Mercury Land Holdings Limited

Business Plan – 1st April 2017

Contents

1. Summary

1.1. Introduction

The Company will undertake three separate activities, development of properties, sale on the open market and rental of PRS properties.

The plan is based on three schemes, a rental scheme at Cathedral Court consisting of 65 flats (fully let), a further development opportunity at North Street for PRS consisting of 44 flats and the development and sale of properties on the Quarles site.

In financial terms, the Cathedral Court scheme has funding consisting of equity and a short term development loan from the Council that is repayable in March 2018 and replaced by 50 year repayment loans.

Funding from the Council for the North Street opportunity will consist of equity and short term development loans that are again replaced by 50 year repayment operating loans once the schemes are completed and the flats privately rented.

Finally the Quarles scheme funding from the Council will again consist of equity and short term development loans that are repaid by sales proceeds with any residual equity and profit used employed in future schemes.

1.2. Rental

The plan shows that by year 4 the company will have a total of 208 flats in the PRS market generating a gross annual rental of £1.6m and a net operating income before interest and fees of £1.1m available to service its debt.

1.3. Development

The Company is forecasting the development of 2 further sites funded by equity and development loans from the Council, the development loans are on an interest only basis and repaid as each scheme moves to the operating phase and the flats are rented with a 50 year fixed term repayment loan. The peak debt is forecast to be £23.6m in year 7.

1.4. Council funding and financial return

The Council will fund the Company through a combination of share capital, short term development loans and fixed term operating loans.

- Share capital – in return for its investment of £8.7m the Council would benefit from the longer term growth of the PRS portfolio.
- Loans – in return for its long term lending the Council will receive interest, arrangement fees and agency fees that is forecast, based on the three schemes, to peak at £2.7m in year 6 and generate a gross return of £58m over 54 years.

2. Background

Since 2014, Council Officers supported by specialist consultants, assessed the potential of the Council participating in the development of market rent ‘PRS’ (its prime focus) and market sale homes in the borough. On 13th May 2015 the Council’s Cabinet agreed in principle to the establishment of the Housing Company, Mercury Land Holdings, which would be a wholly Council owned, arms-length commercial entity to pursue this activity.

The Council’s main objectives for entering into this market are:

- To generate a financial return to the Council from the business.
- To make use of existing Council capital assets and /or funding sources, by way of investment in housing to deliver value to the Council over the long term, whilst helping meet short term housing need.
- To contribute to dealing with the housing supply issue in the Borough which threatens the economic and social well-being of residents and is also a threat to the local economy. It will seek to avoid large tracts of buy-to-let housing characterised by fragmented ownership, poor management of families from outside the Borough, who may place unsustainable pressures on local services.
- To ensure a mix of housing, in terms of type, size and tenure, best matched to the needs of Havering; and improve management standards
- To support the Council’s regeneration and growth aims, bringing forward high quality development on regeneration sites in key parts of the borough, notably, though not limited to, Rainham along the A1306, and Romford Town Centre.

3. Company

3.1. Development

The company will be developed in accordance with the Business Plan. The principle for the growth of the company is to organically evolve, matching staff resource with work load associated with the development contracts.

The business currently has only small scale, core staff essential to enable its development to a fledging commercial operation. This business plan has made an allowance for staffing costs to enable this development. Currently certain appointments within MLH are a shared resource between the Council and the Company, the company compensating the Council for the cost of their time.

The following posts are currently occupied:

- Development Manager – commercially focused with development appraisal experience.
- Financial Manager – to maintain the financial modelling for business cases, business planning & statutory records and accounts as well as operating as the company secretary

Future appointments are proposed as follows:

- Project Manager – to act as client in managing delivery of schemes (it is likely this resource will be from ED and charged time at an appropriate market rate)
- Procure professional individuals as required, e.g. chartered surveyors and Employers Agents. These posts are a mix of temporary and part time staff. Once the company has become established the intention is to recruit market experienced staff to fulfil specialist functions such as housing management.

The Housing Company will also benefit from the resource available to it from the appointed board directors who bring expertise and valuable senior management resource. We have charged considerable time allocations from the directors into the overhead structure of the model.

3.2. Rental

The Company will primarily develop a portfolio of homes for market rent. These will not be affordable homes and will not be targeted at households towards whom the Council owes a housing duty.

The Company has completed the development of the site at Cathedral Court with the aim of long term letting of the properties at market rent. In fact of the 65 flats developed all are currently let, well ahead of the assumptions in the business case for this scheme. The financial model developed to enable assessment demonstrates positive revenues after an initial period and a long term positive return.

Future developments will be subject to a full and detailed business case and viability assessment report to enable approval and sign off for funding. The company will own market rent units and will market and manage the rental of those homes via letting agents or others with market specialisms

Dwellings owned by the company will be let on Assured Tenancies of 1 to 5 years initially. The company's aspiration will be to retain good tenants and incentivise them to stay. As such this will be reviewed with the potential for longer terms to meet the Council's objectives of promoting sustainable communities. The longer term tenancies offer security to tenants and hence help stabilise communities. From the Housing Company's perspective, the longer term also gives some certainty for revenue flows as it provides contracted intent for longer periods. It also reduces the void cycle and letting costs, and thus potentially increases returns.

The market rent dwellings are not subject to Right to Buy or to the allocations of Part VI of the Housing Act 1996. Market rent homes will be let at market rents, which during the tenancy will rise in line with RPI plus 1% per annum. They will generally reflect good quality offers that are currently emerging in the market and supported by institutional investors.

The company has prepared a specification for the marketing and management of the units at Cathedral Court and outsourced this activity along with housing management and maintenance services. This is considered to be the most efficient option at the commencement of its business.

3.3. Sales

On occasions the company will develop homes for sale on sites including Quarles. This will bring capital into the Company and reduce future equity requirements thus improving the returns to funding ratio to the Council.

3.4. Council funding and financial return

The Council will provide loans priced for a commercial rate of return which will be in line with prevailing market rates, and terms and conditions. The funding profile of each loan will be tailored to the requirements of that project.

The loans will be provided on a per project basis and will be fully State Aid compliant and provided on a commercial basis. Initially a State Aid Report was provided by Savills Corporate Finance for the Cathedral Court Development. A new report based on the current financial climate post EU referendum and the Company's proposed portfolio has been produced by Savills.

Standard funding principles are proposed with weighting assumed against the higher risk loans/investment levels and lower cost funding for the lower risk loans. Loans to the company for developments will be provided for the funding of specific assets. As it is the intention of the company to hold the properties for the long term, and as the loans are secured against the assets, the majority of loans will be provided as long term commitments. Should there be a requirement within a scheme to fund over a shorter period, shorter term funding arrangements can be applied provided the basis of repayment is assured, and the financial model evidences viability.

MLH will be involved in both the development of properties and the operational letting of properties, accordingly, both development funding and operational/investment funding terms will be provided. The repayment profiles will be set and contracted within the respective loan agreements. The tenor of Operational/Investment period loans will need to be sufficient to ensure full repayment of the Councils loan commitment.

The Council will provide the senior and sub debt funding to the development projects on a fixed rate basis in order to protect against exposure to interest rate risk. There will be a new loan for each new facility, and potentially staged draw downs. Tranches of loans to the company will relate to specific schemes over time. Havering Council as the provider of equity funding will receive dividends on the equity invested through share subscription, subject to performance. Any sub debt facility provided will generate interest and repayment of capital during the operating period. Once invested equity will remain within the company for the long term.

Havering Council as funder will receive security. Funds provided for the funding of projects will be secured on assets via a debenture. Final sign off for each development will be through the submission of a detailed appraisal of the project inclusive of a funding request, prepared by the company – the viability assessment.

In addition to loan facilities the company will require at least for the first few years a working capital facility. This facility will provide funds to the company to cover costs until such time as the rental income from developments is such that the company will be self-sufficient.

In arriving at a suitable funding arrangement a number of factors have been taken into consideration:

- The Council's objectives of generating a revenue return

- The need to establish the company as a sound and viable long term business
- State aid regulations
- HMRC considerations.

The principals of the lending outlined above are set out in a three documents developed by the Council in conjunction with Mercury Land Holdings. These are as follows:

- Overarching agreement
- Senior and sub debt agreement
- Working capital facility.

The following is a summary of the facilities which the business will require:

Facility	Purpose	Type	Repayment	Comment
Working capital	To fund day to day operations.	Floating rate chargeable on outstanding balance.	From cash flow, priority above dividends in the cash cascade.	365 day facility, annually renewable. Limit and servicing in accordance with the company business plan.
Equity	As equity investment within the business, and apportioned/provided as investment into development projects on a per project basis.	Shareholder investment in exchange for shares.	From dividends, or in certain circumstances from repurchase of shares, or sale of shares to a third party.	
Sub debt	Ranks below senior debt loans and above equity. Attracts interest and therefore enables a regular income return. Fully amortises.	Proposed as fixed rate	Service of interest and capital. Profiled within the financial model.	
Senior debt	Highest ranking loan. Fully amortises in a straight line.	Fixed rate. Lowest rate of the products.	Service of Interest and capital profiled within the financial model.	

