POLICY & RESOURCES Committee	19th January 2022

Affordable Housing Delivery by the Council

Final Decision-Maker	Communities Housing & Environment Committee
Lead Head of Service	William Cornall, Director of Regeneration & Place
Lead Officer and Report Author	William Cornall, Director of Regeneration & Place
Classification	Public with a private appendix. Exempt Category 5: Information in respect to which a claim to legal professional privilege could be maintained in legal proceedings.
Wards affected	All wards.

Executive Summary

At Full Council on 29th September 2021, the Leader of the Council set out an ambition to build and own 1,000 affordable homes in the shortest possible time frame. This report provides a development strategy as to how this ambition could best be achieved.

It is likely that each affordable home will have a net cost of at least £200k, so the overall programme will be worth at least £200m.

Market conditions in terms of high land and house prices are not favourable at present and so the Council will need to be bold, creative, and flexible in respect of the types of projects it will consider and the amount of risk that it will be willing to accept.

The Council has had successes in delivering new homes over the past five years, but the pipeline of new projects has dwindled latterly both because of market conditions and a lack of consensus as to what types of projects should be pursued. Accordingly, there will now need to be a different strategy deployed and this will require Councillors, and this Committee in particular, to prioritise the delivery of the programme over other considerations.

Purpose of Report

Decision.

This report makes the following recommendations to this Committee:

1. To note the proposed capital spend of c£200m, net of any grant, to build a portfolio of 1,000 Affordable Homes over the ten-year period commencing 1st April 2022, with individual schemes subject to approval by this Committee.

2. To note the preliminary officer advice and the legal advice (provided as exempt Appendix 1) on the possible and likely corporate structure arrangements within which an affordable housing portfolio could be held once it passes 200 homes, and that a further report on this matter, for decision, will be brought back to this Committee during the next financial year.

3. To note that a bid for grant to Homes England via the Continuous Market Engagement route will be made in the coming months but subject to a further detailed decision by this Committee to approve any grant Funding Agreement that is offered by Homes England.

4. To note that this Affordable Homes programme is proposed to be supplemented by further additional capital spend of c£46.5m in Private Rented Sector (PRS) Housing, to build a further 200 such homes over the five-year period commencing 1st April 2022, with individual schemes subject to approval by this Committee.

5. To note that the proposed Affordable Homes and PRS programmes will be supplemented by investment in circa 60 Market Sale homes, via joint venture arrangements with incumbent scheme contractors, with individual schemes subject to approval by this Committee. As per the capital programme for approval, proposed exposure will be capital spend of circa c£22m over the programme period.

6. To approve the scheme target hurdle rates for Affordable Housing and PRS investments as being a positive Net Present Value (NPV) and Internal Rate of Return of 4%, and that there will be cognisance of the challenges in respect of the likely cost / value ratio on some schemes. These hurdle rates will be kept under review by the Director of Finance and Business Improvement and any changes will be dealt with through reporting on the Capital Strategy.

7. To note the likely viability gap per Affordable Housing home developed which will equate to circa £1.7m per 100 homes built, and that provision will be made by this Committee elsewhere in the Council's Medium Term Financial Strategy to meet this viability shortfall. I.e., the creation of a Maidstone Housing Investment Fund (MHIF).

8. To approve that all the Affordable Housing will be let as Affordable Rented Homes, with rents set at 80% of the prevailing market rent but capped at the Local Housing Allowance.

9. To approve the overall Development Strategy that is set out from paragraph 2.49 to 2.58 of this report and endorse it for subsequent approval by the CHE Committee at a later date.

Timetable	
Meeting	***Date***
Committee (please state)	19th January 2022
Council	N/A

Affordable Housing Delivery by the Council

1. CROSS-CUTTING ISSUES AND IMPLICATIONS

Issue	Implications	Sign-off
Impact on Corporate Priorities	The four Strategic Plan objectives are: • Embracing Growth and Enabling Infrastructure • Safe, Clean and Green • Homes and Communities • A Thriving Place Accepting the recommendations will materially improve the Council's ability to achieve its corporate priorities.	Director of Regeneration & Place
Cross Cutting Objectives	The four cross-cutting objectives are: • Heritage is Respected • Health Inequalities are Addressed and Reduced • Deprivation and Social Mobility is Improved • Biodiversity and Environmental Sustainability is respected The report recommendations support the achievement of the Council's cross cutting objectives.	Director of Regeneration & Place
Risk Management	Already covered in the risk section.	Director of Regeneration & Place
Financial	Budgetary approval for this project is part of the capital programme report elsewhere on the agenda.	Senior Finance Manager (Client Accountancy)
Staffing	We will need access to extra expertise to deliver the recommendations, as set out in section 3 [preferred alternative]. There is a need for two additional Development Management Officers, that are currently in place on an interim basis, but the intention is	Director of Regeneration & Place

