CABINET

13 July 2021

Title: Reside Business Plan 2021-26	
Report of the Cabinet Member for Finance, Performance and Core Services	
Open Report with Exempt Appendix A (relevant legislation: paragraph 3 of Part I of Schedule 12A of the Local Government Act 1972)	**For Decision**
Wards Affected: All	**Key Decision:** Yes
Report Author: Hilary Morris, Commercial Director	**Contact Details:** Tel: 020 8227 3017 E-mail: hilary.morris@lbbd.gov.uk
Accountable Strategic Director: Claire Symonds, Managing Director	

Summary

This report seeks Cabinet approval of the Barking and Dagenham Reside Regeneration Ltd Co No: 09512728 (Reside) 2021-26 Business Plan, in line with the requirements of their Shareholder Agreement. Approval of the plan is subject to certain conditions which are set out in the Recommendations below. This Business Plan has been scrutinised by the Shareholder Panel, the advisory body created to monitor and to report to Cabinet on the performance of Companies that the Council has a shareholding interest in. Reside is the company which manages the Reside group of companies.

Importantly, this Business Plan has been developed while still operating in a COVID-19 environment and it is possible that there are further impacts on the Company's ability to deliver business plan outcomes which are not known at this stage. Performance against this plan will be monitored through the Shareholder Panel.

The coming five years are ones of expected significant growth in the number of homes which will be managed by Reside. It is essential that the strategy to scale up operations, to enable successful delivery of affordable homes to working households is robust and fit for purpose.

The Business Plan is contained at Appendix A which is in the exempt section of the agenda as it contains commercially confidential information (relevant legislation: paragraph 3 of Part I of Schedule 12A of the Local Government Act 1972) and the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

Recommendation(s)

The Cabinet is recommended to:

(i) Approve the Barking and Dagenham Reside Regeneration Ltd (Co No (09512728) Business Plan 2021-26 at Appendix A to the report, subject to the conditions set out below; and

(ii) Authorise the Council's Managing Director, in consultation with the Shareholder Panel, to:

(a) approve the final detailed operational model and any costs associated with delivering the Property Management functions and any associated legal or contractual documentation.
(b) approve the strategy for reviewing and updating the Reside Group structure to ensure it is in the best possible position to achieve its strategic outcomes and to fulfil its legal obligations.
(c) take all necessary action to enable Reside to carry out its proposals under the Business Plan and to agree any variations to the business plan or shareholder agreement and enter any agreements or warranties necessary.
(d) take all necessary action to wind up or otherwise repurpose any companies in the structure on behalf of the Council as shareholder and apply for all necessary consents to do so.

Reason(s)
To assist the Council with delivering the Inclusive Growth Strategy and delivering a well-run organisation. This proposal is in line with Recommendation 8 of the independent Growth Commission's report published in February 2016 and is therefore aligned to the Council's 'Inclusive Growth' priorities.

1. Introduction and Background

1.1 The approval of the Reside business plan is reserved to the Council as shareholder under a shareholder agreement entered into with Reside in 2020. This is an executive function exercised by the Cabinet on behalf of the Council as shareholder. In line with that agreement this Business Plan has been produced for Cabinet approval as outlined in the recommendations. This Business Plan is a consolidation of financial and other commitments across a portfolio of multiple legal entities within the Reside Group structure.

1.2 The Business Plans were approved by Reside Board on 20th May 2021; Corporate Strategy Group on 17th June 2021 and have been scrutinised by the Shareholder Panel 21st June 2021 and subject to final revisions recommended for approval to Cabinet on 24th June 2021 subject to the conditions listed in the Recommendations section of this Cabinet report.

1.3 This report highlights the key objectives to be delivered and the period by which the returns are expected in the exempt Appendices.

2. Reside Group performance highlights in 2020/21

2.1 The 2020/21 year has been very challenging with impacts being felt on the construction industry resulting in delays to practical completions on some of the Reside schemes, as well as difficulties in rent collection and securing of sales. Despite these challenges, Reside's end of year 2020/21 financial return to the Council is forecasted to be only a 1% negative variance against the 2020-25 Business Plan target.