4. Market Commentary

4.1. Overview

MLH at this point remains confident in market sale and the rental market in Havering. However a number of issues determine that caution is required.

London house price growth is slowing and prices could well start to fall if the economy slows significantly ahead of Brexit and risinginflation that puts pressure on household finances. The prime central London market has seen price falls of c 5% over the past 12 months which is mainly due to the impact of changes to stamp duty land tax on £1.2m + properties, although there is some evidence that the decrease in value of sterling has encouraged some overseas purchasers. However more affordable areas of London are seeing significantly more activity e.g. areas outside travel zones 1 & 2, where demand is supported by domestic buyers underpinned by a continued low interest rate environment and low supply.

The downside risks to the housing market are milder than the events that led to the 2008 financial crisis. However, political and economic uncertainty may curtail housing market activity as discretionary buyers exercise caution following the referendum and the June 2017 election. The potential for banks to tighten lending criteria further presents a longer term risk to market activity, especially among first-time buyers and second steppers. This could mean that UK housing transactions, which reached a post credit crunch high of 1.3 million transactions over the past year, fall back. It is likelyhowever that any resultant slow down in the sales market would lead to an even further increased demand for rental properties than exist at present.

4.2. Romford/Havering Housing Market

Property website Rightmove's House Price Index shows that buyers are widening their net in a bid to find more affordable housing, with increased demand pushing prices up on the outer edges of London in places such as Havering. Havering saw the biggest annual London house price increase in 2016, with the average house price increasing by £40,000 to £392,000 whilst still £200k less than the London average. Buyers are also being drawn by the new Crossrail stations under construction in Romford, Gidea Park and Harold Wood – which are due to open in 2018. A summary of typical current prices is set out below:-

Type	price	psf
Romford - 1 bed new build flat	£250,000	£460 psf
Romford - 2 bed new build flat	£330,000	£440 psf
Romford - 2nd hand 3 bed house	£450,000	£360 psf
Harrold Wood - 1 bed new build flat	£300,000	£510 psf
Harrold Wood - 2 bed new build flat	£380,000	£500 psf

One of the features of the Romford town centre market is the lack of significant new build starts. This is primarily because completed development values need to achieve c £425/450 psf + for major projects to move into profitability - given the existing use value of development sites and the cost of new build construction. This tipping point has now been reached.

<u>Recently Completed schemes</u>

Hexagon – permitted development – 80 flats
Oldchurch – Swan housing completed final phase of 65 flats in 2017

Schemes Under construction

Kings Park, Harold Wood – Countryside – 1000 units through phased completions. Successful scheme, has driven up values.

Planned schemes

Crow Lane, Romford – 150 units
143 North Street, Romford – 40 flats
Dovers Corner, Rainham – 396 units. Has planning permission.
23–25 North Street, Romford – 100 flats
Decathon Site, Angle Way, Romford – 350 units. Old planning permission, but still live.
St Georges Hospital – 279 units
Broadway Parade, Hornchurch – 70 units
89 New Road, Rainham – 59 units
35-87 New Road, Rainham – 248 units

Havering Housing Supply

Year	Total	Private	Affordable
08/09	678	377	301
09/10	515	196	319
10/11	254	161	93
11/12	592	592	445
12/13	497	182	305
13/14	962	645	317
14/15	748	419	329
15/16	1,155	778	401

4.3. Build to rent market

The Build to Rent market is an expanding sector where operators, often backed by financial institutions, are competing with the traditional buy to let landlords by offering professionally managed homes designed with their tenants needs in mind. Knight Frank predict that £50 billion will be invested by institutions in the sector over the next 5 years. The majority of the existing stock is in London (c 13,000 units) and developers are now focusing more in the regional cities such as Manchester and Birmingham where the yields are higher. Schemes are getting larger, with 100 + units being the norm offering the potential to provide other services to tenants.

The fundamentals of the buy to rent sector are strong. People need somewhere to live. There is a desire to live in cities in areas with good transport connections, there is a shortage of accommodation and many cannot afford to buy. In addition, there are an increasing number of employees whose contracts or visas are temporary, so many individuals prefer to rent rather than buy.

Developers vary the level of service and amenities provided within their schemes depending on their target tenant market and their ability to charge increased rents, so will consider concierge, gyms, free wifi, break out spaces, cycle repair facilities, cafes etc., but will also be focusing on anticipated occupancy levels and gross to net income efficiencies.

The design of the accommodation needs to increasingly reflect the demographics of the demand – whether individuals, sharers, and/or families etc. For example a family may prefer a two bed one bath, sharers a two bed two bath and others an enclosed kitchen.

Operational efficiencies are really important. Every £1 of operational savings equates of £25 in value. Opportunities to reduce costs include providing the optimum level of amenities, fitting out the accommodation with durable fixtures which need little or no maintenance, efficient parcel delivery, rubbish systems that cope with recycling demands, minimise staffing, energy efficiencies etc. Rent collection technology and automated letting and tenancy renewal procedures will further improve efficiencies and reduce costs.

MLH is adapting to this market place and in purpose built schemes such as North Street, Hornchurch is tailoring its proposed schemes to the rental market.

From the tenants perspective, flexibility on the length of tenancy, streamlined contract administration, immediate responses to queries and repairs, transparent procedures, a clear understanding of their responsibilities (i.e. no hidden fees), an understanding of the deposit protection process and reasonable rent increases are important areas to focus on to achieve an outstanding level of customer care and corresponding satisfaction. If the property is managed efficiently there will less tenant turnover, it will increase the number of tenant referrals and enhance the operational brand.

In summary MLH remains confident in the Havering rental and sale market. It is cognisant of potential economic uncertainty but with infrastructure spending and the regeneration effect impacting East London, it is felt that housing sale and rental prices will continue to increase

5. Company structures and administration

5.1. Introduction

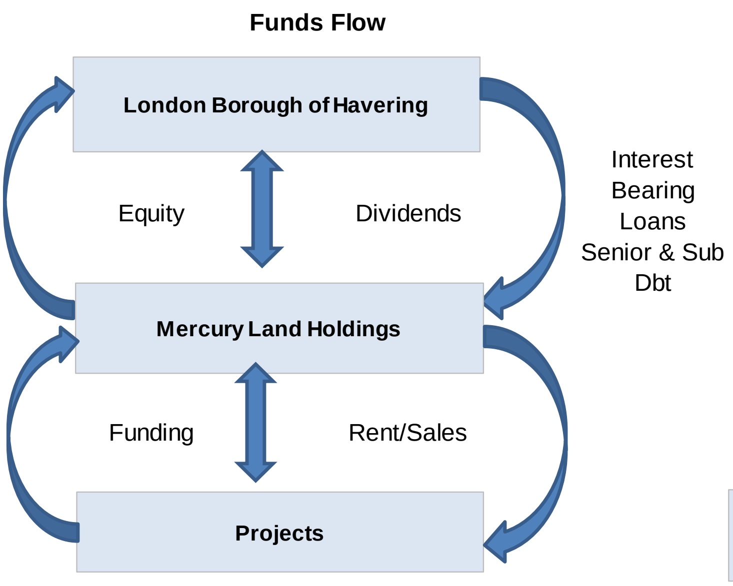
The company was incorporated on the 18th November 2015 as a private limited company wholly owned by the London Borough of Havering.

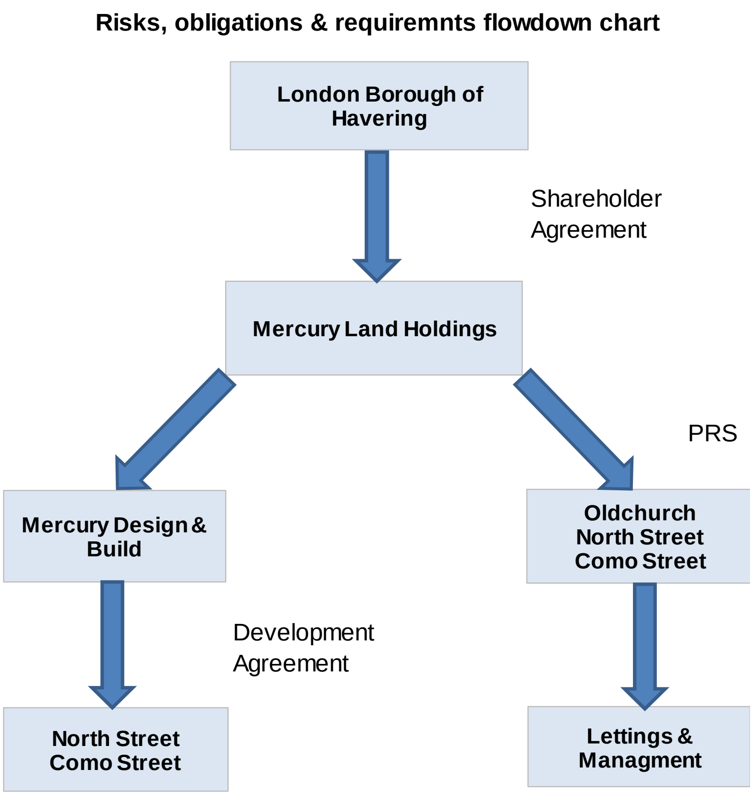
The Company's purpose is set out formally in its Articles of Association and Memorandum of Agreement. These form the Company's constitution and set out its objectives.