	to make permanent appointments in due course. The cost of these additional staff will be capitalised, and this situation will be reflected in the next Medium Term Financial Strategy and Capital Programme (subject to approval).	
Legal	Under s1 of the Localism Act 2011 the Council has a general power of competence which enables it to do anything that individuals generally may do. *Under section 111 of the Local Government Act 1972 the Council has power to do anything (whether or not involving the expenditure, borrowing or lending of money or the acquisition or disposal of any property or rights) which is calculated to facilitate, or is conducive or incidental to, the discharge of any of its functions.* *The Council has the power to acquire properties by agreement under the Local Government Act 1972, section 120.* *Legal advice is sought for all transactions and all necessary Legal documentation will be approved by Mid-Kent Legal Services before completion.* *At this stage legal implications are not specific to proposed schemes yet to be presented for decision.*	Interim deputy Head of Legal Services.
Privacy and Data Protection	Accepting the recommendations will increase the volume of data held by the Council. We will hold that data in line with our retention schedules.	Policy and Information Team
Equalities	The recommendations do not propose a change in service therefore will not require an equalities impact assessment	[Policy & Information Manager]
Public Health	We recognise that the recommendations will have a positive impact on population health or that of individuals.	Director of Regeneration & Place
Crime and Disorder	The recommendation will not have a negative impact on Crime and Disorder.	Director of Regeneration & Place
Procurement	On accepting the recommendations, the Council will then follow its usual procurement protocols and Financial Procedure Rules to deliver the programme.	Director of Regeneration & Place
Biodiversity and Climate Change	The implications of this report on biodiversity and climate change have been considered and are there are no implications on biodiversity and climate change.	[Biodiversity and Climate Change Officer]

2. INTRODUCTION AND BACKGROUND

LSVT Background

2.1 A return to building council housing, or affordable housing, as it is commonly now termed, would be a significant reversal of a previous Council decision, inasmuch, back in 2004 the Council opted to transfer its council housing stock of around 6,000 units to Golding Homes (formerly Maidstone Housing Trust). Therefore, Maidstone is a Large-Scale Voluntary Transfer (LSVT) local authority.

2.2 Consequently, the Council's Housing Revenue Account (HRA) was closed, and at present, an HRA is the only mechanism by which a Council can directly hold and fund council housing at scale (beyond 200 homes). If a Council doesn't any longer have an HRA, like Maidstone, it could re-open one. There are alternative corporate structures that can be considered too, and these will be explored later in the report.

Recent housing delivery by the Council

2.3 The Council's current housing portfolio is as follows:

Tenure	No. of homes	Commentary
Long leases and tied accommodation	15 homes	As these properties become void, they will be considered for either Private Rented Sector (PRS) or Affordable Housing (AH).
Temporary Accommodation (TA) for homeless households	65 homes	This portfolio has been assembled through Purchase & Repair programmes, these properties are able to be held long term in the General Fund.
Private Rented Sector (PRS) homes managed by Maidstone Property Holdings Limited (MPH)	89 homes	Granada House, Lenworth House, Brunswick Street, Union Street and Springfield Mill Phase 1.
Affordable Homes (AH)	23 homes	Trinity Place, to be refurbished and let by 31st March 2022.
	192 homes	

2.4 At the present time, the Council only has one new development on site at Springfield Mill Phase 2, 14 PRS homes, and these will complete in May 2022. Furthermore, there are further sums allocated within the capital programme to acquire further TA homes.

2.5 In 2019 a decision was made to re-enter the AH sector. There is £30m in the current Capital Programme to build circa 200 homes. To date, the Council has only contractually secured Trinity Place, a stock transfer from Hyde Housing Group. Also, there is further capacity (c £35m) within the current capital programme to increase the PRS portfolio to circa 175 units. The balances of these sums will be rolled into the Council's new MTFS and Capital Programme for 2022-27, which will then fully reflect the Council's housing growth ambitions and the strategy set out in this report.

Affordable Housing in the Borough, new delivery, and subsidy

2.6 There are currently around 9,000 affordable rented homes within the borough and around 75% of these are owned by Golding Homes. The other main stock holding Registered Providers (RPs) are Hyde, Town & Country, West Kent, Clarion and Orbit.

2.7 In terms of growing the stock of affordable homes in the borough, this happens through the following means:

- Section 106 affordable housing delivered through planning gain. RPs (formally housing associations) tend to bid circa 75% of market value for these homes. Typically, 70% of these homes are for affordable rent and 30% for shared ownership. Around 300 such affordable homes are delivered through this means every year. It is worth noting that the Council benefits from 100% nomination rights to these homes.

