



Appendix 1

**Sutton Living Limited
Review of the Business Plan 2018**

**Report by the Managing Director
Sutton Shareholdings Board Meeting 22nd February 2018**

1.0 Executive Summary

- 1.1 Sutton Living (SLL) is now in its third year of operation and has entered its development phase with the submission of its first major scheme, Wallington Public Hall for planning. It has appointed staff with more experience of commercial development and adopted appraisal tools to ensure more viable developments are taken forward. The signing of the loan agreement with the Council and adoption of interest rates for SLL is another step in setting up a development company able to compete and secure Council and private projects.
- 1.2 From reviewing its success in meeting its objectives for 2017/18, it is clear that Sutton Living still needs to market itself within the Council and to wider stakeholders, and underline its core objective of being a commercial company developing a range of homes, building up assets and long-term returns to the Council's General Fund. The stress of the 2017 Business Plan was to focus on acquiring and developing Council owned sites in order to establish a track record and make it attractive to future private sector partners. This approach did not identify and deliver many Council sites, and a number of those that were considered were either too small or expensive to develop. As a result of this the focus in the 2018/19 Business Plan is to concentrate on larger developable sites and the Council's regeneration scheme at Elm Grove, the scale of which makes the company more attractive to private sector development and funding partners.

2.0 Goals for 2018/19

- 2.1 The following Goals are proposed for 2018/19

Development & Procurement

(1) Secure planning consent for Wallington Public Hall; scheme; purchase the site and let a building contract

(2) Develop a scheme In Alexandra Gardens in Partnership with Sutton Housing Partnership

(3) Seek to become a development partner on the Council's Elm Grove Regeneration scheme

Funding

(4) Investigate access to private funding and private site opportunities to augment the development programme and bring additional investment into the Borough

Publicity & Marketing

(5) Hold a mini “relaunch of Sutton Living to raise awareness on the start on site of Wallington Public Hall as part of a wider marketing strategy

Governance

(6) Advertise and appoint a non-executive director from outside the Council

3.0 Background to Business Plan approved February 2016

3.1 The Business Plan for Sutton Living Limited was approved in August 2015, and defined four objectives for Sutton Living Limited (then known as the “DevCo”).

4.0 Sutton Living Objectives

- 4.1
- (1) To deliver new housing in the Borough across a range of tenures;
 - (2) To contribute towards meeting existing and forecast demand for housing for both through development of sites already identified and through development on new sites, yet unidentified;
 - (3) To support the Council’s GLA Housing Zone programme;
 - (4) To contribute to the General Fund through surpluses generated from housing developed.

5.0 Taking each objective in turn, in terms of;

(1) Delivering new housing in the Borough: the Plan pointed out that the Company could do this by building a range of new housing tenures including market rent and sale. It had to do this through the effective commercial operation of the company.

(2) Sutton Living could contribute to the development of sites not in the Council ownership by purchasing private sites, but as drawn to the attention of the Shareholdings Board in subsequent reviews of the Business Plan, this first requires a track record by developing sites acquired from the Council, and then the company could more readily compete with the private sector in obtaining development finance at a competitive rate.

(3) Sutton Living has been keen to support the Council’s Housing Zone bid, but the one private site identified was not proceeded with because it was not commercially acceptable. No other sites in the former Housing Zone have become available, but the Company has established a positive working relationship with the Regeneration Team and Sutton Town Centre Programme Manager. As the result of this the Council’s proposed regeneration of Elm Grove provides an opportunity for Sutton Living to play a major role producing homes for market rent, shared ownership and outright sale to complement affordable housing managed by others.

(4) The long-term aim is to contribute to the General Fund through surpluses generated from housing development and this would be most easily achieved

by undertaking developments for sale and passing over the proceeds of sale net of development profit. The emphasis of the first Business Plan and restated in 2017 was to develop a range of tenures and build up the Company's asset base by developing homes for private rent as well as for sale.