The company operates through its own management board (appointed by the shareholders). The Memorandum and Articles define the responsibilities of the directors, the kind of business to be undertaken, and the means by which the shareholders exert control over the board of directors. It also sets out the arrangements by which proceeds will be redistributed back to the shareholder.

5.2. Contractual structure and relationships

The following diagram is intended to illustrate the current structure in place for the projects and the risk flow-down.





MLH is a single company owned by the Council. MLH will take out loans and request investment from the Council in its role as funder and enter into the developments. MLH through its wholly owned subsidiary (Mercury Design and Build) will develop properties, to maximise potential tax savings. Resources are provided to the company through the Council and through MLH on the basis of full costs incurred. Developed properties will be let and managed by Mercury Land Holdings and it will be this company that will receive rents.

5.3. Company status as a commercial operation

The Housing Company is a 100% subsidiary of the London Borough of Havering operating in an arms- length capacity operating in a commercial manner and reporting to its shareholders.

The company has a commercial corporate governance structure, which includes Council officers and includes appointments from outside of the Council so as to bring in experienced market expertise. The Company will comply with UK Company accounting and operating requirements, appoint auditors, pay tax, and complete annual returns.

As the business of the company is for the long term ownership and letting of homes for market rent, and to develop homes for sale, the business will need to engage with partner suppliers including building contractors, letting agents & consultants. The company may also from time to time have a requirement to sell assets predominately units for sale.

The Council are the shareholders and have control of the company and its assets. This also means that the shareholders are responsible for its liabilities and are able to benefit from profits and ultimately any value accumulated through the assets.

The Council also fulfils the separate role as funders of the business and funders of the development projects. As funder the Council will have different and specific interests relating to its role as a lender.

There are therefore two different business relationships with the Council which will form part of the future ongoing business arrangements each with its own governance. The Council's two roles are separate, and are managed within the Council separately. The relationship to the Housing Company is arms-length for both roles.

The key financial considerations from the respective interests include:

a) The returns to the Council as shareholders and funders
b) The performance of the Company, so that it is projected to be viable and operate profitably over the longer term.
c) The funding requirements, for both the operation of the company, and the funding of projects.

5.4. Company costs and budget

Although the company so far only has the Cathedral Court development of 65 properties it requires a minimum level of resource to operate as a coroprate body and to enable the development of future schemes.

The company will be developed in accordance with the Business Plan. The principle for the growth of the company is to organically evolve, matching staff resource with work load associated with the development contracts.

The business has only a small scale operation of core staff essential to enable its development to a fledging commercial operation. This business plan has made an allowance for staffing costs to assist this development. Currently certain of the appointments are staff who will are a shared resource between the Council and the Company, the company compensating the Council for the cost of their time.

The following posts are currently occupied:

- Development Manager – commercially focused with development appraisal experience.
- Financial Manager – to maintain the financial modelling for business cases, business planning & statutory records and accounts as well as operating as the company secretary

Future appointments are proposed as follows:

- Project Manager – to act as client in managing delivery of schemes (it is likely this resource will be from ED and charged time at an appropriate market rate)

- Procure professional individuals as required, e.g. chartered surveyors and Employees Agent.

These posts are a mix of temporary and part time staff. Once the company has become established the intention is to recruit market experienced staff to fulfil specialist functions such as potentially those relating to housing management. The budget below allows for the costs of the current and proposed staffing required.

The other costs included allow for the running costs associated with running a company. It should be noted that the budget below does not include any of the running costs of current or proposed developments.

	2017-18 £'000	20018-19 £'000	2019-20 £'000	2020-21 £'000	2021-22 £'000
Wages and Salaries	226	251	258	266	274
Office Rent and services	3	3	3	3	4
IT	10	11	11	11	12
Post, Printing and Stationery	0	0	0	0	0
Travel and subsitence	1	1	1	1	1
Conferences and training	2	2	2	2	2
Professional Fees	24	24	25	26	27
Insurances	1	1	1	1	1
Bank	1	1	1	1	1
Contingency	12	12	13	13	14
VAT	56	61	63	65	67
	337	**368**	**379**	**390**	**402**

5.5. Tax and Accounting

Specialist tax and accounting advice has been sought including general advice in respect of the company, and which is relevant to the projects. Advice has been received from the Company's appointed advisors Mazars. Further and more specific advice will be procured as the company and individual schemes progress. This is required to ensure compliance and consideration of tax liabilities within the Business Plan. It is noted that tax considerations are subject to change dependent on prevailing HMRC requirements.

Where possible, and in accordance with market practice the company will seek to use tax and accounting advice to ensure that it operates in line with market convention, and is not disadvantaged by deal structure and associated costs relevant to tax and accounting practices. This will also ensure that the company is protected from challenge and operates in a professional and compliant basis.

Advice as relevant to each scheme will form part of the development of a scheme and the assumptions with advice (where relevant) will form part of the respective viability assessment report.

As the company development has progressed further advice has been sought in respect of (amongst other matters):

- The impact on the Councils accounts, and any matters that require consideration for the Council in respect of audit,
- Effective tax and accounting, such as for SDLT, and other taxes, relevant to the company and in relation to the treatment of the debt and equity finance.
- Treatment of VAT, timing and eligibility for VAT registration.
- The potential cost of irrecoverable VAT and appropriate treatment.
- The creation of Mercury Design and Build Ltd and associated tax issues

The intent is to be prudent, ensure compliance, and to build the business going forward on an informed and efficient basis, giving consideration to the impact of the business on the accounts of the Council.

6. Sites acquisition and development

6.1. Introduction

The company buys land from the Council at market value in order to satisfy the Council's best value requirement, state aid requirements and to ensure it is compliant with the Councils general consent to dispose of land at best value, so no special consent would be needed

In terms of a financial payment from the company to the Council for land it is proposed that funding is satisfied through a mix of share issued to the Council, and a loan from the Council.

This business plan is based on three developments. These developments are:

- Cathedral Court, Romford which has already been developed and is partially let
- North Street, Hornchurch which has current planning permission and is in the business case development stage
- Quarles Campus which is still at the design stage.

6.2. Cathedral Court Wideford Drive, Romford

The freehold interest of Cathedral Court – a residential block of 65 flats - was purchased off plan by MLH for £16.5m ie £345 psf from the developer - Swan Housing. Completion was in April 2017. The flats are let at the open market rent on standard residential tenancy agreements. The estimated rental value is £930k pa – which equates to a gross yield of 5.5% before operating expenses. The business plan is to hold the units as a long term investment. Occupancy is significantly ahead of forecasts, and capital growth is likely to be c£3m this year, given market evidence of £420 psf is the current market level for new build properties close to the ring road.

Cathedral Court is located in the Oldchurch residential district of south east Romford circa 10 minutes walk from Romford Station and 5 minutes from Queens Hospital. Access will improve in the short to medium term with a new crossing planned across the ring road. Vehicular access is via Oldchurch Road and an internal estate road known as Crown Drive. The building is adjacent to Jubilee Park as well as a cleared development site fronting Union Road, which has planning consent for a four storey school building – to be operated by Concordia Academy.

The property is a 5 story rectangular shaped brick clad residential building completed in April 2017 comprising 65 flats. (13 one beds, 36 two beds & 16 three beds) which are accessed via 4 lift cores. The flat roof is arranged as a terrace for the use of the occupiers of the building.

Accommodation

Beds	No.	Av. Flat Size (Sq.Ft.)
1 Bed Units	13	538
2 Bed Units	36	763
3 Bed Units	16	968
Total	65	49,945

In addition there are 65 car spaces, both Wideford Drive and underground spaces in the communal car park below block C.

Cathedral Court was designed as a 'for sale scheme' by the vendor – and there was limited opportunity for contract variations. In summary the specification is mid range and entirely appropriate for the target market, including wood laminate flooring in living rooms, carpets in bedrooms, laminate kitchen surfaces, AEG kitchen appliances, recessed lights in the living and bathrooms, pendent lights in bedrooms, wall mounted radiators, video entry system, hyperoptic internet etc. Fitted wardrodes in the 2nd bedrooms, wifi, curtains, sockets with integrated USB power outlets and kitchen carosels were added following MLH's purchase.

Mercury Land Holdings owns the freehold interest of Cathedral Court and a 999 year long leasehold interest from the 18th July 2016 on 50 covered allocated car parking spaces.

