

Appendix 2

Hackney HLR Housing Company Ltd.

Business Plan

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1. Executive Summary

1.1 Hackney Housing Company Limited (HLR Co.) has been established as a fully owned subsidiary of Hackney Housing Company Limited. The latter is itself fully owned by Hackney Council.

1.2 As parent company Shareholder, the Council will provide strategic guidance on HLR Co. decisions and direction, with the aim of delivering an additional Affordable Housing rental product in Hackney.

1.3 HLR Co. will purchase properties from the Council's regeneration schemes and let these at 'Hackney Living Rent' (HLR) levels. HLR is aimed at local residents and/or workers unable to access housing in the private or intermediate sectors, but whose means exclude them from consideration for Social Rented accommodation.

1.4 This Business Plan sets out the housing solution Hackney HLR Company aims to deliver and how it will be achieved.

2. Mission

2.1 HLR Co.'s primary purpose is to acquire properties developed on schemes within the Council's Regeneration programmes to let at a sub-market rent level (Hackney Living Rent) intended to occupy the housing availability gap between Social Rented and Intermediate/Private housing.

2.2 In adopting this business model, HLR Co. facilitates Hackney Council's ambition to respond to multiple challenges faced by those impacted by the housing crisis, specifically those who are unable to access a social rented home but are priced out of other intermediate offerings such as Shared Ownership.

2.3 By delivering these homes at Living Rent on longer term tenancies of up to five years, we will be improving the situation for individuals commonly referred to as the 'squeezed middle'.

2.4 HLR Co. will operate in alignment with Hackney's Better Renting Principles.

2.5 The establishment of HLR Co. will not divert the Council from campaigning for either further investment or freedoms to deliver social housing nor for better regulation of the private rented sector.

2.6 Outcome based indicators to measure the success of the company will be developed in the next 12 months and agreed by the Board of Directors.

3. Governance

3.1 Hackney HLR Housing Company is a wholly-owned subsidiary of Hackney Housing Company which is itself wholly-owned by Hackney Council. Hackney HLR Housing Company will not develop properties, nor directly employ any staff.

3.2 The Board of Directors (the Directors) of Hackney PRS Housing Company will be comprised of Council officers who will not be remunerated for Company duties. Further information on the Board of Directors is provided on page 3 of the Hackney Housing Company Business Plan (item 3.7).

3.3 Set out below are the operational parameters which, in addition to compliance with the Articles of Association, the Board of Directors (the Directors) will work within, contributing to the delivery of Company objectives. The Directors will:

- i. Give due consideration to the objectives laid down by its shareholder, in making business decisions
- ii. Report to the Shareholder at least annually, such reporting to contain both a forward and backwards look on performance and outcomes
- iii. Be responsible for maintaining the company financial liquidity in line with agreed minimum requirements (including any intra-group loans or transfers that may be required)
- iv. Ensure that properties generate sufficient income to repay a prescribed proportion of servicing costs attached to the borrowing used to fund property purchases
- v. In the unlikely event that HLR Co. at any time generates cumulative annual profits, the Board will prioritise safeguarding the cashflow requirements of companies within the group and investment in delivery of more affordable housing prior to considering distributing any dividends outside the group
- vi. Seek to procure goods, services, assets and financing on terms which are the most economically beneficial to HLR Co

3.4 Significant business decisions, such as acquisitions and disposals by directors of Hackney HLR Housing Company are authorised by the Intelligent Shareholder function and reported Cabinet, as shareholder of the Parent company, in the Annual report of Directors.

3.5 Board Members will undergo individual Conflicts of Interest scrutiny to ensure that the responsibilities of substantive roles do not run contrary to Directors' obligations. The Board will meet at least quarterly and are bound by the Company's Articles of Association and the Code of Conduct for Board Members of Public Bodies (June 2019).

3.6 The properties made available for Hackney Living Rent will be provided in concert with the building of new homes for Social Rent and Shared Ownership and will not replace the delivery of any of those homes.

3.7 An intelligent Shareholder Function is employed by the Council to streamline the decision-making and sign-off processes for all companies within the Group. Matters of strategic importance and/or requiring consultation at that level will continue to be referred directly to the Group Shareholder via the parent company. Further information on the role of the Intelligent Shareholder is provided on page 2 of the Hackney Housing Company Business Plan (item 3.4).

3.8 HLR Co. is wholly owned by the Council through its interest in Hackney Housing Company and influence over the subsidiary is exercised by Council approval (or otherwise) of the Hackney Housing Company business plan, which will encompass the aims of the HLR Co. business plan.

3.9 The Directors are also responsible for maintaining and regularly reviewing a robust risk management framework. However, Cabinet on behalf of the Council, must approve any decisions that would have an effect on the parent company's shareholders' rights.