6.0 Goals for 2017/18

6.1 The Business Plan in 2017 set some modest targets for achievement by the year ending 31st March 2018. These related to adopting an appraisal process to assess the viability of scheme, to market the Company and to have a number of schemes in development and management. The five objectives were:

- (1) To adopt an industry accepted appraisal tool to appraise projects at key development stages
- (2) To get a minimum of 30 units in development, from the schedule in Annex A on site by 31st March 2018
- (3) To get 10-12 units to let and in management by 31st March 2018
- (4) To publicise projects to key stakeholders and wider audiences at key stages
- (5) To constantly review new development and funding opportunities and to recommend whether to register with the GLA for grant funding; and investigate the viability of individual leasehold purchase to facilitate longer-term regeneration aims of the Council.

6.2 In terms of achieving those objectives

(1) the "Proval" viability appraisal

system has been adopted jointly by Sutton Living and the Council's Housing Development Team,

(2) Wallington Public Hall will have 31 units in development if planning consent is obtained in March 2018. In addition terms have been agreed to acquire 11 units in a new build scheme to be completed by the Council in 2019.

(3) The third target, to have 10-12 units in management, has not been achieved as SLL was unsuccessful in bidding for various Council assets. Progress on the purchase of other Council assets has been slow either because of valuation or property repair issues. As the first Business Plan concluded in 2015 "the nature of a housing development company is one of continuing opportunity, negotiation and change so that many projects, will be appraised, some will progress, some will be delayed before they progress and others will be discarded" (Conclusion Business Plan 2015).

6.3 In terms of meeting its fourth goal (4), Sutton Living has continued to publicise its activities to key stakeholders but further work needs to be done in this area.

(5) The Company reviewed whether to bid for grant funding from the GLA and recommended subsequently to a meeting of the Shareholdings Board not to proceed at the present time.

6.4 In addition to the targets set out above, in 2017 the interest rates for development and long-term loans were agreed and the funding agreement signed in the summer of 2107. This was key to the ability of Sutton Living to acquire and develop sites

7.0 Current assessment of Sutton Living in relation to its Development Programme

7.1 The first development programme identified a number of sites delivering 273 units over a minimum 5 year term for a mixture of market rent, shared ownership and market sales and affordable homes for rent. Approximately 270 homes were identified on eight Council and private sites, and after sales it was assumed around 220 homes would be left in management at the end of the first funding term.

7.2 The Business Plan in 2017/18 identified a revised programme of between 230 and 250 units in sixteen Council and private sites. These are set out in Confidential Annex A. These have been reviewed and a new development opportunity, the potential regeneration of Elm Grove, has been added. The previous list of sixteen sites has now contracted to nine potential schemes. However, as pointed out in para 5.2 above; in the development process schemes will move in and out of the development programme as the viability of schemes are reviewed.

8.0 Review of the Success of Sutton Living in achieving its planned targets

8.1 Sutton Living's success in achieving its targets, is dependent on number of factors:

(1) Need to have Competitive Funding terms

Sutton Living has the ability to draw down loans with interest rates covering both short-term development and long-term loan repayments. The loans cover 70% of the debt finance for schemes, and the remaining 30% is taken up by Council equity in the scheme. The current borrowing rates for development finance and long-term loans were only agreed in July 2017, so this created a challenge in bidding for schemes before that date. The current rates are relatively high compared with some other wholly-owned Council subsidiaries, but the justification is that they are set at a level to avoid the risk of being challenged under "state aid" rules, and the rates cover the 30% of the Council equity for which there is no additional interest charge. Rates, however need to allow the Company to be competitive in bidding for projects, and need to have some flexibility depending on level of scheme risk. For example, the rate for the affordable element could be less than for private sector rent. Until finance is drawn down borrowing is not protected from the increase in interest rates,

so in the course of developing the Wallington Public Hall scheme the increase of 0.25% in the base lending rate has had an adverse effect on costs.