There are no legal or planning restrictions on the use of the accommodation or claw back provisions if any of the flats are sold in due course.

The accommodation is let on an Assured Shorthold Tenancy Agreement compiled by Freeths LLP. At the time of preparing this business plan all flats are let. This is significantly ahead of schedule. Our financial plan was assuming the development would have been 50% let by the end of June.

A summary of the key information for Cathedral Court is shown below.

PRS		Per Unit			Total site	
	Total Units No.	Monthly Rent £	Build Cost £000's	Market Price £000's	Build Cost £000's	Market Price £000's
1 Bed Units	13	975	185	208	2,411	2,799
2 Bed Units	36	1,273	263	278	9,479	10,361
3 Bed Units	16	1,368	334	308	5,340	5,102

6.3. North Street Hornchurch (Proposed)

MLH has been working on this scheme for over one year, following the LBH decision to dispose of this site. MLH has prepared and successfully acheived a resolution to grant planning permission for 44 flats. MLH has prepared and successfully achieved planning permission for 44 flats on this 0.7 acres developmentsite, subject to signing of the S106 Agreement. The plan is for MLH to purchase the site, implement the consented scheme and hold as a long-term investment. MLH has begun the tender process for construction partners, and following return of tenders will submit for Board and shareholder approval to deliver the scheme.

After the approval of this buiness plan a full business case will be provided to the Council to approve the go ahead on the scheme and appoint its contruction partners.

The property is situated between Emerson Park BR Station (Romford to Upminster line) to the north and Hornchurch High Street to the south both circa 10 minutes walking distance from the site. Immediately adjacent is the Queen's Theatre (a 500-seat purpose built theatre), Menthorne Place (a four storey purpose built block of 18 flats – built in 1970s) and the Billet Lane surface car park (94 spaces). Langtons Registry Office and Hornchurch Library are also nearby.

The square shaped slightly sloping 0.7 acre site comprises circa 13 local authority operational public car spaces and the demolished and fenced off former Nalgo social club. There is a substation on the northern boundary and a public recycling facility on the southern boundary fronting the Queen's Theatre.

Application (ref P0960.16) was submitted by MLH for the construction of a three and five storey building comprising 44 residential units and 42 car spaces. The Committee resolved to grant detailed planning consent at the meeting held on 28 April 2017 subject to the signing of the section 106 Agreement. The Section 106 Agreement will be signed by MLH following purchase of the site. The main payment is a payment for education provision of £264,000 (index linked) payable in instalments – 50% prior to commencement and 50% prior to occupation. There no affordable housing provision as long as the units are to be used as private rented housing for 15 years. If sold within this period a disposal viability appraisal will need to be undertaken to ascertain the provision of affordable provision that is required.

Proposed accommodation is shown in the table below.

Beds	No.	Av. Flat Size (Sq.Ft.)
1 Bed Units	11	548
2 Bed Units	33	871
Total	44	34,766

The heating system is self contained with individual gas boilers – otherwise the proposed specification will be similar to Cathedral Court – i.e. wood laminate or similar flooring in the living rooms, carpets in the bedrooms, fitted ward rodes, laminate kitchen surfaces, wifi enabled.

Other information for the scheme is shown below

PRS		Per Unit			Total site	
	Total Units No.	Monthly Rent £	Build Cost £000's	Market Price £000's	Build Cost £000's	Market Price £000's
1 Bed Units	11	1,000	196	248	**2,161**	2,725
2 Bed Units	33	1,300	312	382	**10,299**	12,618

Depending on the timescale for approval of this business plan and the proceeding business case the proposed timescales for this develeopment are set out as below.

Complete detailed design	May 17
Release tender packages	Jun 17
Tender returns expected	Aug 17
Purchase site	Oct/Nov 17
Start on site	Jan 18
Complete construction	Mar 19

6.4. Quarles

MLH has been working with the Council to deliver an opportunity to develop a site on the old Quarles campus site in Harold Hill to deliver in the region of 99 units for resale both into the private (65%) and the affordable (35%) housing market.

Currently the site comprises the main college building, 2 and 3 storeys, and various single storey and two storey buildings spread over the site. The buildings are set within a 9.28 acre site, with a field to the rear, part line-marked as sports pitch, and a number of car parks throughout.
It should be noted that the proposals for this scheme are still under consideration so the numbers of properties assumed and the financial detail are subject to change. At this stage the Quarles campus numbers used in the business plan are indicative only to enable the plan to be completed.

The site is located approximately 3 km north of Harold Wood Train Station, with direct services of 35m to London Liverpool Street. Harold Wood Station will become a Crossrail station, which will see direct trains to Bond Street in 42m and Heathrow 68m as well as more frequent services and improved capacity.

A summary of the proposed scheme detail is shown below:

Beds	No.	Av. House Size (Sq.Ft.)	No. Baths
3 Bed Units	40	936	1
4 Bed Units	50	1302	2
5 Bed Units	9	2002	2
Total	99	56,180	

The key financial information assumed in this plan is as below.

		Per Unit			Total site	
	Total Units No.	Monthly Rent £	Build Cost £000's	Market Price £000's	Build Cost £000's	Market Price £000's
Private Sale						
3 Bed Units	19	N/a	226	400	4,287	7,600
4 Bed Units	36	N/a	314	475	11,298	17,100
5 Bed Units	9	N/a	483	550	4,343	4,950
Affordable Sale						
3 Bed Units	21	N/a	226	223	4,738	4,680
4 Bed Units	14	N/a	314	265	4,394	3,705

6.5. Development Funding

Development funding for the three schemes Cathedral Court, North Street and Quarles campus is set out below.

The funding is a mixture of equity, mezzanine and senior debt, debt attracting interest at fixed commercial rates, arrangement fees and commitment fees.

The peak debt is £23,648k and equity investment of £16,726k.

For Cathedral Court a senior debt interest rate of 6.11% has been used whilst for both North Street and Quarles a senior debt rate of 4.91% and a mezzanine debt rate of 8.00% have been assumed with all rates in line with the prevailing interest rates and relevant state aid funding requirements that are affordable to the company.

Development funding interest costs are capitalised as the company does not have relevant rental income for the relevant scheme during the development period. Within 12 months after the completion of the scheme the development costs and capitalised interest are refinanced with operational finance loans. These loans are annuity based with principle being repaid over the loan life.

6.6. Pipeline Schemes

MLH continues to review opportunities reactively and proactively. However no assumptions have been made in this business plan for any potential schemes other than those above.

LBH are authorised to negotiate suitable arrangements with appropriate developers including MLH, who will be acting in a commercial capacity, to deliver the Council's vision and delegate approval of the terms of such arrangements to the Portfolio Holder for the Romford Housing Zone.

7. Rental business

7.1. Introduction

This chapter provides a summary of the data and assumptions that have informed this business plan for Mercury Land Holdings (the Company).

The key objectives are to assure that the Company is able to meet its financial obligations in terms of interest and principle repayments of the total development costs over a 40 year period.

The modelling has been undertaken using a comprehensive model on a scheme by scheme basis and an aggregated set of financial statements.

The following table shows the aggregate number, cost & value of flats across both PRS and its build to sell schemes.

		Per Unit			Total site	
	Total Units No.	Monthly Rent £	Build Cost £000's	Market Price £000's	Build Cost £000's	Market Price £000's
PRS						
1 Bed Units	24	986	191	230	4,572	5,524
2 Bed Units	69	1,286	287	333	19,778	22,979
3 Bed Units	16	1,368	334	319	5,340	5,102
Private Sale						
3 Bed Units	19	N/a	226	400	4,287	7,600
4 Bed Units	36	N/a	314	475	11,298	17,100
5 Bed Units	9	N/a	483	550	4,343	4,950
Affordable Sale						
3 Bed Units	21	N/a	226	223	4,738	4,680
4 Bed Units	14	N/a	314	265	4,394	3,705

The above market values are correct at the time of refinancing and rental levels are based on those currently being achieved at the Cathedral Court development.

7.2. Development of properties

The table below identifies the key development information of the three schemes.

	Total	2016-17	2017-18	20018-19	2019-20	2020-21	2021-22
	£000	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Development							
Land	10,779	-	2,572	-	8,207	-	-
Development	47,675	16,306	4,193	6,324	6,604	8,999	5,249
Capitalised Interest	4,759	153	422	377	781	1,046	1,542
	63,212	16,459	7,187	6,701	15,592	10,045	6,792
Funding							
Share Capital		8,615	8,735	8,735	16,726	16,726	16,726
Mezzanine Debt		-	6,034	6,330	10,293	10,595	10,889
Senior Debt		7,844	9,066	15,425	19,053	28,394	34,493
		16,459	23,835	30,489	46,072	55,715	62,108

The land costs are based on market value at the time of purchase and development costs are based on either contractor actuals or estimates verified by independent quantity surveyors and cost consultants.

