

Cabinet

10 October 2022

Wards: Cricket Green, Figges Marsh, St Helier, Wandle,

Housing Delivery Options

Lead officer: Adrian Ash, Interim Director of Environment and Regeneration

Lead members: Cllr Billy Christie, Cabinet Member for Finance and Corporate Services
Cllr Andrew Judge, Cabinet Member for Housing and Sustainable Development

Contact officer: Paul McGarry, Head of Future Merton

Recommendations:

- A. That Cabinet notes the options appraisal setting out how the Council can achieve its strategic ambition to deliver affordable housing on council owned sites.
 - B. That Cabinet agrees not to dispose of the first four sites for private sale and instead allocates the sites for affordable homes, delivered either by the Council or a Registered Provider (Housing Association).
 - C. That Cabinet note the implications for the Council of Merton re-establishing a Housing Revenue Account should it decide to be the direct provider of social needs housing.
 - D. That Cabinet note the finance, timescale and officer resource implications for the programme.
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1 PURPOSE OF REPORT AND EXECUTIVE SUMMARY

1.1. The new administration has made clear its ambition to increase the delivery of genuinely affordable housing in the borough utilising council-owned land. Members have set an ambitious target of 400 new homes by 2026.

1.2. One of the administration's strategic priorities is creating a sustainable future for Merton and our service priority is the creation of a new era of high-quality social housing.

1.3. This report sets out a series of options for delivering the affordable housing programme, ranging from open-market site disposal, disposal to a Registered Provider or direct delivery of affordable homes by the Council.

1.4. The report considers the timescales, costs and other resources required for each option. Members are asked to consider the options available and set a direction of travel for the programme.

2 DETAILS

2.1. Merton Council is committed to increasing the supply of genuinely affordable housing in the borough, not only via the planning system but through direct intervention utilising the Council's land and property assets.

2.2. The Council's ambition is to deliver 400 homes by 2026. The Council has identified a number of sites as surplus to operational requirements and these have also been allocated for residential use in Merton's emerging new Local Plan.

THE SITES

2.3. The first four sites in the programme are the former Merantun Development Ltd (MDL) sites which benefit from existing planning permission; granted in 2020.

2.4. The initial four sites will deliver 93 homes and they are:

- Elm Nursery Car Park, Mitcham CR4 3TA (21 homes)
- Raleigh Gardens Car Park Mitcham CR4 2JB (36 homes)
- Land at Canons, Madeira Road, Mitcham CR4 4HD (18 homes)
- Farm Road Church, Farm Road, Morden SM4 6RA (18 homes)

2.5. At the special Cabinet meeting on 31st August 2022, Cabinet agreed a budget provision of £300,000 to update the planning details of the schemes to current building regulations and to enhance the environmental sustainability of the proposals beyond that of the Local Plan requirements. The funding will also allow for the preparation of construction tender packs to speed up the delivery of the developments, whether delivered by the Council or a Registered Provider.

2.6. In addition to the sites listed above; the following sites have also been identified as suitable for housing development and are being assessed for inclusion in the longer-term programme of 400 homes by 2026.

2.7. These sites have been included in Merton's emerging Local Plan where indicative site capacities have been assessed and could accommodate 393 homes. Subject to further detailed design and definition of the mix of homes for each site, there is capacity to achieve the housing programme's target.

2.8. The potential pipeline of sites includes:

- Chaucer Centre, Morden (35-65 homes)
- Gifford House, Morden (20-25 homes)
- Worsfold House, Mitcham (45-65 homes)
- Battle Close, South Wimbledon (50-65 homes)
- Sibthorpe Road, Mitcham (20-40 homes)
- Hallowfield Way (13-30 homes)

2.9. Including the former MDL sites at 93 homes, the subtotal range on LBM available sites is: 276 – 393 homes. 7 additional homes are needed to meet the target which could be achieved through the detailed planning and design process.

OPTIONS APPRAISAL (Council Build)

2.10. A detailed options appraisal is being prepared by the Council's consultant advisors SQW. The full details will be available for the Cabinet meeting on 10th October.

Design

2.11. Weston Williamson and Partners, the original design team of the initial four sites have been appointed to undertake a detailed review of the approved schemes and have issued a mark-up of the plans highlighting areas which will need to be revisited/updated to ensure 2022 Building Regulations Compliance, and potential Passivhaus accreditation – these will be costed and modelled separately to provide Cabinet with the detailed costs.