- Grant funded affordable homes. This is where Homes England pays grant at circa £50k possibly up to circa £65k per home, to convert a new build home not designated as affordable via a S106 agreement to become an affordable home. I.e., these are homes that would otherwise typically be offered for market sale or rent by the developer. A note of caution on this option is that the amount of grant offered by Homes England often makes the viability marginal. Furthermore, the Planning Committee has recently taken to capping the quantum of affordable housing on consented sites, so have started to close this route to some degree.

- Rural exception sites. These are small sites that would not ordinarily secure planning consent but can be used for affordable housing in perpetuity. Rural exception sites seek to address the needs of the local community by accommodating households who are either current residents or have an existing family or employment connection. Through this mechanism, land can be acquired at typical agricultural value, plus a very modest uplift of say 10%. This ability to acquire land at below normal residential land values in effect provides the subsidy. Given the considerable rural nature of the borough, this is a source of affordable housing land that the Council is already exploring.

2.8 Over the past ten years virtually all new affordable housing delivered in the borough has been delivered through the Section 106 route.

Affordable Housing Tenure Options

2.9 In terms of the available affordable housing tenures, these are as follows:

- Social Rent, which has the cheapest rents at circa 50% of the market rent plus service charge.
- Affordable Rent, with rents charged at 80% of the market rent (capped at the Local Housing Allowance (LHA), inclusive of service charge.
- Shared Ownership, where the purchaser buys a minimum 25% share in a home and pays a low rent on the unsold equity. Purchasers can buy (staircase) further shares through to outright ownership.
- First Homes, typically delivered by the housebuilder, with a home sold at a discount to market value (say 70% of market value), and this discount must remain vested in the property for perpetuity. There is no rent payable on the unsold equity. Realistically, it is more practical for housebuilders to offer this product directly to purchasers, and the scope for the Council to deliver it is very limited.

2.10 For the first two rented products, the landlord would hold all the repairing liabilities, and the properties would usually be subject to the Right to Buy, meaning there is a risk they could be sold for less than their net cost, so providing an unwelcome financial exposure to the Council. For the sale tenures, 100% of the repairs' liability is with the tenant.

2.11 Officers do not feel that it is wise for the Council to offer Low-Cost Home Ownership (LCHO) products. This is because of the introduction of First Homes, which will be most appropriate for developers and housebuilders to deliver themselves. The other consequence of First Homes is that the quantum of homes for Shared Ownership will be squeezed and so it may become a diminishing sector in years to come.

Corporate Structure for holding an Affordable Housing portfolio

2.12 The Council can hold 200 completed affordable homes within its General Fund. Once the Council's portfolio goes above 200 completed homes, they must be held in one of the following;

a) Housing Revenue Account.
b) 100% Council owned Registered Provider.
c) Community Benefit Society.

2.13 Preliminary specialist legal advice has been sought on these options and this is enclosed in **Private Appendix 1.** The Council does not need to take a firm decision now on its preferred structure, as it will take time to get to 200 AH units, and so a further report dealing with this point specifically will come to this Committee later in 2022.

2.14 The officer view is that option C should be dismissed as it would result in the Council losing direct control over its considerable investment in the portfolio. Option A is the most straightforward although there are some drawbacks created by the risks presented by the Right to Buy (RTB). However, there is an option to manage this risk through the housing assets being held in a Council owned company and then leased to the Council itself to manage.

2.15 Regardless, the reduced discounts on offer nowadays arguably make the risks of RTB more manageable financially and it has also caused the tenant interest in it to decline too. Officers are therefore at this stage of the view that Option B may be overly complex, time consuming and costly to set up and run, given the modest RTB risk.

2.16 Irrespective of the chosen corporate structure, the Finance Director is unequivocal in his view that Prudential Borrowing is the most advantageous means of funding the portfolio at the present time, so this therefore rules out the use of any Income Strip Lease arrangements (referred to in the legal advice note) for the time being.

2.17 MPH is not appropriate because it is not an RP and so cannot access Homes England Grant nor hold stock delivered via S106 agreements.

Development Opportunity Appraisal

2.18 The Officer advice is that the Council's programme for affordable homes should be entirely rented, so either social rent or affordable rent. The following tables demonstrate that whilst social rent is a laudable ambition, the Council will not be able to offer social rented homes at the scale sought, because they would require too much internal subsidy to be affordable for the council. Therefore, the advice is that the Council should deliver only Affordable Rent homes in its AH programme to be let at 80% of the market rent but capped to the Local Housing Allowance (LHA) (capping to the LHA means that homes remain affordable to households on benefits).

2.19 The table shows the typical rents that would be charged for different rented tenures (Social Rent, Affordable Rent and PRS) and shows the estimated investment value of the different tenures, and for ease the 2-bed apartment column is highlighted as this could form the mainstay of the programme.