Development costs have been spread to reflect actual valuations on the completed scheme and evenly across the anticipated development period on the others.

It has been assumed that at the point of taking out operational financing loans that the amounts above are used for the relevant scheme at the appropriate time. Any terms finally agreed will need to be in line with State Aid requirements applicable at the time the financing is undertaken

An arrangement fee of 1.25% applies to each loan taken out as well as a Commitment Fee of 0.47% per quarter and a lenders agency fee of £20,000 per annum. These fees are in line with the commercial sector and therefore in line with state aid.

7.3. Rental income & operating costs

Once completed the flats are leased on the private rental market on either one to five year agreements.

The average rentals used in this plan are shown in the table below

PRS	Per Unit Total Units No.	Monthly Rent £
PRS		
1 Bed Unit:	24	986
2 Bed Unit:	69	1,286
3 Bed Unit:	16	1,368

The modelling has to make provisions for the loss of rental income for when a property is void inbetween lettings. Obviously with demand being high in the Borough for quality market rented properties the void period would expect to be on the low side.

Therefore void loss as percentage of gross rents has been modelled at 2.0% for the properties. In addition a provision has been made of 2% of annual gross rent income to place in a bad debt reserve in case of the need to write-off bad debts. Within the model certain assumptions have been made, it is assumed that the flats will be re-let annually, the fee is assumed to be 5% for a new let and 1% for a continued let.

MLH currently has a contract with HERA for the provision of housing management services including general management and rent collection costs, repairs management and letting costs. This amount is set at 5% of rental income exc. the re-let costs shown separately above.

To ensure that all rental properties are maintained at an appropriate standard in terms of day to day repairs and minor void repairs an annual net allowance of £550 per property has been made. In addition an allowance for lifecycle costs has been made on each scheme. This amount varies for each scheme each year but aims to provide an average of £1500 per annum per property.

Costs of communal services provided are included. Such costs include landscape maintenance, lift maintenance, communal lighting and Wi-Fi provision.

Bank fees and interest costs are payable to the Council on the basis of the loan agreements. In addition the provision of the working capital facility to the company attracts an interest rate of 6% per annum when utilised.

As the Company will be a separate legal entity to the Council there are some unavoidable operating costs. In summary, these cover the cost of external audit of the accounts, Board expenses and external accountancy support. These costs are summarised below are charged to each scheme on a per rented unit basis. More detail on these figures is shown in Chapter 3 of this business case.

	2016-17	2017-18	20018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-2031	2031-36	2036-41	2041-46	2046-51	2051-56	2056-61	2061-66
	1	2	3	4	5	6	7	8	9	10	11-15	16-20	21-25	26-30	31-35	36-40	41-45	46-50
	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's	£000's
Wages and Salaries	222	226	251	258	266	274	279	285	291	296	1,573	1,737	1,918	2,117	2,338	2,581	2,850	3,148
Office Costs	16	17	17	18	18	19	19	19	20	20	107	119	131	145	160	176	194	215
Professional Fees	23	24	24	25	26	27	27	28	28	29	153	169	186	206	227	251	277	305
Other	69	70	76	78	81	83	85	86	88	90	477	526	581	641	708	782	863	955
	330	**337**	**368**	**379**	**390**	**402**	**410**	**418**	**427**	**435**	**2,310**	**2,550**	**2,816**	**3,109**	**3,432**	**3,790**	**4,184**	**4,623**

The above costs will be allocated against schemes as and when the scheme becomes operational. An assumption has been made for this plan that there will be 4 PRS schemes to which these cost will apply therefore the total overhead allocation in this plan does not fully recover the overhead.

The table below summarises the overall income and expenditure, the first 10 years are presented on an annual basis and thereafter in 5 year blocks. The table below makes no assumption of dividends distributable to the Council as shareholder.

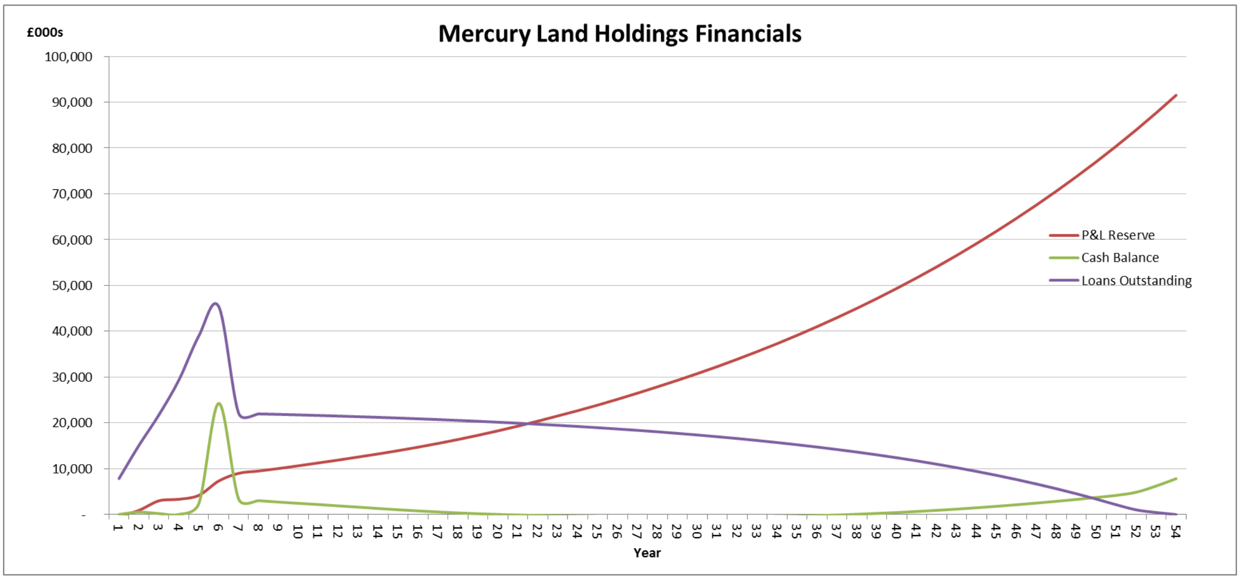
	2016-17	2017-18	20018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-2031	2031-36	2036-41	2041-46	2046-51	2051-56	2056-61	2061-66	2066-71
	1	2	3	4	5	6	7	8	9	10	11-15	16-20	21-25	26-30	31-35	36-40	41-45	46-50	51-55
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	
Income																			
Revenue From Rent	-	828	964	1,642	1,675	1,708	1,742	1,777	1,813	1,849	9,815	10,836	11,964	13,209	14,584	16,102	17,778	19,628	17,164
Non Recurring Revenue	-	-	-	-	481	3,081	1,412	-	-	-	-	-	-	-	-	-	-	-	-
Expenditure																			
Letting Fees	-	38	44	30	30	31	32	32	33	34	178	196	217	239	264	292	322	356	311
Property Management Fees	-	50	58	99	100	102	105	107	109	111	589	650	718	793	875	966	1,067	1,178	1,030
Maintenance Costs	-	-	37	38	65	66	68	69	70	72	380	420	464	512	565	624	689	761	665
Lifecycle Costs	-	-	-	-	12	12	12	13	13	13	422	672	847	1,101	1,216	1,343	1,482	1,637	1,431
Service Charges	-	153	172	225	230	235	239	244	249	254	1,347	1,488	1,643	1,814	2,002	2,211	2,441	2,695	2,356
Bank Fees	172	54	44	80	72	73	52	53	54	55	292	323	357	394	435	480	530	585	323
Interest Costs	153	592	753	1,351	1,332	1,327	1,321	1,316	1,310	1,304	6,413	6,193	5,899	5,503	4,969	4,246	3,262	1,916	347
Overheads	-	88	89	153	156	159	162	165	169	172	913	1,009	1,114	1,229	1,357	1,499	1,655	1,827	1,597
Profit Before Taxation	(325)	(147)	(234)	(334)	159	2,784	1,164	(221)	(194)	(165)	(721)	(115)	707	1,624	2,900	4,442	6,330	8,675	9,103
Taxation	-	-	-	-	-	342	210	-	-	-	-	-	-	165	522	800	1,139	1,561	1,639
Net Profit	(325)	(147)	(234)	(334)	159	2,441	954	(221)	(194)	(165)	(721)	(115)	707	1,460	2,378	3,642	5,191	7,113	7,465
Revaluation Reserve	-	1,378	2,323	673	687	701	715	729	743	758	4,025	4,444	4,907	5,418	5,982	6,604	7,291	8,050	7,039
Dividends Paid	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Retained Income	(325)	1,231	2,089	339	846	3,142	1,669	507	550	593	3,304	4,330	5,614	6,877	8,359	10,246	12,482	15,164	14,504
Cumulative Retained Income	(325)	906	2,995	3,334	4,180	7,322	8,991	9,499	10,048	10,642	13,946	18,275	23,889	30,767	39,126	49,373	61,855	77,019	91,523

Assumptions for inflation have been applied to the profit and loss statement above as follows.