2.12. Key areas requiring updates to comply with current Building Regulations include reviewing potential thermal bridges (Part L and Passivhaus), the addition of Mechanical Ventilation with Heat Recovery units (Part F and Passivhaus and updating of overheating calculations which might impact on window sizes and the requirement for shading devices (Part O and Passivhaus)

2.13. Additional work required to achieve Passivhaus accreditation has also been highlighted both in terms of process and updates to specifications (i.e. window specification, drawing requirements and differing construction processes required to meet Passivhaus standards)

















Cost and Procurement

2.14. The design changes noted above have been discussed and reviewed by WW+P and the cost consultants Warhurst Bourne (WB)

2.15. Initial cost plans for the four sites account for the updated scheme assumptions (based on WW+P work detailed above), revised specification for affordable housing, BCIS baseline cost information and allowance for recent inflationary pressures

2.16. The diagram below provides members with some context to construction cost inflation over the past six months and projected for the next six months which will be of interest.

Work Package Price Movements 2022.

Work Package	Movement last 6 months	Forecast next 6 months	Work Package	Movement last 6 months	Forecast next 6 months
 Groundworks	▲ 3.35%	▲ 3-5%	 Tiling	▲ 215%	▲ 1-3%
 Steel Frame	▲ 10%	▲ 5-7%	 Pools	▲ 1175%	▲ 7-9%
 Dry lining	▲ 25%	▲ 3-5%	 Washroom Vanities	▲ 6%	▲ 5-7%
 Brickwork	▲ 3.5%	▲ 3-5%	 Soft Flooring	▲ 5%	▲ 3-5%
 Carpentry	▲ 1%	▲ 5-7%	 Bespoke Joinery	▲ 6%	▲ 5-7%
 Timber Frame Building	▲ 1%	▲ 5-7%	 Slate Roofing	▲ 7.75%	▲ 7.75%
 Roofing	▲ 3%	▲ 5-7%	 Lifts	▲ 8%	▲ 7-9%
 UPVC Windows	▲ 14%	▲ 7-9%	 Acoustic Panels	▲ 3%	▲ 1-3%

2.17. WB and the project manager, Cobalt PM, have engaged informally with contractors with experience on similar scale (and Passivhaus) projects who will provide some programme, risk, procurement and cost views between them – advice will be provided around alternative direct development routes (single-stage, two-stage, framework options etc); SQW will provide commentary re. the alternative approach of disposal/procurement of a Registered Provider as well as direct development by the Council.

2.18. The current assumption is that previous structural strategy (2 sites being built of timber frame, 2 sites being concrete/steel construction) remains applicable and fitting with Passivhaus standards. The cost plans have been issued based on two alternative scenarios: (a) building regulations compliant and (b) allowance for Passivhaus.

2.19. Importantly these construction costs are in draft and subject to review/interrogation by the team – there might be areas to potentially value engineer, including around specification, although this is unlikely to make a material difference to the overall magnitude of cost.

2.20. There are other development costs which need to be included in the viability analysis (design fees, legal fees, financing costs and ongoing management and maintenance costs) which are highly material to the overall viability of the schemes. Therefore the costs set out below represent core construction costs only.

Indicative costs of developing the sites

2.21. The emerging build costs for developing the first four sites are included below.

2.22. The table provides the build costs as of 2020, the costs now in 2022 to meet a building regulation compliant scheme and a 2022 cost if the schemes are built to Passivhaus standard.

2020 (base)	2022 (Building Regulations)		2022 (Passivhaus)	
Cost	Cost	% uplift	Cost	% uplift

£ 19,789,644	£28,212,031	+43%	£29,561,532	+49%
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Viability

2.23. SQW will model two principal scenarios: (1) Building Regs compliant and (2) Passivhaus compliant

2.24. Within these two scenarios two different tenure mixes will be assumed, for comparison:

(1) 100% social rent and

(2) GLA compliant affordable mix including Social Rent, London Living Rent and Shared Ownership.

2.25. The model will be able to switch 'on' and 'off' GLA grant for all scenarios to model the implications. Assumed grant rates in the GLA affordable housing programme are £100,000 per socially rented home.