(2) Support from the Council for the Company's objectives

The significant strength of Sutton Living should be its support from the Council given it is a wholly owned subsidiary serving the wider aims of the Council. However, this support can be qualified when other priorities take precedence. For example, if the Company is presented with sites or property where the priority of the Council is to maximise income for the capital programme through sales, Sutton Living it may not be able to compete on price with developers who are driven by short-term returns. There needs to be agreement on which sites should be sold for maximum return, on which Sutton Living will compete as a short-term developer, and those which should be developed to build up the long-term assets of both Company and Council, and which would be sold on both a qualitative and financial return. In all cases it is important that business assumptions are not compromised in order to offer a higher land figure otherwise Sutton Living will end up developing schemes where the gross development cost of the scheme exceeds the value of the completed units and the scheme would be unviable. The Council needs to balance the benefit of short-term capital income against the long-term growth of Sutton Living and longer-term income to the Council through repayments on the long-term loan.

(3) Clarity about the objectives of Sutton Living

The Company must first and foremost be a commercial business, run a tight business plan, and not undertake loss-making developments. While the Company sets out to have high quality design, this can be achieved without necessarily being expensive. The build cost rate has to be within market parameters otherwise schemes will not be viable. Some expensive design solutions can be difficult to maintain in the long-term. In terms of providing affordable housing, Sutton Living has to comply with the London Plan and Local Plan in terms of the provision of affordable housing. The Mayor's requirement of 50% affordable housing on public land is particularly challenging if no grant is available. This figure is still based on a viability assessment, which Sutton Living will undertake like other developers. Where it differs from other developers is by striving to provide the maximum amount of affordable housing it can in scheme, subject to scheme viability.

(4) Sutton Living needs to restate its identity

Sutton Living also needs to take more active steps to sell itself both with the Council and outside parties, and it is proposed that a "mini relaunch" should take place on the letting of a building contract for Wallington later this year. In addition, the Company should consider developing its own identity starting with its own email address, and develop a marketing strategy and branding to avoid it being confused as being seen as a part of the Council.

(5) Need to consider development and funding opportunities outside the Council

The focus of the 2017/18 Business Plan was to concentrate on developing Council owned sites, then seek development opportunities with the private sector. The experience of the last year would suggested the focus should be more selective on which Council sites are chosen, such as where there is a strategic opportunity for the Company, or where there is strong stakeholder support. Elm Grove regeneration represents a good strategic opportunity and Alexandra Gardens an opportunity of joint working with Sutton Housing Partnership. Opportunities outside the Council should be considered where they generate a good commercial return. In tandem with looking at private sites are private funding opportunities, for example in accessing pension fund money. Sutton Living has been approached by investment consultants and the additional monies they claim they can access could be suitable for larger regeneration initiatives. Confidential Annex A provides more detail of scheme opportunities.

9.0 Governance & Operations

- 9.1 The Governance arrangements are set out in the Shareholder Agreement on which decisions can be taken by the Company and those that need to be referred to the Shareholdings Board. There are also clear fiduciary duties set out for company directors. It is important that any future changes by the Council in terms of governance structures do not take away the ability of the company to act commercially, or affect the fiduciary responsibilities of directors.
- 9.2 As the Company enters its next phase in developing schemes on site this would be an opportune time to appoint a non-executive director with commercial experience from outside the Council.
- 9.3 While outside OJEU procurement rules Sutton Living needs to be transparent in its selection of consultants and contractors. All major appointments (above £50,000) will be made on both a financial and qualitative basis, and building contractors bidding for more schemes of more than £1 million would be expected to be registered on "Constructionline" or similar body, or be from a recognised Registered Provider or local authority framework .

10.0 Core Development Assumptions

- 10.1 The core development assumptions were set out in the initial review of the 2016/17 Business Plan in January 2017. They are attached as Appendix 1.
- 10.2 There are no major changes proposed, but comments are made where relevant.