3.10 Services and contracts will include performance measures and outcomes. They will be reviewed annually in line with stated performance standards and stated outcomes. This includes the Service Level Agreement, finance support contract and any other business critical contract.

4. Product and Services

4.1 The Hackney Living Rent product is designed to respond to the Mayor of Hackney's commitment to provide a range of genuinely affordable housing options to residents. It is a sub-market rental product aimed at low to middle-income households who currently live or work in Hackney and are currently unable to purchase a home, whether through shared ownership or outright sale. As is good practice, this will not exclude welfare benefit recipients.

4.2 In the lettings policy applicable to Hackney Living Rent properties, approved by Cabinet in July 2019, priority is given to working applicants who have been living and/or working in the borough for at least a year – this includes those in temporary accommodation and the private rental sector.

4.3 This primary focus on local workers and residents means that people who would not typically qualify for social housing and for whom home ownership is out of reach are offered a stable tenancy and a high-quality, genuinely affordable home.

4.4 The lettings policy slant towards prioritising those living in the borough ensures that local residents can benefit from the #BetterRenting principles that have been adopted by HLR Co.

5. The Market

5.1 Setting up HLR Co. is a response to the multiple challenges faced by those impacted by the housing crisis, specifically in this case those that are finding it increasingly difficult to rent in the private sector in Hackney. By delivering homes to rent at Hackney Living Rent and on longer tenancies we will be improving the situation for individual households and starting to tackle some of the issues faced in terms of workforce retention in the public, private and third sectors in Hackney.

5.2 Around one third of Hackney residents are in private rented sector accommodation and while a majority of private renters are satisfied with their home there are too many properties suffering from poor conditions and management.

5.3 Most of Hackney's renters are on short fixed-term tenancies and have no long term security over their accommodation. In addition to this, there is often concern around raising issues around repairs and maintenance for fear of reprisal from rogue landlords who jeopardise good practice in favour of easy money.

5.4 With a social housing waiting list of more than 13,000 and a proportion of private renters who are realistically unable to purchase a home outright or even through Shared Ownership, there is a clear and identified need for a Living Rent product, where rental values are relative to income.

5.5 Hackney Living Rent is a product that meets this need and will provide secure and stable accommodation for those who would not qualify for social housing and are unable to purchase homes outright, even potentially through shared ownership. These homes will provide tenants living in Hackney with a more affordable and secure option to private renting.

6. Marketing Strategy

6.1 Hackney Living Rent properties will be marketed by the Council's Hackney Sales Team utilising the principles of the established Sales & Marketing Strategy to achieve lettings in line with the Hackney Housing Company Lettings Policy. The Hackney Sales website and Hackney Council social media outlets will be the main advertising outlets, supported by commercial portals and other advertising resources as necessary. Property specific marketing strategies will form part of the Investment Proposal for Board approval.

7. Operations

7.1 The Directors will appoint Council services to manage the day-to-day operations of the properties but directors will hold the responsibility for the day-to-day operation of HLR Co., making decisions, providing leadership and monitoring the performance of HLR Co. The Directors are responsible for obtaining appropriate legal, financial and tax advice to enable them to make informed decisions in running HLR Co..

7.2 The Board of Directors hold ultimate responsibility for property acquisition. The Board monitor the overall standing of the HLR Co. property portfolio and take any decisions required regarding a change to the company financial model and/or parameters.

7.3 The Board also provide direction as to the type of properties that should be purchased, with consideration given to the financial viability and suitability of properties on a case by case basis, to best protect the financial interests of HLR Co., Hackney Housing Company, the Council.

7.4 Service Agreements have been set up between the Council and the Company which outline the services that will be provided by the Council and how these will be charged to the Company. These services include legal, financial, lettings, property management, and administrative functions.

7.5 The Council will inject equity into HLR Co. via the parent company in exchange for additional Group share capital. Company Directors will then secure borrowing at the most economically advantageous rate, which will enable HLR Co. to undertake property acquisitions.

7.6 The property acquisitions will act as collateral for the loans made to HLR Co. Interest and financing costs due to lenders will be met in part by let-property rental income (i.e. met to the extent that HLR Co. resources allow). Debt servicing costs not met by HLR Co. resources will be funded by Hackney Housing Company contributions.

8. Financial Forecast

8.1 Hackney HLR Housing Company will seek to acquire up to £5m of properties from the Council's Regeneration programmes each year for the period 2019-24.

8.2 Though HLR Co. is not subject to State Aid restrictions to the same extent as its sister company, Hackney PRS Housing Company Limited (PRS. Co), Directors nonetheless anticipate gearing the HLR Co. balance sheet at between 70% and 75% in the first year, with 80% as an upper limit in all circumstances.