- Rent in the business plan assumed is in line with the long term national assumption on inflation i.e. CPI at 2%. No assumption is made for real growth over the term of the business plan. However, rents will in reality fluctuate around this assumption. Actual rents will be set at the market rate applicable at the time.
- Retail price inflation 2% applied to all costs including development costs where relevant
- House price inflation 2% (for use on balance sheet)

From the P&L account it can be seen that the company does not start to make an operating profit until 2020/21 however under FRS 102 property revaluation reserves flow through the P&L into retained income. This is due in main to the delay in rental income flowing through until schemes are completed against the company overheads costs, bank interest and bank fees on an annual basis.

The P&L account position is summarised by the chart below:



7.4. Cash Flow

The table below summarises the overall cash flow of the Company, the first 10 years are presented on an annual basis and thereafter in 5 year blocks.

	2016-17	2017-18	20018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-2031	2031-36	2036-41	2041-46	2046-51	2051-56	2056-61	2061-66	2066-71
	1	2	3	4	5	6	7	8	9	10	11-15	16-20	21-25	26-30	31-35	36-40	41-45	46-50	51-55
	£000	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Inflows																			
Rental Income	-	828	964	1,642	1,675	1,708	1,742	1,777	1,813	1,849	9,815	10,836	11,964	13,209	14,584	16,102	17,778	19,628	20,021
Sale Proceeds	-	-	-	-	3,485	23,056	11,494	-	-	-	-	-	-	-	-	-	-	-	-
Sr Debt Drawdowns	7,691	9,704	6,230	10,054	8,999	5,249	-	-	-	-	-	-	-	-	-	-	-	-	-
Mezzanine Debt Drawdowns	-	6,017	94	6,538	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Working Capital Facility	200	200	-	270	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Equity Investment	8,615	8,735	-	11,729	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Inflows	16,506	25,484	7,287	30,233	14,159	30,014	13,236	1,777	1,813	1,849	9,815	10,836	11,964	13,209	14,584	16,102	17,778	19,628	20,021
Outflows																			
Developer Costs	16,306	6,765	6,324	14,811	8,999	5,249	-	-	-	-	-	-	-	-	-	-	-	-	-
Selling Costs	-	-	-	-	61	404	201	-	-	-	-	-	-	-	-	-	-	-	-
Operating Expenses	-	241	311	392	438	446	455	464	474	483	2,917	3,427	3,888	4,459	4,923	5,435	6,001	6,625	6,758
Overhead Costs	-	88	89	153	156	159	162	165	169	172	914	1,009	1,114	1,229	1,357	1,499	1,655	1,827	1,863
Bank Fees	172	195	81	599	258	114	60	53	54	55	293	323	357	394	435	480	530	585	597
Sr Debt Interest	-	161	464	576	811	807	892	799	794	789	3,863	3,697	3,482	3,206	2,848	2,388	1,793	1,026	847
Mezzanine Debt Interest	-	72	289	365	520	519	539	517	516	515	2,550	2,496	2,416	2,297	2,121	1,859	1,469	890	745
Sr Debt Repayment	-	8,841	41	6,691	76	80	19,156	89	93	98	573	739	954	1,230	1,588	2,048	2,643	3,410	3,589
Mezzanine Debt Repayment	-	1	6	2,895	12	13	4,480	15	16	17	111	164	244	363	539	802	1,191	1,770	1,916
Equity Withdrawl/Reallocation	-	8,615	-	3,738	-	-	7,991	-	-	-	-	-	-	-	-	-	-	-	-
Taxation	-	-	-	-	-	342	210	-	-	-	-	-	-	165	522	800	1,139	1,561	1,658
WC Facility Repayment	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Outflows	16,478	24,979	7,605	30,220	11,331	8,135	34,147	2,102	2,116	2,130	11,219	11,854	12,455	13,343	14,333	15,310	16,421	17,695	17,972
Net Cash Movement	28	505	(318)	13	2,828	21,879	(20,911)	(325)	(303)	(281)	(1,405)	(1,018)	(491)	(134)	251	792	1,357	1,933	2,048
Opening Balance	-	28	533	215	228	3,056	24,935	4,024	3,699	3,396	3,115	1,711	692	202	68	319	1,111	2,468	4,401
Movement	28	505	(318)	13	2,828	21,879	(20,911)	(325)	(303)	(281)	(1,405)	(1,018)	(491)	(134)	251	792	1,357	1,933	2,048
Closing Balance	28	533	215	228	3,056	24,935	4,024	3,699	3,396	3,115	1,711	692	202	68	319	1,111	2,468	4,401	6,450

The Internal Rate of Return based on the above values is calculated as 8%.

An overall working capital facility of £3m currently exists and there is no need in this plan to increase that figure.

7.5. Long term value of business

	2016-17 1	2017-18 2	20018-19 3	2019-20 4	2020-21 5	2021-22 6	2022-23 7	2023-24 8	2024-25 9	2025-26 10	2026-2031 11-15	2031-36 16-20	2036-41 21-25	2041-46 26-30	2046-51 31-35	2051-56 36-40	2056-61 41-45	2061-66 46-50	2066-71 51-55
	£000	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Total Assets	16,134	24,941	33,684	45,001	65,145	69,430	39,799	40,203	40,643	41,121	43,742	47,168	51,584	56,868	63,100	70,497	79,145	89,129	91,292
Total Liabilities	7,844	15,300	21,954	24,940	44,239	45,382	22,073	21,969	21,860	21,745	21,061	20,158	18,960	17,367	15,240	12,389	8,555	3,375	(8,965)
Net Assets	8,290	9,641	11,730	20,060	20,906	24,048	17,726	18,233	18,783	19,376	22,680	27,010	32,624	39,501	47,861	58,107	70,590	85,754	100,258
Equity	8,615	8,735	8,735	16,726	16,726	16,726	8,735	8,735	8,735	8,735	8,735	8,735	8,735	8,735	8,735	8,735	8,735	8,735	8,735
P&L Reserves	(325)	906	2,995	3,334	4,180	7,322	8,991	9,499	10,048	10,642	13,946	18,275	23,889	30,767	39,126	49,373	61,855	77,019	91,523
Shareholders funds	8,290	9,641	11,730	20,060	20,906	24,048	17,726	18,233	18,783	19,376	22,680	27,010	32,624	39,501	47,861	58,107	70,590	85,754	100,258

The loan balances initially increase as the schemes are fully developed and then gradually reduce as loan repayments are made.

The initial cost of building the properties is shown on the balance sheet in the first line revalued to open market value where currently available and on an annual basis and shown as the revaluation reserve in Shareholders funds. An inflation rate of 2% per annum is assumed for property values

The Equity input from the Council is not officially repaid and is shown as an investment set against the property values.

Market Values are forecast to increase by 2% long-term with the properties potentially being worth £79 million in 45 years' time.

In the above tables no dividends have been forecast.

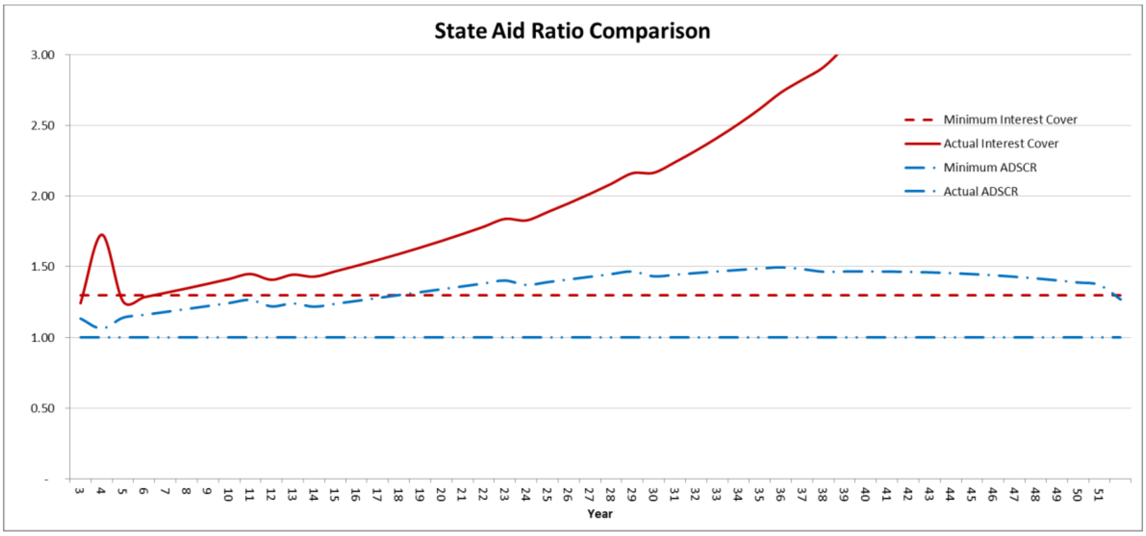
7.6. Interest Cover ratios

Any commercial lender would require MLH to meet a minimum requirement for interest cover. The two measures are the Minimum Interest Cover ratio and the ADSCR (Average Debt Service Coverage Ratio). In effect both of these ratios measure whether the company has sufficient income to cover its debt servicing requirements.