- 10.3 Under Core Assumptions interest rates have been agreed since the last Business Plan Review; the developer's profit has been set at 15-20% in the light of market trends under Development Assumptions, along with the seeking of 35% affordable housing (subject to viability) on Council land having regard to no grant being sought. While the repayment is set for 50 years for new build schemes, 35 years may be a more appropriate period for refurbishment schemes. An increased provision for voids and bad debts to 6% is proposed for market rent schemes.
- 10.4 Confidential Annex A updates the review of sites carried out in 2017/18 as a list representing opportunities for SLL. They are also predominantly Council owned, and as such provide a better opportunity for Sutton Living to establish a viable programme as opposed to a predominantly private portfolio. The proposed affordable homes target for 2018/19 Business Plan is set at 35%, subject to viability, and will be directed to "intermediate" tenures, and in the case of Council land, may have a nominations agreement attached to it which may affect the price of the land being acquired. The Company will need to ensure that these nominations agreements put forward those who can afford to pay the rents sought and allow the Company to obtain applicants from elsewhere if nominations are not made within a reasonable period of time, in order to minimise rent loss.

11.0 Sensitivity Testing & Risk Register

- 11.1 As set out the last Business Plan, each scheme will be the subject of sensitivity testing to allow for a variety of scenarios, using the Proval Appraisal system using core development assumptions.
- 11.2 The summary of the key strengths, weaknesses, opportunities, and threats to Sutton Living were set out in the March 2017 Business Plan, and are set out in Appendix 2.
- 11.3 Sutton Living's Risk Register is kept under review and presented to each meeting of the Shareholdings Board. Principal risks remain around scheme viability; the level of interest rates and increases in the base rate; and reliance on Council land and funding. Proposals to mitigate these risks are contained in the risk register. In addition, each project will have its own risk register and allocated responsibilities within the development team.

12.0 Conclusion

- 12.1 This review of the Business Plan is an update on one presented to the Shareholdings Board in January and March 2017, covering 2017/18. The objectives of SLL remain unchanged and the key message of this review is that SLL should focus its activities in 2018-19 in securing planning permission, and purchasing Wallington Public Hall, and taking the development on site. It should also seek to become a development partner for the Council's potential Elm Grove regeneration scheme. Sutton Living should also investigate

opportunities for sites and funding outside the Council and seek to remarket itself to the Council and key stakeholders. Above all the Company must act commercially in its business activities.

13.0 Recommendation

- 13.1 That the 2018 Review of the Business Plan, and goals set out in para. 2.1 are agreed.

Mike Kirk Interim Managing Director – Sutton Living Limited 5th February 2018

Appendix 1 Summary of Business Plan Assumptions

Parameters	Terms	Comments updated 22/2/18 - changes proposed are highlighted in bold
Core Assumptions para.3.0		
Term of the Model	50 Years (Year 1 2015/16)	
Scheme payback	Within 50 years	
Inflation	2%	
Real growth	1% above inflation	
Property Growth	3% in appraisals	
Voids & Bad debts	4% for voids and all tenures	A higher percentage should be considered for market rent (6%) because of higher lettings risks
Management costs	£1000 per dwelling	Review annually against actual scheme costs
Maintenance costs	£600 average: but will vary according to unit size and whether units new build or refurbished	Review annually against actual scheme costs
Lifecycle costs	£1222 average commencing year 6: will vary against unit size	Monitor against actual costs
Interest costs	To reflect current market conditions	Interest rates have been agreed for both the development phase and long-term loan
Rent assumptions para. 4.0		
Market rents	By unit size by postcode	Review annually and set for each scheme using RICS accredited Valuer
Affordable rents	To be linked to Mayor of London affordable rent benchmarks	Affordable units in terms of SLL to be linked to Local Housing Allowance
London Living Rent (Intermediate Rent)	To be linked to Mayor of London's London Living Rents (ward-specific rent levels for London Living Rent homes based on one-third of median gross household income for the local borough. The level is based on the borough median, but varies by up to 20 per cent in line with house prices for the ward.	Affordable units in terms of SLL to be linked to Local Housing Allowance

