# Southend on Sea Borough Council

## Queensway Housing Options

## Summary Report



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# Summary Report

Southend on Sea Borough Council (the Council) commissioned 31ten Consulting in April 2015 to support the Council in developing a scalable delivery approach to the Queensway development site and broader housing development across the Borough. This paper summarises the work completed to August 2015 and supports the presentation of a series of options to be taken forward as potential delivery solutions for the Queensway site.

### Background – The need for redevelopment

In line with wider South East of England demand for affordable housing in Southend far outstrips current supply. Over the last 5 years there has been a sizeable reduction in direct capital subsidy to support building of new affordable housing, and as such this issue is not being adequately addressed

The Council has been examining a variety of different options for the development, maintenance and management of its housing stock over this period and beyond. This has resulted in a number of initiatives ranging from the establishment and operation of the Council's Arm's Length Management Organisation, potential Joint Venture development routes such as with BV Strategies Facilitating Limited and Council development of new homes on HRA land. A key pillar of the Council's housing is strategy has been a commitment to regenerate council owned stock within the major tower blocks of the town in order to change the tenure mix and dynamics of the area. Queensway is a prime example of a collection of these towers.

Traditionally Local Authorities have relied on the private sector to deliver significant new housing development across their regions. Where they have land that is suitable for such development they would sell this to the open market with a development obligation for specific elements of housing thus locking a guaranteed land receipt and passing all development risk, both upside and downside, to the delivery partner. In this way the development risk is largely ring fenced to the private sector, in exchange for a commensurate level of profit, so that the "risk-averse" public sector is able to limit its exposure in return for a locked land receipt.

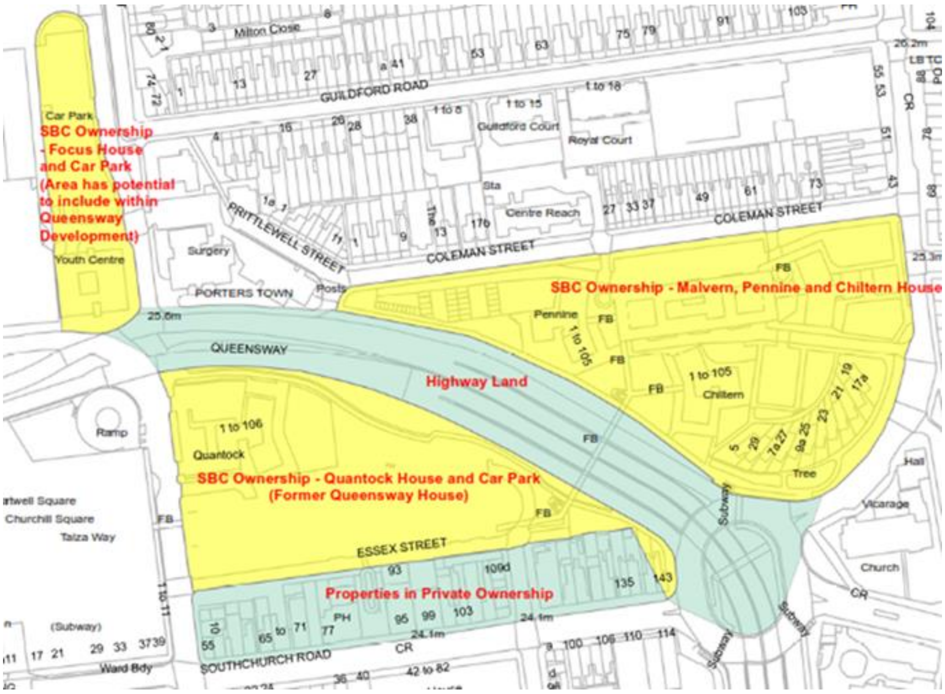
In the current economic and development environment this model is more challenging to structure and achieve. The overall reduction and availability of liquidity in the banking markets has meant that developers have been much less able to access sufficient debt over the time period to allow them to forward fund these costs, deliver development and sell assets in time to repay debt. As a consequence the private sector have been seeking different, more innovative risk share approaches with partners across the public sector.