Rents PCM	1 bed apartment	2 bed apartment	2 bed house	3 bed house	4 bed house
Social Rent + Typical Service Charge	£ 492	£ 561	£ 524	£ 625	£ 674
Affordable Rent (80% of market rent, capped @ LHA)	£ 640	£ 760	£ 813	£ 972	£ 1,247
Market Rent	£ 800	£ 950	£ 1,050	£ 1,400	£ 1,650
Investment Values (80% of rent capitalised @ 4%)					
Social Rent + Typical Service Charge	£ 117,967	£ 134,753	£ 125,726	£ 149,906	£ 161,772
Affordable Rent (80% of market rent, capped @LHA)	£ 153,600	£ 182,400	£ 195,062	£ 233,354	£ 299,177
PRS Market Rent	£ 192,000	£ 228,000	£ 252,000	£ 336,000	£ 396,000

2.20 The investment value is created by capitalising the net rental income at a yield of 4%. The Council's investment hurdle is set at 4% as this reflects being able to access Prudential Borrowing at 2%, with the need for capital to be repaid too over the maximum 50-year borrowing period (as well as interest costs being met).

2.21 The table shows that the investment value of each unit type tends to flatten as the units get larger, and this is even more pronounced for social rented homes.

2.22 The difficult market conditions of rising land and construction prices coupled with relatively flat rental returns and modest grant or S106 subsidy means that the investment value of AH homes tends to be lower than their production cost, again using the 2-bed apartment example.

2 bed 4 person apartment, 70m2	Affordable	PRS
Open Market Value (OMV) @ £365 per Sq ft	£ 275,000	£ 275,000
Target Price, circa 90% of OMV	£ 250,000	£ 250,000
Build Cost @ £2,500 per m2 inc communal parts	£ 201,250	£ 201,250
On Costs @ 8% of Constuction Costs	£ 16,100	£ 16,100
Residual Land Value	£ 32,650	£ 32,650
Gross Cost Per Unit	£ 250,000	£ 250,000
Subsidy S106 Discount or Homes England Grant	-£ 50,000	£ -
Net Cost Per Unit	£ 200,000	£ 250,000
Net Cost Per Unit as % of OMV	73%	91%

2.23 The table below demonstrates this viability gap for a typical 2-bed apartment for affordable rent, where in fact the viability gap is at its lowest.

Typical 2-bed flat for Affordable Rent	
Likely cost	£ 200,000
Investment Value	£ 182,400
Viability Gap Per Unit	-£ 17,600
Viability Gap Per 100 homes	-£ 1,760,000
Viability Gap Per 1,000 homes	-£ 17,600,000
How do oher RP's subsidise?	
Existing asset base / business plan	
Stock disposals	
Homes for market sale	

2.24 Therefore, market forces mean that there tends to be a viability gap for every affordable housing home delivered, the competition from other RPs to deliver new affordable stock can drive up the cost of production too. The table shows how other RPs can subsidise their programmes, but the Council is more constrained inasmuch it does not have an existing sizeable asset base and its overall income is too small (relatively) to risk a sizeable market sale programme.

Internal subsidy and the creation of a Maidstone Housing Investment Fund (MHIF)

2.25 Therefore, even though the Council's portfolio will benefit from either (or both) S106 subsidy and grant from Homes England, each AH unit will require circa £17.6k of internal subsidy too. If it was assumed the 1,000 homes would be delivered over ten years, this internal subsidy would be circa £1.7m per annum or £17.6m over the ten-year delivery period. Therefore, a MHIF will be required and the options for how this is achieved include:

- Putting aside council resources including New Homes Bonus (NHB) or potentially other one-off funding or windfall resources;
- Making existing Council owned land available for housing development;
- Selling some homes for market sale;
- Cutting other Council services / costs to create financial headroom.

2.26 Following discussion with political party leaders, the favoured route is that of utilising one off resources where appropriate and NHB and to a lesser degree making use of some Council owned land with perhaps some market sale exposure through joint venture (with the developer contractor) on suitable sites. A reduction in spend on other Council services was not favoured.

2.27 Given the uncertainty over the existence of NHB in the medium to long term, the use of it to help subsidise the 1,000 homes project in the short term is very important, as well as making some Council owned land available too. In the latter years of the programme, it is possible that some modest market sale exposure could be a source of subsidy too, but this will need to be proportionate to the Council's revenue budget and only where schemes are suitable for this tenure in terms of surety of demand, and where there is a willing and appropriately experienced contractor available with who the Council can joint venture with.

Grant funding from Homes England

2.28 As per the section on development opportunity appraisals, any affordable homes that are not delivered through the Section 106 route will require grant, and in most cases, this will be provided by Homes England, but is subject to strict bidding criteria and Value For Money assessments. To streamline their processes, and support the largest developers of affordable housing, Homes England allocates the bulk of its resources to a relatively small number of RPs that they classify as Strategic Investment Partners. The current Homes England programme for 2021-2026 is for £7.39 billion.