Service charges	Those applicable to scheme and based on recovering expenditure	Service charges form part of the market rent. Charges should recover costs
Development assumptions para. 5.0		
Acquisition land/buildings	Based on RICs Red Book	
Build cost inflation	Based on BCIS and cost consultant review of relevant tender prices	
Developer's profit	Target between 15-20% of total costs depending upon scheme risk	A developer's profit should be included for all units and has been adjusted (to 20-25%) in the light of market trends. It maybe less for PRS schemes where units are not sold
Establishing scheme profit	Residual from scheme Gross Development Value	
Sales Assumptions para.	Market sales based on RICs valuation	Validity three months
	Shared ownership assume average initial tranche of 35%	Current staircasing assumption 1% additional equity sold each year
Rent on retained equity	2.75%	
Grant from GLA	No assumptions on receipt of grant in current Business Plan	Reviewed following the 2017/18 Business Plan and decision taken not to apply for grant
Affordable housing	To seek 35% (subject to viability) on public land in either intermediate rent, or shared ownership	Affordable rented housing will be delivered by the Council's new build programme
Fees & other on-costs para 7.0	15% for professional fees and SLL development allowance	Additional fee of 1½ % for marketing in schemes with outright/shared ownership
Works contingency	3%	Or higher at 5% (more for refurbishment) where risk is judged to be higher. To be controlled by the client and not the contractor
Tax para 8.0		
VAT	To be charged on all fees, and refurbishment works costs	Awareness of different rates (e.g. refurbishment where there is a change of use from commercial to residential).
SDLT	Allowance to be made for SDLT where applicable	

Financial Performance para 9.0		
Internal Rate of Return (IRR)	Schemes cumulatively to achieve 4%	
Net Present Value	Scheme to achieve +NPV	Where evaluating multiple projects NPV can be used to prioritise one scheme over another
Repayment of loan	Within 50 years	For new build schemes. A target for refurbishment is that it should repay in 35 year given the lower element of renewal

Appendix 2

The following SWOT analysis is a summary and update of the key strengths, weaknesses, opportunities and threats to Sutton Living Limited referred to in the February 2016 Plan and updated (*indicated thus*):

Strengths:

- Supporting the Council in maximising housing development in the borough;
- Ability to use internal skills and resources within the Council;
- Knowledge of the borough and its development opportunities;
- Ability to secure funding at competitive rates;
- Council and Senior Councillor support;
- Long term capital growth and scope to repay loans in longer term;
- Intention to hold assets seen as important to the community long-term.

Weaknesses:

- Current higher funding rates reflect a company with no current assets;
- Lack of developable land;
- Low land values compared to much of London;
- Relative lack of experience of housing development/*construction has been addressed by appointing experienced staff*
- Being associated with the perception of the Council as not being ‘commercial’, while at the same time wishing SLL to be an “exemplar” developer;
- Lengthy time scale before significant numbers of homes are available *by adhering to the full pre-application planning process and agreement of terms for council land purchase*;
- Lack of scalability to develop economies of scale;
- Potential for conflicting objectives particularly in early stages e.g. on the true value of land and property disposals.

Opportunities:

- To increase the supply of high quality housing in the borough;
- Ability to assist the Council in supporting its Regeneration initiatives, and in the retention of important buildings by investing in their refurbishment;
- Increasing the range of tenures to help local people to rent or buy a home;
- Ability to bring in suitably skilled external non-executive directors and staff;
- Capacity for increased growth in housing prices from low base;
- Long-term income generation for the general fund.

Threats:

- Development opportunities taken by private sector, especially in the early years until a credible track record is achieved;

- Competition from RPs or PRS providers who are providing for similar client groups; *and competition from developers for Council sites where maximum financial returns are sought*
- Inability to attract suitable staff;
- Challenge from private sector over 'state aid' (low);
- The 'not in my backyard' syndrome and other adverse publicity;
- Land values increase and make development unviable;
- Government clampdown on Council companies/prudential borrowing;
- Impact of Right To Buy extension on new rented housing if provided with grant funding (*decision taken not to register for grant aid in 2017*);
- Increase in interest rates;
- Sustained low period of inflation;
- Inaccurate development appraisal assumptions (*mitigated by use of agreed development assumptions underwritten by specialist advice*).

Annex A Confidential Sites Register

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