At the same time public sector bodies, and especially local authorities, have begun to understand that they have to take on a bigger role in facilitating redevelopment and regeneration in their area and that actually they have the powers and balance sheets to do so with access to cheaper borrowing over significantly longer periods. Therefore, provided there is a clear business case for repayment, the Authority can significantly advantage the delivery of these schemes by taking on a development role themselves, either through self-development or through Joint Venture partnerships. It needs to ensure however that as a result of the public sector taking on a larger degree of the development risk that it also receives a greater proportion of the rewards. These models form a principal part of this review.

### The site

The Queensway Estate, together with the recently cleared Focus Site and Southchurch Road are the primary focus of the development at this stage, although the Council requires a scalable approach which could be used to address the needs of other sites in the future.

The main Queensway Estate site is in Council ownership, predominantly within the HRA and is situated to the north of the main town centre in close proximity to Southend Victoria train station, although the current configuration of the site and resultant access mean that the town centre is far less accessible to residents of the estate than its proximity suggests, especially considering that Queensway, a major eight lane highway splits the site in two.




There are currently 441 units on site situated primarily in four tower blocks. The tenure makeup of the units is as follows:

- Affordable Housing (390 Social Rented);
- Resident Leaseholders (25 units); and
- Non-Resident Leaseholders (25 units).

Current plans indicate a development of up to 575 units on the Queensway site. The tower blocks themselves are falling into a state of disrepair. Their condition together with their shape and structure and the configuration of the estate generally are thought to be contributing factors to an increase in anti-social behaviour across the estate.

The Focus site is adjacent to Southend Victoria station and is owned by the Council. The site has already been cleared and as such provides the ideal location of a phase 1 of the development. Southchurch Road borders the Queensway Estate to the south. All of the properties on the road are privately owned. The reason why Southchurch Road has been included as a site for consideration is that the road is seen as one of the major contributors to the limited connectivity between the town centre and Queensway.

### Approach

The approach taken by 31ten Consulting and the Council is detailed in the stepped methodology detailed below. This process has been by regular presentation and discussion of the emerging findings with the project Board in a series of check and challenge workshops:

- Step 1 – Understanding the site
- Step 2 – The potential approaches
- Step 3 – The Council's aspirations and desired role
- Step 4 – Comparing and shortlisting the approaches

- Step 5 – Next steps

**Step 2 – The potential approaches**

There are a number of tried and tested approaches that local authorities have utilised or are utilising to meet the needs and expectations they have from their development opportunities. The various approaches differ from each other in terms of the role the Council takes in the development, the risks they assume ownership of, and the level of reward they can expect to achieve. There are also a number of differences in the way developments are funded, both in terms of the type and source of funding, its repayment timeframe and the type of return an investor is seeking to achieve. As part of this work the following "long list" was developed of potential delivery approaches that might be appropriate and which were discussed in detail with the Council:

- **Option 1 – Development Agreement:** This is the most common traditional approach pursued by local government whereby the Council seeks to dispose of the relevant land/assets through a development agreement, although a direct disposal without a development agreement is also an option. There is the potential under this approach for the Council to take on the role of delivering and operating the affordable units and that the private elements of the site are sold by development agreement. This approach limits the sales / development risk the Council is exposed to and also the potential reward it achieves, which is limited to a capital receipt for the sale of its land.
- **Option 2 – Partnership Structure, Sale:** The Council forms a Joint Venture (JV) with a development partner or partners. A JV can be used to develop a single site or programme of sites. The partnership could deliver all residential and commercial elements of a site as well as any community facilities required, although it is often the case that the Council will develop and operate the affordable elements outside of the JV. There is crucially, however, a need for scale as it is expensive to establish a JV and the costs can only be recovered through significant income streams. The advantages of this approach are clear. An effective JV will bring together the relevant skill sets necessary to enable development and share the risks of investment and return. It is structured such that the objectives of all parties are served better by working together rather than alone. In this model, all the private units are built to be sold and the Council reward from the JV will be short term as it is secured through asset sales.
- **Option 3 – Partnership Structure, Rent:** This is essentially the same structure as with Option 2 but all private units are built for rental not sale. This is likely to impact on the type of JV partner required especially if the JV is to operate the rental units once they are completed. The Council will be rewarded in the form of a share of a long-term income stream.
- **Option 4 – Direct Development**: This is, on paper at least, the high risk, high reward approach. In this situation the Council develops all elements of the site itself. As such it takes all development, sales and rental risk but also all of the financial return generated, both capital and revenue. Experience of this approach elsewhere suggests the Council will need to significantly invest in its workforce / external support to ensure that it is appropriately skilled to undertake all the necessary roles. Experience also suggests that due at least in part to the political nature of a local authority and its strategic objectives beyond financial return, that all else being equal, a Council undertaking direct development is not likely to be as efficient or commercial in driving out the same financial return as a private company;

- **Option 5 – Funder Leasehold Guarantee:** This option is ostensibly a funding option in which an external funder backs the development risk associated with delivering the required housing. The Council puts in place a lease mechanism with an external funder to develop housing. Under this option the funder takes all development risk, the Council commits from outset however to make a guaranteed lease payment to the funder to repay this borrowing. This lease payment is covered by the rent payments from the new stock, as are all void and management costs agreed through the business plan. At the end of the lease period the units pass to the Council. This is an attractive model as it passes development risk to the private sector and the Council have a back to back arrangements between tenant payments and lease payments to pay for the new stock. There is no capital outlay up front, instead the Council are taking risk on the level of income received; and
- **Option 6 – Partnership Investing HRA Surpluses:** As with Option 5 but adapts the mechanism to utilise HRA surpluses over time.

### Determining the most appropriate approach

In order to determine which of the approaches is most appropriate in this instance the Council needs to understand what it requires from the project, the level of risk it is prepared to take and the role it wishes to retain for itself and how the project is to be funded. The diagram below illustrations the necessary considerations.


One of the key determining factors as to the most appropriate approach for any authority is the risk appetite of the Council, or alternatively the level of reward they are seeking to achieve. These two aspects are generally complimentary to each other in that the greater level of managed quantifiable risk the Council has the appetite for then the greater potential reward can be generated. There are major financial risks associated with each step of any redevelopment project, be that at planning, the development stage or when the units are ready for sale or rental. Developing an understanding of these risks, how they can be managed and where the Council are well placed to manage them helps define the role it is willing to take. The diagram below gives example of the different approaches various local authorities have taken with different balances between risk and reward.


However, it is important to note that risks are not just financial in nature and those associated with reputation, politics and media can be particularly acute for an elected body. For example should a local authority choose to dispose of a potential redevelopment site on the open market for private delivery, it will have allayed itself of financial risk at all stages of the redevelopment and received a market tested land receipt. However, by transferring all control the Council loses much of its ability to influence design or delivery and so, whilst it no longer bears financial risk it has assumed reputational and political risk that, for example, the new housing will get delivered, within the expected timeframe and with the expected balance between market and non-market properties.

### Step 3 – Understanding the Council's Aspirations and Desired Role

In order to identify the most appropriate delivery approach for Southend in this instance a workshop was held in which the Council's aspirations for this development project were discussed and also the role the Council wished to play in the development. The questions that were posed and the outcomes of that workshop are discussed below.

To understand the Council's aspirations and desired role for this development the following questions were considered by the Council's officers:

- What are the Council's Aspirations from the programme?
- What are the required / desirable physical and financial outcomes?
- What are the required timeframes?
- Is the approach limited to the Queensway site or should it be scalable?
- What if any interaction with other public sector partners is sought?
- What is the Council's Appetite for Risk?
- Is the Council willing to Borrow / pledge financial resources to the scheme? HRA vs. GF?
- Are Capital or Revenue receipts the priority?
- Do the Council want to bring in private funding?
- Is the Council interested in self-development?