The usual required rates are as flows:

- Minimum Interest Cover 1.30
- ADSCR (Average Debt Service Coverage Ratio). 1.00

The chart below identifies the ratio performance for MLH for the three combined schemes. The minimum interest cover performance is slightly below the required amount for the first 5 years whilst the schemes reach maturity.



8. Council financial return

8.1. Introduction

The Council is committed to funding the Company by way of equity and a series of development and operating senior and mezzanine debt. The loans are secured against the properties in order to receive revenues from agency fees, commitment fees and interest. The rates have been set by reference to the latest State Aid Report prepared by Savills in March 2017. The table below shows the rates applied for each development.

Loan Arrangement Fee	1.25%
Commitment Fee (DSRF)	0.47%
Commitment Fee	0.50%
Lenders agency Fee per loan	£20k per annum
Senior Debt Development Phase APR	4.9% (Libor + 3.75%) (exc. Cathedral Ct)
Senior Debt Operational Phase APR	5.13% (PWLB 50 yr. fix + 2.20%)
Mezzanine Debt Development Phase APR	8.00%
Mezzanine Debt Development Phase APR	8.00%

8.2. Shareholder/investor

The company will operate in the same way as any other private sector company, driven by the requirement to provide a return to its shareholders and to operate in a commercial manner. The London Borough of Havering is both shareholder/investor and lender to the company.

8.3. Lender

The Company borrows on commercial terms from the London Borough of Havering Council acting in its capacity as lender at terms that are compliant with the advice in the State Aid Report prepared by Savills.

8.4. Projected financial return for the Council

The table below sets out the forecast returns to the Council - the first 10 years annually and thereafter in 5 year blocks.

	2016-17	2017-18	20018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-2031	2031-36	2036-41	2041-46	2046-51	2051-56	2056-61	2061-66	2066-71
	1	2	3	4	5	6	7	8	9	10	11-15	16-20	21-25	26-30	31-35	36-40	41-45	46-50	51-55
	£000	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Profit & Loss Account																			
Retained Income	(325)	1,231	2,089	339	846	3,142	1,669	507	550	593	3,304	4,330	5,614	6,877	8,359	10,246	12,482	15,164	14,504
Cumulative Retained Income	(325)	906	2,995	3,334	4,180	7,322	8,991	9,499	10,048	10,642	13,946	18,275	23,889	30,767	39,126	49,373	61,855	77,019	91,523
Investment Return																			
Arrangement Fees	152	154	40	536	193	48	15	7	7	7	39	43	47	52	58	64	70	77	49
Agency Fees	20	41	42	64	65	66	45	46	47	48	254	280	309	342	377	416	460	507	273
Interest Payment Receipts	153	611	1,131	1,527	2,064	2,562	1,758	1,316	1,310	1,304	6,413	6,193	5,899	5,503	4,969	4,246	3,262	1,916	347
Total Return on Investment	**325**	**806**	**1,212**	**2,126**	**2,322**	**2,677**	**1,818**	**1,369**	**1,364**	**1,359**	**6,705**	**6,516**	**6,255**	**5,897**	**5,404**	**4,726**	**3,792**	**2,501**	**670**

The returns to the Council figures are shown as a return on senior and mezzanine debt only. It should be noted that these figure include an assumed increase in value of the properties and reflected in the profit and loss in accordance with FRS102.

9. Risks & Sensitivities

9.1. Financial sensitivities and risks

Project and funding risks are shown in the risk matrix below.

The company operates a risk register and the management will be responsible for risk management, risk reporting, and reporting regularly to the board. The risk register will include mitigation measures as part of the operational processes of the business.

9.2. Risk and sensitivity analysis results

A number of scenarios have been run to test the assumptions in the plan and to identify the potential issues. These are shown below. Following on from this is a table looking at other possible risks / sensitivities from a financial view point.

Baseline Position

	2016-17	2017-18	20018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-2031	2031-36	2036-41	2041-46	2046-51	2051-56	2056-61	2061-66	2066-71
	1	2	3	4	5	6	7	8	9	10	11-15	16-20	21-25	26-30	31-35	36-40	41-45	46-50	51-55
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
Profit & Loss Account																			
Retained Income	(325)	1,231	2,089	339	846	3,142	1,669	507	550	593	3,304	4,330	5,614	6,877	8,359	10,246	12,482	15,164	14,504
Cumulative Retained Income	(325)	906	2,995	3,334	4,180	7,322	8,991	9,499	10,048	10,642	13,946	18,275	23,889	30,767	39,126	49,373	61,855	77,019	91,523
Investment Return																			
Arrangement Fees	152	154	40	536	193	48	15	7	7	7	39	43	47	52	58	64	70	77	49
Agency Fees	20	41	42	64	65	66	45	46	47	48	254	280	309	342	377	416	460	507	273
Interest Payment Receipts	153	611	1,131	1,527	2,064	2,562	1,758	1,316	1,310	1,304	6,413	6,193	5,899	5,503	4,969	4,246	3,262	1,916	347
Total Return on Investment	325	806	1,212	2,126	2,322	2,677	1,818	1,369	1,364	1,359	6,705	6,516	6,255	5,897	5,404	4,726	3,792	2,501	670

Rent increase 1% per annum (rather than 2%) Case 1

	2016-17	2017-18	20018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-2031	2031-36	2036-41	2041-46	2046-51	2051-56	2056-61	2061-66	2066-71
	1	2	3	4	5	6	7	8	9	10	11-15	16-20	21-25	26-30	31-35	36-40	41-45	46-50	51-55
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
Profit & Loss Account																			
Retained Income	(325)	1,224	2,072	295	786	3,103	1,593	398	423	449	2,293	2,787	3,462	4,195	5,243	6,508	8,065	10,015	9,844
Cumulative Retained Income	(325)	899	2,971	3,266	4,052	7,155	8,749	9,147	9,570	10,019	12,311	15,098	18,560	22,755	27,998	34,507	42,572	52,587	62,431
Investment Return																			
Arrangement Fees	152	154	40	536	193	48	15	7	7	7	39	43	47	52	58	64	70	77	49
Agency Fees	20	41	42	64	65	66	45	46	47	48	254	280	309	342	377	416	460	507	273
Interest Payment Receipts	153	611	1,131	1,527	2,064	2,562	1,758	1,316	1,310	1,304	6,413	6,193	5,899	5,503	4,969	4,246	3,262	1,916	347
Total Return on Investment	**325**	**806**	**1,212**	**2,126**	**2,322**	**2,677**	**1,818**	**1,369**	**1,364**	**1,359**	**6,705**	**6,516**	**6,255**	**5,897**	**5,404**	**4,726**	**3,792**	**2,501**	**670**

If the rent increase is limited to 1% per annum for the lifetime of the plan profits will be reduced as expected as rental income is the largest number in the plan. In reality rental inflation is unlikely to remain at this level for 50 years and would more likely go in cycles. 2% reflect the long term average for CPI measure of inflation. If rental income was to be below forecast for any reasonable amount of time the company would look to reduce operational costs or need to negotiate with the Council regarding financing costs or potentially sell some properties depending on the sales market at the time.

Interest rate (operational) 1% increase Case 2

	2016-17	2017-18	20018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-2031	2031-36	2036-41	2041-46	2046-51	2051-56	2056-61	2061-66	2066-71
	1	2	3	4	5	6	7	8	9	10	11-15	16-20	21-25	26-30	31-35	36-40	41-45	46-50	51-55
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
Profit & Loss Account																			
Retained Income	(325)	1,199	1,961	186	619	3,052	1,482	278	320	362	2,139	3,149	4,427	5,864	7,742	9,876	11,764	14,702	14,411
Cumulative Retained Income	(325)	874	2,836	3,022	3,641	6,693	8,175	8,453	8,773	9,135	11,274	14,423	18,850	24,713	32,455	42,331	54,095	68,797	83,207
Investment Return																			
Arrangement Fees	152	154	40	536	194	49	16	8	8	8	45	49	55	60	67	74	81	90	57
Agency Fees	20	41	42	64	65	66	45	46	47	48	254	280	309	342	377	416	460	507	273
Interest Payment Receipts	153	643	1,258	1,679	2,290	2,789	1,985	1,544	1,539	1,534	7,572	7,367	7,079	6,673	6,100	5,287	4,128	2,468	453
Total Return on Investment	**325**	**838**	**1,340**	**2,279**	**2,549**	**2,905**	**2,047**	**1,598**	**1,594**	**1,590**	**7,871**	**7,696**	**7,443**	**7,075**	**6,544**	**5,777**	**4,668**	**3,065**	**784**

Under this scenario the rate of return is greater for senior a mezzanine debt as expected with the interest rate being higher. Any further increase in interest costs would have a greater effect. This demonstrated below. In reality increases in interest rates are likely to lead to a slowdown in the housing market and therefore a potential increase in the private sector rental market.