2.26. The viability model in the final report will include richer data on the target social rent levels in Merton and will model:

- Valuation (GDV) of the affordable housing
- The development appraisal
- The investment cashflow for the individual completed sites
- The investment cashflow for the overall programme (4 sites)

2.27. Cumulatively this will establish

- (a) the cost to the Council of funding the development,
- (b) acquiring the affordable homes and
- (c) the potential viability funding gap

Summary of the Council build option

2.28. If the Council were minded to develop the first four sites of 93 homes; the estimated build costs would be;

2.28.1 £28,212,031 for a building regulations compliant scheme

2.28.2 £29,561,532 for a Passivhaus standard scheme

2.29. The difference between building regulation compliance and the Passivhaus standard is negligible in cost in terms of the overall programme. This is mainly due to the high sustainability specification adopted by MDL at the time which went beyond the Local Plan Policies at the time.

2.30. The key driver for cost increase is the wider economic climate with increased inflation on build costs, materials, labour and the cost of financing.

2.31. The potential grant available from the GLA could be £9.3m. Therefore the indicative build costs of the programme would range between £18,912,031 and £20,261,532.

OPTION TO DISPOSE TO A HOUSING ASSOCIATION

2.32. At the Cabinet meeting of 6th December 2021, Cabinet agreed to dispose of surplus property assets to facilitate increasing the supply of housing as set out below:

2.33. *Properties declared surplus by the Council be marketed for housing as soon as they are ready for sale provided the Director of Environment and Regeneration, in consultation with the Cabinet Member for Finance, considers that the market is favourable.*

2.34. *That authority is delegated to the Director of Environment and Regeneration, in consultation with the Cabinet Member, to determine which of the properties agreed for disposal be sold on one or more of the following terms:*

- *Option 1. Disposal to maximise capital receipt; or*
- *Option 2. Disposal to provide redevelopment with 50% affordable housing; or*
- *Option 3. Disposal to provide redevelopment with 100% affordable housing.*

2.35. As set out in Recommendation B for this report, Cabinet are invited to consider and agree, for the former MDL sites that options 1 and 2 are discounted as this no longer fits with the administration’s priorities.

2.36. Below is an extract from the 6th December 2021 Cabinet Report detailing the anticipated capital receipts for the four MDL sites that could be achieved if they were disposed of to a Housing Association to deliver 50-100% affordable housing. These were indicative valuations arrived at in conjunction with the District Valuer. It would be prudent to obtain an up-to-date valuation as part of the decision-making process.

Number of homes	Policy compliant (50% affordable housing)	50% social rented with 100% nomination rights	100% social rented with 100% nomination rights with GLA grant funding	100% social rented with 100% nomination rights without grant funding	Parking income foregone (per annum)
93	£6,975,000	£6,171,000	£6,130,000	£1,385,000	£32,846

2.40 Initial feedback from SQW is “*indicative potential land receipts reported then by DVS [above] are, in our view, likely now unrealistic given the assumptions made regarding build costs associated with the re-development etc*”.

COMPARING OPTIONS

2.41 The Council’s ambition is to increase affordable housing supply. This can be achieved utilising LBM owned land through two measures:

1. By the Council developing homes itself, or
2. Disposing of the sites to a Housing Association to develop and provide nomination rights to the Council’s housing list.

2.42 The Council developing homes itself would require an investment in the programme of c£21million (assuming GLA grant received; c£29million if not)

to meet build costs; with further ongoing investment needed in the staff to manage and maintain the properties and rent collections.

- 2.43 The option to dispose to a housing association may still result in a capital receipt returned to the council, depending on the levels of GLA grant available to the Housing Associations. A further valuation will be obtained as part of the options appraisal although it will only be possible to know for sure what any actual receipt will be at the point at which the sites are offered to the market. The disposal option remains the lowest risk option for the Council as it would not be undertaking the construction phase itself. This option also reduces the requirement for additional and ongoing staff resources as the properties would be managed by a Housing Association; whilst still delivering much needed homes for those on Merton's housing waiting list.

3 ALTERNATIVE OPTIONS

3.1. In December 2021, Cabinet resolved to agree the disposal of surplus sites to a Housing Association partner (through competitive bidding) to deliver affordable housing on sites (ranging from 50% affordable to 100% affordable).

3.2. This decision remains an approved option for the delivery of homes via a Housing Association partner. (The alternative to LBM self-build)

3.3. The level of affordable housing is delegated to the Director of Environment & Regeneration in consultation with the Cabinet Member; this will now be 100% to meet the administration's ambition.