2.29 For the Council to access the grant monies it needs, up to £50m, based on 1,000 homes multiplied by £50k per affordable home, it has two options:

- Make Continuous Market Engagement (CME) bids to Homes England on a scheme-by-scheme basis.

- Access the grant via forming a partnership with an existing Homes England Strategic partner. In the Maidstone area, these are Hyde, Orbit, Optivo and Clarion.

2.30 The officer view is that in the early years of the programme it is most appropriate to use the CME route direct to Homes England. In time, once the Council has built up a good land bank and has more to offer, it would be worth exploring the possibility of joining a strategic partner under their umbrella.

2.31 Furthermore, the Council does also have some commuted sums (circa £1m at present) from developers via Section 106 agreements that are intended for the provision of off-site affordable housing. This pot can be utilised to get the schemes underway in the early years, pending successful bids to Homes England.

2.32 Regardless of which route the Council engages with Homes England, it must be appreciated that they are a delivery focussed organisation that awards grants to those RPs that deliver on time, and they withdraw funding from those that do not, so building a credible pipeline of schemes will be vital to strengthen the relationship with them.

2.33 For the CME route, the Council will need to apply to Homes England to become a (regular) partner as part of making its first CME bid and enter into a Grant Funding Agreement with them, and this would need to be subject to a further decision by this Committee in due course.

Typical project timelines / milestones

2.34 There appears to be a cross party political will to build 1,000 affordable homes and a desire for these homes to be delivered as soon as possible. However, it is worth noting that the lead time for new homes from the initial scheme identification through to the keys being handed over is significant reflecting a long process, typically as follows:

- Month 1 Scheme identification.
- Month 3 Negotiate land purchase & gain Committee Project Approval.
- Month 6 Complete land purchase.
- Month 12 Submit Planning application.
- Month 18 Secure Planning consent.
- Month 24 Contractor completes post Planning design & starts on site.
- Month 48 Scheme handover, assuming a typical 24-month build period.

2.35 Therefore, an aggressive programme for a typical scheme is 4 years, but this can be longer if there are delays in any of the stages.

2.36 The programme for certain schemes could be shortened in some cases, were the Council to, for example, purchase sites with the benefit of an existing planning consent or indeed buying (to be) completed homes off plan once they are already on site. However, there is usually a premium to be paid if it is perceived by the vendor that they have already added value or have held some risk in the process prior to disposal.

2.37 Furthermore, the later in the development process the Council identifies the opportunity, there then becomes much less scope to have the homes designed and specified to the Council's exact requirements. This can be an issue also in terms of the fact that Homes England usually require higher standards in the new homes they grant fund, than the market would typically deliver. An example of this would be that a condition of securing Homes England grant is that the funded homes need to meet the National Space Standards, which are not mandatory for developers to meet, unless they are adopted within a borough's Local Plan (which in Maidstone they currently are not).

2.38 Similarly, Homes England is usually reluctant to provide grant funding for "Purchase and Repair" programmes of acquiring second-hand stock for affordable housing. The reason being is that Homes England are motivated to use their grant funding to leverage the delivery of the government's ambition for 300k new homes each year. Also, they want grant funded homes to be of the highest standards, and this would not usually be the case in terms of eco and space credentials for second-hand stock.

2.39 Regardless, Officers have expressed an interest (to Homes England) in undertaking a grant funded "Purchase & Repair" programme for 50 Affordable Rented Homes to be completed by 30th April 2022. Their response is awaited, but as stated previously, such programmes tend not to be their preference. Furthermore, there is the current dearth of good quality, well priced second-hand stock on the market to consider too.

2.40 The Council could in theory deliver such a Purchase & Repair programme without the benefit of grant funding, but this would increase the amount of internal subsidy required by a further c£50k per unit, and so would be difficult to justify. Furthermore, the Council is already undertaking a similar programme for Temporary Accommodation at the present time, but this has slowed markedly in recent months because of the dearth of suitable homes available. I.e., taking these matters into account, the potential for the early delivery of Affordable Homes is difficult.