Interest rate (operational) 2% increase Case 3

	2016-17	2017-18	20018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-2031	2031-36	2036-41	2041-46	2046-51	2051-56	2056-61	2061-66	2066-71
	1	2	3	4	5	6	7	8	9	10	11-15	16-20	21-25	26-30	31-35	36-40	41-45	46-50	51-55
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
Profit & Loss Account																			
Retained Income	(325)	1,167	1,834	34	392	2,962	1,294	49	89	131	971	1,960	3,221	4,655	6,554	8,880	11,793	14,654	14,305
Cumulative Retained Income	(325)	842	2,676	2,710	3,102	6,064	7,359	7,407	7,497	7,628	8,598	10,559	13,780	18,435	24,989	33,869	45,663	60,317	74,621
Investment Return																			
Arrangement Fees	152	154	41	537	195	50	18	9	9	10	51	56	62	69	76	84	93	102	65
Agency Fees	20	41	42	64	65	66	45	46	47	48	254	280	309	342	377	416	460	507	273
Interest Payment Receipts	153	675	1,385	1,831	2,516	3,016	2,213	1,772	1,768	1,764	8,734	8,549	8,276	7,874	7,278	6,392	5,069	3,083	574
Total Return on Investment	**325**	**869**	**1,467**	**2,432**	**2,776**	**3,132**	**2,275**	**1,828**	**1,824**	**1,821**	**9,039**	**8,885**	**8,648**	**8,284**	**7,731**	**6,892**	**5,621**	**3,693**	**913**

If interest rates at the time of refunding at operational asset stage should be 2% higher than now the company and Council would need to look at potentially refinancing over a shorter period of time, say 5/6 years and using 3 month LIBOR + the relevant margin which would be lower than using the PWLB 50 year fixed rate and refinancing later on.

Development costs 10% greater Case 4

	2016-17	2017-18	20018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-2031	2031-36	2036-41	2041-46	2046-51	2051-56	2056-61	2061-66	2066-71
	1	2	3	4	5	6	7	8	9	10	11-15	16-20	21-25	26-30	31-35	36-40	41-45	46-50	51-55
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
Profit & Loss Account																			
Retained Income	(325)	1,231	786	278	494	1,470	833	450	493	537	3,025	4,059	5,355	6,798	8,305	10,087	12,355	15,080	14,480
Cumulative Retained Income	(325)	906	1,692	1,970	2,464	3,934	4,767	5,217	5,710	6,247	9,271	13,330	18,685	25,484	33,789	43,876	56,231	71,311	85,791
Investment Return																			
Arrangement Fees	152	168	43	589	212	53	17	7	8	8	41	45	50	55	61	67	74	82	53
Agency Fees	20	41	42	64	65	66	45	46	47	48	254	280	309	342	377	416	460	507	273
Interest Payment Receipts	153	613	1,169	1,604	2,194	2,743	1,858	1,373	1,367	1,360	6,690	6,461	6,155	5,744	5,189	4,437	3,414	2,014	373
Total Return on Investment	**325**	**822**	**1,254**	**2,257**	**2,471**	**2,862**	**1,920**	**1,426**	**1,421**	**1,416**	**6,985**	**6,787**	**6,514**	**6,140**	**5,627**	**4,921**	**3,947**	**2,603**	**699**

Any movement in development costs has a minimal effect on the plan. This is because the development costs are refinanced and spread over 50 years. Development costs would have to increase massively to have any real effect.

9.3. Overall financial risk analysis

Risk	Related Sensitivity Analysis	Mitigation
Increase in the cost of funding, not offset by increase in rent inflation.	Case 2, increases of 1% and 2% above current rates.	Housing Company (HC) Could develop to sell, sell existing stock or halt development for rent
Increase in voids	Not shown	Marginal impact. If arising because of lack of demand for accommodation, the company could re-structure the operating model to include other options such as offer short term rental deals to manage the market fluctuation.
Increase in land costs above the rate of increase modelled	Not sensitised, but increase in construction costs has been sensitised.	The impact on potential new developments would be tested as part of the viability test. Typically expect increase in land costs to flow through to increase in rents which would offset the impact. A market increase in rents would also benefit the existing portfolio bringing a net gain.
Increase in build costs	Case 3. Increase of 10%.	This only affects projects up to FC, or where the cost is considered as an overrun. The impact on potential new developments would be tested as part of the viability assessment. The impact could potentially be offset by a market increase in rents. Or determine not to proceed. Increase in build costs may also have impact of increasing market values.
Increase in operating costs	Not run.	This is likely to be an area of cost which the business can manage as appropriate.
Increase in costs of life cycle	Not shown	Business is structured to operate with a maintenance reserve which would help manage the impact of cost rises. Likely to be an area of cost which the business can manage.
Reduced rent inflation, or fall in rent.	Case 1 Case 5, Reduction in rental income by 10%.	Existing agreements protected by contracted requirement for annual increase of RPI+1. On renewal will be reset to market rent levels. In part can be addressed through the management of the business by a corresponding reduction in costs. If rent does not increase over a period this is likely to be a response to demand. Ongoing and persistent reduction in rent could otherwise be addressed by reduction of exposure through effective management of the portfolio, selected disposals and crystallising of value. The HC could also offer units at affordable rates with support of the council. If this problem developed early on, the vehicle would not continue developing and if it came later would have enjoyed benefit of previous inflation.
Decrease in assumed growth of property prices	Not shown	Provided rent levels are not also adversely affected then there is no short term impact on the company. Over the longer term property prices are expected to increase and there is therefore opportunity to recover any lost value. The wider scheme carries the benefit of portfolio built over time. Therefore generating a build up of equity value in the assets across the portfolio,enabling down turn periods in property values to be managed. Sales could be perceived in the event of failure to let.
Failure to deliver programme on time – timing risk affecting cash flow	Not shown	Outcome shows marginal impact. Business would need to adjust its growth plan and manage its overheads budget accordingly. The HC’s obligation to make contractual loan payments would need to be met. Some protection may be available through the construction insurance packages if the event has arisen at the fault of the contractor.

9.4. Other risks

Risk	Related Sensitivity Analysis	Mitigation
Lack of available sites/opportunities	Not a sensitivity	HC will need to compete for land as it becomes available. An option would be
Increase in competition	Not a sensitivity	The majority of private rent landlords (relative to the number of units) typically own just a single or small number of properties. Currently there is only limited corporate competition in the Borough, but larger scale investment is now being seen. In order to compete in the market,
Lack of public sector funding- cap on Council borrowing capability	Not a sensitivity	The policy of using Council funds is to: a) help establish the company, so that it adds value, b) To enable a flow of income into the Council by way of interest margin, and returns.
Withdrawal of PWLB	Not a sensitivity	As per response directly above. Council finance also has additional Treasury
Political risk affecting the sector	Not a sensitivity	Considered unlikely in the current environment with significant demand for housing. In the event of a change, the business could decide to sell units or
Funding terms at transfer pricing requiring adjustment to meet market	Not a sensitivity	In the event that transfer pricing recommends an adjustment, the model would be updated accordingly. This could either reduce or increase the overall level of return, and/or the number of units. The impact will be seen on a per
H.M. Treasury intervention	Not a sensitivity	As per response for withdrawal of PWLB, dependent on the nature of the intervention. If there is intervention to restrict the size of financial exposures
Change in tax environment- Higher tax levels	Not a sensitivity	Higher tax levels would be included in any viability assessment and their impact flowed through into the business plan. It may reduce returns or
Change in law risk	Not a sensitivity	Could be additional cost, use of maintenance budget would be redirected in first instance. Or sale of units used to fund more major cost requirements if
Design risk	Not a sensitivity	Risk is that the design does not meet purpose, or is insufficient to attract tenants. Use of professional advisors and architects should mitigate this. The
Portfolio size fails to meet required economies of scale	Not a sensitivity	There are fixed overheads for operating and managing the vehicle. Certain of these overheads are committed as a result of the Cabinet commitment to a Housing Company, generating set up and development costs. Given the fixed nature of these costs, until the portfolio has reached a global mass it is not economic to run the vehicle without reducing costs. The HC will build up the business with each scheme assessed in order to manage other risks. If global mass is not achieved the mitigation is to reduce the overheads.
No investor willing to purchase the portfolio, if the council needs to fully or partially exit.	Not a sensitivity	While the intention is to hold the portfolio in the long term, a mitigant to some of the risks outlined above is for the council to sell all, or a part of its interest in the vehicle to an investor landlord. At present there is an emerging market amongst institutional investors for rental housing products. In addition to institutional investors, some more commercially minded Registered Providers are also starting to move into the private rental market.