be acceptable with the introduction of private rented properties (through a housing company) where rather than taking the sales receipt on completion, the return is delivered through a long term rental return, whilst retaining the value of the asset.

3.4 The report and charts map the overall house building risk, but some of the schemes are in the development process and therefore some of the earlier risk elements have been managed/mitigated. Therefore it is recommended that the current risk profile is mapped with the current risk of each scheme and updated each quarter.