Types of Project

2.41 There are several different routes through which the Council could assemble stock, and these together with their pros and cons are set out in the table below:

	Route	**Pros**	**Cons**	**AH**	**PRS**
1	Acquire S106 stock from developers (without grant)	Low risk High quality High demand	RP competition Not new supply Nomination rights regardless	Yes	
2	Acquire Non-S106 stock from developers	Low risk High quality High demand	Tenure balance Seller's market	Yes	Yes

			Planning Committee resistance		
3	Rural Exception sites	Desirable locations Meets local needs Land at agricultural value +10%	Parish support needed Speed of delivery Small schemes	Yes	
4	Develop Council owned sites	Free / cheap land Design excellence Regeneration impact	Opportunity cost Consensus Small land bank	Yes	Yes
5	Buy & develop non-Council owned (urban brownfield) sites	Scale & density Design excellence Regeneration impact Enabling grants	Overpriced Brownfield risks Construction risk Planning risks	Yes	Yes
6	Master-developer role (E.G. Heathlands)	New supply Design impact Develops pipeline	Slow to deliver Limited sites Up front “at risk” investment	Yes	Yes
7	Acquire old social housing stock from housing associations	VFM	Scarcity Not new supply	Yes	

2.42 In terms of route 1, in the main, this is already being effectively delivered by the RPs and the Council already benefits to the Nomination Rights (from our Housing Register) to these properties. Arguably, there would be limited value in the Council investing its resources in this route, unless a given scheme was not attracting RP interest, as is sometimes the case with smaller schemes of less than 10 affordable homes.

2.43 Under the current market conditions there will be a scarcity of options from route 2, but this will ebb and flow over time.

2.44 Route 3 often provides excellent and popular schemes but realistically, the officers will be largely dependent on Parish and Ward Councillors to identify and bring forward suitable sites. This route can make a valuable contribution to the programme, but it is unlikely to be the mainstay, as such schemes are usually small, complex, and lengthy to deliver.

2.45 In terms of route 4, the Council does not have an extensive land bank, and for the sites it does use, there are usually competing uses that would need to be sacrificed to make way for development. Such sites tend to be resisted by Ward Councillors for this reason.

2.46 Route 5, therefore would be able to make the largest contribution to delivering the program, with the added benefit of delivering it within a relatively small number of larger, high density schemes. Such schemes would also bring an important regeneration impact to their localities too. There are several such sites, especially in and around Maidstone town centre, some of which appear to be stalled. However, viability is invariably challenging on these sites, and this is being exacerbated by steeply rising construction prices too. The opportunity is whether these viability challenges can be offset by securing additional brownfield type grants from Homes England and government, a tactic the Council has successfully deployed on previous schemes. N.B. our planned acquisitions and investments at Maidstone East fall into this route.

2.47 The Heathlands project, where the Council is acting as master developer (route 6) may deliver some homes for the programme if it becomes an allocation in the Local Plan Review, as the Council has the right of first refusal on all the affordable housing that will be delivered at Heathlands, but this will not yield any homes for around seven years. There is the potential to deploy this type of approach on other sites, whereby the Council acquires land, secures planning consent, allows a private developer to deliver the market sale homes but retain the affordable itself. This route can contribute and there may be other schemes of this ilk, but it will not be the mainstay of the programme.

2.48 Finally, route 7, the number of opportunities is likely to be scarce, but they will be considered when they arise. However, even if such deals were to occur, they would not increase the overall supply of affordable housing in the borough.

Development Strategy

2.49 To deliver 1,000 affordable homes in a reasonable time frame, say by March 2032, the Officer opinion is that all routes to market would always need to be supported by Cllrs. The officer opinion is that a realistic distribution of stock through these routes would be as follows:

	Route	**%**	**Number**
1	Acquire S106 stock from developers (without grant)	10%	10
2	Acquire Non-S106 stock from developers	15%	150
3	Rural Exception sites	5%	50
4	Develop Council owned sites	10%	100
5	Buy & develop non-Council owned (urban brownfield) sites	50%	500
6	Master-developer role (E.G. Heathlands)	10%	100
7	Acquire old social housing stock from housing associations	0%	0
		100%	**1,000**

2.50 The table above indicates that the most effective means to build new homes at pace will be to buy and develop further brownfield sites. As discussed previously, this will also give a regeneration impact but there is an increasing risk around rising build costs, which seems to be particularly acute in respect of higher density schemes. This does present the risk that whilst schemes may still deliver acceptable financial returns, the cost of production may from time to time exceed end values. Additional grants maybe available to offset this phenomenon, but it is not uncommon in terms of regeneration projects, but the situation seems to be becoming extreme at the present time.

2.51 The counter argument might be to instead purchase greenfield sites, but competition for these from private sector housebuilders is intense. As these firms have "in-house" contracting capacity, so can build cheaper, and therefore offer more for the land than the Council could. Similarly, housebuilders are at the present time reluctant to bulk sell off plan new stock to the Council, as they have strong demand from private purchasers, and bulk sales bring some perceived risks in terms of social cohesion and estate management. However, market conditions will ebb and flow over the programme period.

2.52 Also, this proposed strategy of developing a small number of larger schemes in and around the town centre, irrespective of the challenging costs, is consistent with the delivery of the Council's emerging Town Centre Strategy. I.e., focussing a sizeable slice of the capital programme towards construction in and around the town centre is logical and is likely to deliver social value and returns, beyond purely the financial returns.