4 CONSULTATION UNDERTAKEN OR PROPOSED

4.1. None for the purpose of this report.

5 TIMETABLE

5.1. None for the purpose of this report which considers the financial implication of the development options. An indicative programme for development has been provided to the member steering group.

6 FINANCIAL, RESOURCE AND PROPERTY IMPLICATIONS

6.1 Developing Housing Sites In-house

6.1. The Authority transferred its entire housing stock (6,326 dwellings) and associated land to a housing association in March 2010 and closed its Housing Revenue Account (HRA). These dwellings were organised into estates, serviced by suitably experienced/qualified staff in area offices and the Civic Centre and all related staff were TUPEd as part of the transfer. The authority retained a small number of dwellings.

6.2. The purpose of the transfer was to secure a significant level of future investment in the stock to deal with a backlog of repairs and to ensure that the Government's Decent Homes Standard could be delivered for all stock. Since this time there have been significant changes in the way local authorities are required to account for and fund their housing stock, mainly around the expectation that the HRA is self-financing

and the removal of the HRA borrowing cap. These changes have paved the way for local authorities to investigate opportunities for the delivery of new housing.

6.3. Under current legislation/regulation the Authority can hold up to 199 housing homes without the need to re-establish its HRA, when this threshold is breached, the authority would need to request to the Secretary of State to set up an HRA. Under Section 76 Local Government & Housing Act 1989 the council has a duty to “prevent a debit balance on the HRA”, i.e. avoid the account going into a deficit position - for authorities seeking to re-establish their HRAs this is demonstrated by modelling a break-even position over a 30 year period. Therefore, there is a requirement that any housing development, even that below the threshold, will need to be progressed as cost effectively as possible or any moves to establish an HRA will fall at the first hurdle.

6.4. The table below summarises the estimated costs of developing the proposed homes in-house:

Development and Build Costs	100 Houses	*400 Houses
	£000s	£000s
Premises Build Costs incl Project Management	£35,000	£140,000
GLA Funding	£(9,300)	£(37,200)
Total	£25,700	£102,800

* Would require the establishment of an HRA which would need to demonstrate the ability to break even over a 30 year period

6.5. The revenue financing to service this debt is estimated as:

Debt Costs to Merton	100 Houses Full Year £	400 Houses Full Year £
Depreciation/Minimum Revenue Provision	877,133	3,508,532
Interest	1,107,670	4,430,680
Total	1,984,803	7,939,212

Estimated Annual Cost per House

£19,848

6.6. If the Authority can apply Section 106 affordable housing (£4.6m) to the development costs as well as receive GLA subsidy, then this will reduce the debt charges by £337k per annum.

6.7. To break even the Authority would need to generate sufficient rental income to offset the debt charges above, management and maintenance costs and contribute to a renewals and repairs reserve.

6.8. Modelling undertaken by Campbell Tickell during 2021 concluded that to break even a percentage of the developed homes would need to be sold and additional capital funding would need to be made available by the Authority to any scheme to make it viable. The Authority has a finite number of sites to develop, if it has to sell off a percentage of the developed homes this will not maximise the affordable housing developed on the sites.

6.9. Whilst it is recognised that management and maintenance expertise would need to be purchased from external sources, it will be extremely difficult to gain sufficient economies of scale in operation with multiple small sites spread throughout the borough. In addition, it is essential that provision is made for rent collection and debt chasing, where possible this would utilise the existing infrastructure within the Authority, but would be essential to ensure a break even position is achieved. Financial expertise would also need to be developed and resourced to maintain the newly established HRA.

Development by a Housing Association (Registered Provider)

6.10. Under this option it is envisaged that the land will be disposed of via some kind of tendering process, this is likely to be limited to housing associations to ensure that the “100% affordable housing nomination rites in perpetuity” is delivered.

6.11. In August/September 2021 the District Valuer estimated that as well as delivering 100% and nomination rites affordable housing disposal to a housing association may also generate a reduced capital receipt (sale proceeds). It is likely that these estimates will have been adversely affected by changes in the economy since the date of valuation (see 2.40).