8.3 Placing a limit on gearing ensures that HLR Co. is able to meet its debt servicing liabilities for the duration of the borrowing term.

8.4 [Maturity Repayment] Borrowing is expected to be available at around 4% per annum. State Aid exemptions applied to HLR Co. enable the achievement of less prohibitive Terms & Conditions than apply to PRS Co. borrowing.

8.5 Arrangement Fees and other charges levied against PRS Co. borrowing will also not apply to HLR Co. borrowing (to the full extent that State Aid exemptions allow).

- 8.6** As HLR Co.'s property portfolio grows it is anticipated that it will be possible to secure better value for money in respect of the lettings management function, as HLR Co. benefits from improved market understanding and economies of scale.
- 8.7** Rental streams are predicted to strengthen with inflation (estimated at an average of 2% per annum for the full 35-year borrowing term) and, in conjunction with streamlined cost base mentioned in the previous paragraph, the gap between interest liabilities and net income will be eroded.
- 8.8** House Price Inflation (HPI) is estimated at 3% per annum¹ (also over the full 35-year borrowing term) which will result in Hackney HLR Housing Company ultimately holding assets significantly more valuable than the borrowing which supports them.
- 8.9** As business needs or opportunities dictate and/or arise HLR Co. Board may take the decision to dispose of properties on the open market. Disposals will be at open market value as no subsidy is applied to the acquisition of the HLR Co. assets.
- 8.10** The timing of such disposals is uncertain and therefore, none are included within the HLR Co. Business Plan Financial Forecast.
- 8.11** HLR Co. is not expected to generate an annual surplus at any point during the borrowing term, although annual deficits will decrease year-on-year over this period.
- 8.12** It is planned to use HLR Co. deferred tax assets within the tri-company structure to reduce aggregate Corporation Tax liability. The Directors are currently taking advice on how this may be actioned, but Group finances remain robust without applying this offset.
- 8.13** Post tax surpluses generated through property sales are immediately returnable to the shareholder in proportion to the extent to which share capital underpins the balance sheet (at most recent Balance Sheet date prior to disposal). Surpluses not immediately returnable to the shareholder will be treated in the same way as revenue surpluses.

9. Risk Mitigation and Exit Strategy

9.1 Exit Strategy

9.1.1 The Financial Plan of HLR Co., which underpins the business plan, is predicated on an exit from the established business arrangements after thirty five years (for each

¹ It is assumed that rent yields remain (at least) constant over the business plan term, representing a viable business proposition for Hackney PRS Housing Company as an investor. In a stress-free rental market, government estimates of rent increases is CPI + 1% and the government's long term fiscal target for CPI is 2%. To (minimally) maintain a constant rent yield, HPI must match rental increases.

batch of properties acquired), at which time it is planned that the capital element of the loan for all property purchases is repaid.

9.2 Financial Risk Mitigation:

9.2.1 Potential key financial risks facing HLR Co. are:

a. Non-achievement of annual rent increases

Rent and revenue costs uplifts have both been linked to CPI (forecasts) over the financial planning period. This means that if predicted annual rent increases are not achieved, then cost increases factored into financial modelling are also unlikely to materialise to the extent presumed. This provides protection to business plan finances.

b. Interest rate variations

Asset financing arrangements lock in debt servicing costs from the outset of business operations and so HLR Co. is shielded from interest rate variations over the debt repayment period.

c. A stall in house prices

An analysis of long term property cost movements underpins the business model and prudent annual property price increases are included within financial modelling.

This risk materialises only at the point that HLR Co. plans disposal of properties. Empirical evidence of house price movements suggests that this risk will not be realised but in the event that it is, HLR Co. has the opportunity to refinance its debt and retain the assets until the impact of this risk crystallising has dissipated.

d. Missing out on opportunity sales

HLR Co. is able to dispose of properties to take advantage of favourable market conditions (in the event that doing so delivers a financial advantage to HLR Co. which exceeds the benefits of retaining the same properties) at any time during the financial planning period. The annual report to shareholders will give an indication on the housing market, property values and disposal plans, which will be approved and executed on approval of intelligent shareholder function.

e. Lack of demand for Living Rent properties

The lack of affordable properties in Hackney ensures a continual supply of potential tenants for these properties. Anecdotal evidence suggests that, notwithstanding the prescriptive qualification criteria, there is huge demand for properties of this tenure.

f. The ability to achieve affordable borrowing terms and meet debt servicing costs

The inclusion of a significant element of equity in the initial capital advance ensures a manageable debt-servicing liability and de-risks the loan made by the lender enabling access to favourable borrowing terms and conditions.