2.53 Furthermore, it is proposed that the Council continues to invest in PRS housing too, so the capital programme contains proposals to continue to grow this portfolio, by a further 200 homes over the next five years, and these homes will be managed by Maidstone Property Holdings Limited.

2.54 Similarly, the capital programme assumes that the Council will also invest modestly in market sale housing, perhaps delivering around 60 such homes over the next five years, and ideally with the risk shared with the incumbent developer / contractor on a given scheme. Market sale will not be a suitable tenure for all schemes, it will be site specific and generally is best suited to houses rather than apartments within the Maidstone market.

2.55 By delivering PRS, as well as modest levels of market sale, this does benefit the overall programme as it will allow the Council to create more balanced communities, and this is especially important on larger schemes. Market sale also can provide some modest levels of subsidy back into the overall affordable housing programme.

2.56 In terms of the Council investing in affordable rented housing, returns will be modest. The net rent will be around 80% (of the gross) allowing for management, rent loss, void loss, and repairs and maintenance costs to include service costs. As per the current investment criteria, the Council will seek a positive Net Present Value (NPV) and an Internal Rate of Return (IRR) of 4% or above. On some brownfield land developments, it may be that grant monies for brownfield remediation and infrastructure will be necessary to ensure development costs do not exceed development value. The investment profiles of Affordable Rent and PRS housing will be comparable, and as such the investment hurdles will be the same too.

2.57 The PRS programme will not subsidise the Affordable programme from a revenue perspective, but with the PRS programme there is potential to capture capital growth through sales, which could in theory pay down overall borrowing. The affordable housing programme has no potential for long term capital growth because of the conditions attached to it either through Homes England grant funding or the Council's own S106 agreements, as affordable housing is generally required to be provided in perpetuity.

2.58 In terms of the development strategy generally, it will need to be reviewed annually and be flexed to reflect the pace of progress made as well as the prevailing market conditions.

Risks

2.59 Developing and investing in residential property is capital intensive, requiring considerable cash lock up, followed by modest but steady long-term returns. The overall programme will be subject to several risks, the main ones being:

- **Committee approvals**. New housing is often contentious, and often new proposals have been brought forward to this Committee, even when they have been approved, there has been resistance to the projects from some Cllrs, especially those local to the scheme. To deliver a programme of this scale will require difficult decisions to be made, to start to build the programme at pace. Realistically, the housing programme started well in 2016 but the pipeline has dwindled in the last two years as it has been difficult to gain consensus as to the best types of projects to take forward. Similarly, pragmatic approaches in terms of key design facets will be required too, around such issues as, for example height, density, and parking ratios, to allow the Council to be competitive in the marketplace.

- **Land availability**. The amount of developable land in the borough is very constrained, and demand for it is high, which means high prices. Land prices tend to remain high even in tougher economic times, as landowners can utilise cheap finance to mothball sites until such time as the economic environment improves, hence there tend not to be bargains / fire-sales irrespective of prevailing market conditions. Land values are also determined by the "residual" means of valuation, whereby those bidders that have the cheapest rates of production (build costs) will be the most successful in acquiring sites. Furthermore, those purchasers that develop for market sale will be in a more advantageous position too, as investment values of rented stock tend not to match open market values.

- **Construction prices.** This is perhaps the biggest threat to the delivery of the programme at the present time. Construction prices have been rising above inflation for many years, arguably driven by higher quality standards being rolled out in terms of design, aesthetics, building safety, eco-credentials, space etc, but there appears to have been a seismic shift upwards in the build up to BREXIT and since then. This phenomenon has been exacerbated by the pandemic, further driving labour shortages, and adding to on site complications around working practices and the supply and availability of materials.

  To illustrate this point, when the Council tendered the works for Brunswick St and Union St, prices were around £2,000 per m2 when the schemes started on site in Jan 2019. Over the past three years, the team have been modelling schemes with an assumption that build prices will be around £2,500 per m2. However, more latterly our cost consultants have been quoting expected rates of £3,500 to £4,000 per m2. At these quoted rates, build prices will already exceed end values of the homes, before taking into the cost of land and other production costs.

Even with these costs of construction, it should still be possible to deliver schemes that have an acceptable IRR and NPV, but this is because the Council can use Prudential Borrowing to finance the programme at very low rates. But Cllrs will need to be cognisant that they may be approving schemes where the cost of production exceeds end open market values.

Obviously, officers can work at the margins with their professional teams to design schemes that are efficient to build, and the government is pushing other remedies such as the greater use of "off-site" and Modern Methods of Construction (MMC) which can help to curtail the problem, as per the proposed King Street scheme design.

Realistically though, inflation is rising elsewhere in the economy, and there are also imminent new housing standards to meet in the form of the Future Homes Standard (carbon neutral housing) as well as any other local standards that the Council may choose to implement through its own Local Plan Review. So, to summarise, rising build prices are a huge issue, and it is difficult to see this situation reversing, and so it may well be that production values exceed end values on some schemes.