- Does the Council want to own and manage new housing?
- What if any, is the role of South Essex Homes?

In answering these questions the Council's aspirations and desired role were defined in the following way:

- Southend requires a long-term vehicle that can be utilised for multiple sites across the borough, it must be scalable and therefore whilst clearly the approach must be right for Queensway itself, the scale, type and location of future development across the borough must also be considered.
- In terms of delivery of the Queensway development, the Council's Key aspirations are:
  - High quality homes throughout the development;
  - The development of a mixed and integrated community comprising of a range of different tenure type with associated community facilities;
  - Application of a mixed funding model that draws on private investment where available but also effectively uses the Council's balances, HRA and General Fund, and the powers available to it e.g. cheap, long-term debt available from the PWLB and other sources where supported by a business case Impacts on the GF and HRA are suitably mitigated.;
  - Significant financial returns comprising both capital (for sale units) and revenues (private rental units and affordable rental units), with a preference for revenue;
  - To establish an approach that can commence as soon as possible.
- It was stated that as things stood the Council was not seeking a partnership with other public sector bodies but that it was keen to bring in expertise of a partner where it adds value;
- The Council has some appetite for taking on risk itself but this must be balanced by the attainable reward;
- The Council is interested in self-development as a means of maximising its return from the development but the differential return and risk ratios offered by the different approaches should be fully considered;
- The Council would consider owning and managing any private rented stock;
- The Council would like to own and manage the affordable housing;
- South Essex Homes would not necessarily be the operational vehicle but could bid for management contract;
- It expects to see at least a 30% increase in density on the Queensway site.

**Step 4 – Comparing and Shortlisting the approaches**

The next step was to appraise the six potential approaches by applying the outputs and discussion from the workshop. The following table is a summary of that appraisal process undertaken with Council officers.

| Approach | Decision |
|---|---|
| **Option 1 – Development Agreement** Council deliver and operate all affordable units. Private elements of the site are sold by development agreement. | **Discount** – the Council wants to take some risk and participate in the development in order to generate a greater financial return, including revenues. Is suitable for one off developments i.e. it's not scalable. |
| **Option 2 – Partnership Structure, Sale** Council delivers and operates all affordable units. Private sale units are developed through a Joint Venture. | **Merge with Option 3** – a partnership approach reflects the Council's risk appetite. And desire to participate in development. Desire for both capital and revenue suggests a hybrid approach . |
| **Option 3 – Partnership Structure, Rent** As Option 2 but all private units are rental not sale. | **Merge with Option 2** – as above. |
| **Option 2/3 – Hybrid Partnership Structure, Rent & Sale** Council delivers and operates all affordable units. Private sale and rental units are developed through a Joint Venture. Risk and return are shared. | **Include** – as described above. This mixed funding option facilitates a "scaling up" for further development as well utilising the skills and expertise of others. Scale and configuration of scheme will impact on sale/rental mix. |
| **Option 4 – Direct Development** Council develops all elements of the site. As such it takes all development, sales and rental risk but also all of the financial return, capital and revenue. | **Include** – Although preference is to share risk, the Council's financial position is such that this option must be considered perhaps with specialist skills and resources brought into the Council on a short-term basis or for as long as the "scaled up" development programme requires. Funding could come from numerous sources. |
| **Option 5 – Funder Leasehold Guarantee** Council puts in place a lease mechanism with an external funder to develop housing within the General Fund. The funder takes all development risk, the Council takes all rental risk | **Merge with Option 6** – this approach allows the Council to take some risk and some return but does not require it to invest nor be involved with development. Forming a hybrid with Option 6 would see Council investment. Makes use of external development skills and the Council owns (eventually) and operates the stock. |
| **Option 6 – Partnership Investing HRA Surpluses.** As above but adapts the mechanism to utilise HRA surpluses over time. | **Merge with Option 5** – nearly all risk transferred to Investco, the Council takes/gets investment risk/return. Permits affordable development outside the HRA without the need for upfront receipts. Utilises external skills and resource. No development role. |