6.12. A local authority is required by legislation to not dispose of land for a consideration less than the best that can reasonably be obtained. The Secretary of State has issued the General Consent Local Government Act 1972 general disposal consent (England) 2003 disposal of land for less than the best consideration that can reasonably be obtained. This provides that

- a) a local authority may dispose of land at an undervalue where the local authority considers that the purpose for which the land is to be disposed is likely to contribute to the achievement of any one or more of the following objects in respect of the whole or any part of its area, or of all or any persons resident or present in its area;
 - i) the promotion or improvement of economic well-being;
 - ii) the promotion or improvement of social well-being;
 - iii) the promotion or improvement of environmental well-being; and
- b) the difference between the unrestricted value of the land to be disposed of and the consideration for the disposal does not exceed £2,000,000 (two million pounds).

6.13. It is for the council to determine the “well-being” test on a case by case basis taking into account all relevant matters such as policy and fiduciary duty.

6.14. Officers note that no disposal will proceed where there is any reduction in the amount of capital receipt arising as a result of the affordable housing conditions without considering and adhering to the state subsidy legislation.

6.15. It is not envisaged that the Authority would incur any additional costs and would look to invest the £4.6m available from Section 106 Affordable Housing in the scheme. The risks to the Authority would be minimised and the required objective achieved.

7 LEGAL AND STATUTORY IMPLICATIONS

7.1. The Council has power to provide social housing by virtue of Part II of the Housing Act 1985. If it does so, then the provisions of section 74 of the Local Government and Housing Act 1989 which relate to the establishment of a housing revenue account (HRA) apply. Put shortly, if the Council wishes directly to provide housing either by building it or by purchasing land or buildings for that purpose it will need a direction from the Secretary of State permitting it to do so. If the number of homes provided is 200 or more, then the Council will also need to apply for permission to reopen an HRA. In order to do the latter, it will likely be necessary to produce at least an outline business plan.

7.2. Should the Council wish to dispose of the sites, it has power to do so under section 123 of the Local Government Act 1972. However, if it wishes to do so at an undervalue, which is likely, the consent of the Secretary of State under section 25 of Local Government Act 1988 will also be required. The Secretary of State has issued some general consents under this section and when the structure of any proposal is clearer, further consideration will be given to which consent will apply. Similarly, the Council will have to consider whether the transaction is covered by the provisions of the Subsidy Control Act 2022 (which replaces the old state aid regime).

7.3. If the Council decides to build out the sites itself, it will need to follow the processes that comply with the Public Procurement Regulations and the Council's contract standing orders.

7.4. In reaching a decision about which route to take, the Council should balance its wish to achieve its strategic objectives with the fiduciary duty it owes to the residents and taxpayers of the borough to ensure it is achieving value for money.

8 HUMAN RIGHTS, EQUALITIES AND COMMUNITY COHESION IMPLICATIONS

8.1. None for the purpose of this report.

9 CRIME AND DISORDER IMPLICATIONS

9.1. None for the purpose of this report.

10 RISK MANAGEMENT AND HEALTH AND SAFETY IMPLICATIONS

10.1 From the information contained in this report it is apparent that the in-house development of sites within the borough bears more financial risk for the Council than developing sites via a housing association. This financial risk is heightened by the current and projected economic situation.

10.2 The in-house skills/expertise gap could increase the identified financial risks, time taken to deliver and increase the chance of non-delivery.

10.3 Disposing of sites within the borough via a housing association with nomination rites in perpetuity, minimises the financial risks to the Authority at the cost of ultimate control over the site.

10.4 There is also a risk that utilising a housing association will not be within the subsidy rules permissible by the Secretary of State if the land is sold significantly below market value.

11 APPENDICES – THE FOLLOWING DOCUMENTS ARE TO BE PUBLISHED WITH THIS REPORT AND FORM PART OF THE REPORT

12 BACKGROUND PAPERS

12.1. Special Cabinet Report 31 August 2022.

<https://democracy.merton.gov.uk/ieListDocuments.aspx?CId=146&MId=4316>

12.2. Cabinet Report, 6 December 2021: Disposal of surplus property assets to facilitate the increase in the supply of housing.

Agenda Item 7

<https://democracy.merton.gov.uk/ieListDocuments.aspx?CId=146&MId=3977>

12.3. Planning approvals for LBM owned sites:

- Elm Nursery Car Park
- Raleigh Gardens Car Park
- Land at Canons, Madeira Road
- Farm Road Church, Farm Road

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