- **Contractor solvency**. When the Council lets construction contracts, it is on the basis of "design & build" fixed price contracts, whereby the client (Council) commissions the design up to the grant of Planning permission, and the contractor undertakes the post Planning design and delivers the works for a guaranteed fixed price thereafter. Therefore, the contractor holds the risk of future construction price rises and so if they bid incorrectly, they can be exposed. Past experiences are that contractors can be most vulnerable in a rising construction market rather than in a recession, and so the Council will need to protect itself using financial stability checks, overall exposure checks, Performance Bonds, quality monitoring and retentions. Needless to say, the more stable the contractor, the greater the premium. Contractor failure on smaller lower density sites whilst not ideal, is not hugely problematic, but on larger higher density projects it is. This is a risk that needs to be managed very carefully, inasmuch when trying to mitigate the risk of rising construction prices, the perceived remedy (of using smaller, newer, and less experienced contractors) can instead just expose one to another risk (of contractor insolvency).

- **Town Planning**. When buying sites "at risk" of or "subject to" Planning consent, it is important that the team take pre-application Planning advice to ensure that the development aspirations for a given site will be achievable in terms of Planning. This is a relatively straightforward risk to manage if the Council acting as developer is treated comparably to others by the Local Planning Authority.

- **Pipeline**. The Council does not have a large land bank nor a pipeline of approved scheme, and so the programme will take ten years to deliver, and there will need to be rapid progress in the early years in terms of scheme approvals and site acquisitions, and this period will realistically coincide with adverse market conditions.

- **Competing priorities.** The market conditions will make the programme challenging to deliver. The ambition to deliver 1,000 affordable homes in the shortest time possible will be further compromised if the Council then seeks to add further "softer" aspirations to various schemes such as enhanced eco credentials (above policy), increased affordability to the end user (in terms of Social Rent versus the proposed Affordable Rent), a general bias towards larger homes and houses, will all further adversely affect the financial metrics and deliverabilty of the programme.

- **Market sales**. A modest market sales programme is proposed. Should market conditions move against such schemes, once work on site has begun, this risk can be managed by switching tenures to either Affordable Rent or PRS.

- **Grant funding.** The Council will need to build a strong delivery reputation to secure long-term grant funding support from Homes England. Furthermore, when securing grant, the Council will be bound by the conditions sought by Homes England too in terms of the long-term stewardship of the affordable housing assets, as well as adhering to good practice (Scheme Development Standards) in terms of how those assets are developed.

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3. AVAILABLE OPTIONS

3.1 Option 1 – to approve the proposed Development Strategy set out in the main body of this report.

3.2 Option 2 – to give the lead officer feedback as to how the proposed Development Strategy could be amended and invite that it be brought back to a subsequent meeting for further consideration. The most practical alternative approach might be to instead to focus the programme on acquiring Section 106 affordable homes from developers, to meet the ambitious growth target. Beyond an expansion of this route (S106) the other routes to market are unlikely to achieve the number of homes required even with a much greater amount of officer focus and attention.

3.3 Option 3 – to decide not to proceed with affordable homes programme at all.

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4. PREFERRED OPTION AND REASONS FOR RECOMMENDATIONS

4.1 The preferred approach is Option 1, the Development Strategy as detailed in this report, as it will ensure that the sizeable investment made by the Council into this sector will be focused upon new affordable homes that would otherwise not have been delivered and bring a regeneration impact to the town centre too. I.e., If the Council were to amend the

Development Strategy to instead focus upon the acquisition of S106 homes, this is not recommended, as these homes are already largely being delivered acceptably by RPs, and the Council already benefits from the nomination rights to these homes, irrespective of who owns them.

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5. RISK

5.1 The various risks are covered within the main body of the report.

6. CONSULTATION RESULTS AND PREVIOUS COMMITTEE FEEDBACK

6.1 All the various political party leaders have been briefed and consulted with in respect of the development of this development strategy. This report and its recommendations are consistent with those discussions.

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7. NEXT STEPS: COMMUNICATION AND IMPLEMENTATION OF THE DECISION

7.1 There are several subsequent steps that will need to be undertaken to include:

- Agree the longer-term corporate structure for holding the affordable housing portfolio.
- Agree the details of any grant funding agreement with Homes England.
- To review the progress made in delivering the programme in January each year at this Committee, making any adjustments necessary.
- To receive feedback from Homes England on the prospects of them funding a Purchase and Repair programme to deliver early home completions by May 2022, and if encouraging, bring a more detailed scheme approval paper to this committee.

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8. REPORT APPENDICES

- Private Appendix 1: Legal advice on corporate structure options.

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9. BACKGROUND PAPERS

None.