### The shortlisted delivery approaches

Following the appraisal the delivery approaches shortlisted for further consideration are:

- **Option A – Hybrid Partnership Structure, Sale & Rent:** A JV approach in which both sale and rental units are developed. The Council will therefore take on some risk but utilises the specialist skills of a partner to mitigate those risks. The Council will be rewarded with both capital receipts and a long-term revenue stream. The Council will deliver and operate all affordable units outside the partnership.
- **Option B – Direct Development:** An approach in which the Council develops all elements of the site. As such it takes all development, sales and rental risk but also all of the financial return, capital and revenue.
- **Option C – Funder Lease Guarantee utilising HRA Surpluses:** An approach in which the Council puts in place a lease mechanism with an external funder to develop housing within both the HRA and General Fund, utilising HRA surpluses over time.

### Step 5 – Next Steps

There are a number of actions and activities that are now required in order to identify which of the three shortlisted options is the most appropriate for the Queensway development and the Council's broader development ambitions and then to take the opportunity to market. These activities have been captured in three phases and illustrated in the diagram below with approximate timeframes for completion. Phase 1 is broadly complete, subject to an opportunity to gather views from members and the first stage of Phase is included in the Options Appraisal from the long list of options to the shortlist within this document. The next stage is to further appraise the shortlist utilising detailed financial modelling and business case review.

| Phase | Activities | Duration |
|---|---|---|
| Phase 1 | • Define Council Objectives<br>  • Quality of homes / Mixed tenure / Affordable vs. private / Reward mix - Capital vs. Revenue<br>  • Architectural considerations / high level master planning / density and height studies<br>• Define Council role<br>  • Funder / Developer / Operator / Risk appetite | 2 to 4 weeks |
| Phase 2 | • Option Appraisal<br>  • Define Financial & Non Financial Criteria<br>  • Tailored & Bespoke / No off the shelf model<br>  • Financial appraisal<br>• Overlay Council Requirements<br>  • Best consideration / s151 review / Reward commensurate with Risk / The "right" partner | 2 to 3 months |
| Phase 3 | • Market Engagement<br>  • Only once defined potential approaches<br>  • Use to refine offer<br>  • Soft Market Test / Re-appraise / Soft Market Test<br>• Consideration of Business Plan<br>• Procurement Strategy<br>  • Driven by all of the above / Drop out of | 1 to 2 months |

In order to complete the financial appraisal of the three options, a detailed and bespoke financial model is being developed. This will allow comparison of the financial viability of the site overall and the different options. Already, some high-level viability calculations have been modelled. This modelling suggests that approximately 1,000 units are required on the Queensway and Focus sites to make the development viable regardless of the approach taken. This estimated level of density, which is significantly higher than the initial estimate of 545 units, was supported by the feedback provided by developers during a soft market testing exercise undertaken by the Council.

There are three other major cost / financial implications that are being considered in this next stage of the model:

- **Southchurch Road -** As described above, Southchurch Road borders the south of the Queensway site. It is considered vital to the proposed scheme because it will provide the connection between the Queensway Estate and the main town centre and as such key to the delivery of the perceived associated benefits. The properties on Southchurch Road are all in private ownership and the likely cost to the Council to compulsory purchase those properties was estimated to be in excess of £12m, although £6m of the total costs was accounted for by only two of the c20 properties. The inclusion of these units is being appraised

- **Covering Queensway** – The challenges to the site brought about by the eight lane highway running through it are significant. As such options are being appraised to cover the road and change the surrounding junctions. Engineering solutions and their financial implications are being built into the model.

- **HRA or General Fund** – Key to the next iteration of the financial modelling will be to identify and distinguish between the HRA and the General Fund and any appropriations between the two discussed as the revenue implications, accounting treatments and available funding will need to be considered on an account by account basis.