2.2 Despite these challenges Reside have reported achievement of several of their 20/25 Business Plan commitments, highlights of which include;

- Making improvements to governance and business planning, which have created the foundations for future success and help to mitigate Reside and the Council from risk.
- Put in place a suite of key policies, procedures, rules and delegations (financial and contractual), and set out a timetable for review.
- Undertaking a Strategic Options Appraisal to support the development of a new Target Operating Model to ensure Reside is set up to succeed and support growth.
- Developing a Target Operating Model framework and approach to take forward future requirements in a strategic and planned way, based on best practice. The outcome of this work and the implementation of any activities required to complete this is a key commitment for the 21/22 financial year.
- Supporting the bringing in-house of legal services relating to leasing structure and sales, reducing costs and improving both the quality of service and commissioning oversight.
- Reviewed and refreshed the Reside brand, including their vision and values and the creation of a new website.

2.3 However, there are a number of areas where further work is required to detail the mix of functions and roles required to deliver Property Management Agreement in the future, hence why the detailed operating model is being reserved for once that exercise has been completed. As such, this plan is another interim business plan until a finalised operating structure and model is agreed.

2.4 It is also acknowledged that due to the complexity of the Reside Group structure, one of the 2020-25 business plan commitments which was to review and refine the structure to ensure it is robust, both from a governance perspective and to optimise Business Plan outcomes is not yet complete. Further work is needed in this area in the coming year to bring this commitment to completion.

3. Reside Business Plan Commitments 2021-26

3.1 The Reside Business Plan identifies some of the activities undertaken in 2020/21 and further activities required in the coming year to scale up operations, in conjunction with expected growth of homes being managed by Reside in the coming five years and it gives a summary outline of the anticipated resources likely to be required in the future, albeit these are subject to approval as part of the detailed operating model.

3.2 The table below shows the projected growth in number of homes planned to be allocated to Reside during the 2021-26 Plan period.

Year	Number of homes
2021/22	1,057
2022/23	1,435
2023/24	2,361
2024/25	3,109
2025/26	3,495

3.3 Reside have set out an intention to deliver services in accordance with organisation values including being resident focused, caring and providing quality services with integrity. These describe the ways Reside will work, inform its desired culture and guide its behaviour in the workplace for the benefit of residents and colleagues.

3.4 Within that values framework Reside have set out a number of commitments for the 21/22 financial year including;

- Reviewing and refreshing its service offer delivered to residents which will include developing an asset strategy based on the costed 30-year stock maintenance programme Reside initiated and developed during 20/21. This is intended to help deliver quality, forecast spend more effectively and ensure Resides properties remain in good condition and lettable for many years to come.
- Reviewing the void specification for existing homes and refreshing the specifications and commissioning arrangements for responsive repairs and voids
- Developing a different service offer for new-build private rented homes so Reside can become the landlord of choice for Private Rented Sector residents. This will include a bespoke responsive maintenance and void works contract which will increase accountability, provide cost transparency, and deliver better services to residents.
- Agreeing the detailed operating model for services delivered under the Property Management Agreement, including the transfer of any agreed functions and resources to Reside
- Re-designing the Finance function to increase capacity and capability within Reside which may include transferring functions and resources from the Council.

3.5 Reside have indicated that at this pivotal development in their transformation journey, additional interim transformation resource is needed to deliver the commitments listed above and which have been factored into the financial model. Identification of further permanent resources will be considered and approved as part of the detailed operating model.

3.6 The Plan outlines at a high level a commitment to implement communications and marketing strategies in the coming year and identified that a communication and engagement manager will be required to develop Resides own marketing and engagement strategy. Further detail and an associated timeline still need to be confirmed.

4. Consultation

4.1 The Reside Business Plan has undergone the following consultation:

- Endorsed subject by Corporate Strategy Group in June 2021
- Endorsed by the Shareholder Panel on 24 June 2021
- Commissioner for Inclusive Growth
- LBBD Legal
- Finance Director
- Director of My Place
- Commercial Director

5. Financial implications

Implications completed by: David Dickinson, Investment Fund Manager

5.1 The Reside Business plan includes a 5-year financial plan, which includes forecast returns based on existing homes and sites being developed by the Council / Be First which are expected to go into Reside. This income will form part of, but not all, of the Council's Investment and Acquisitions Strategy (IAS) income target, which also includes net treasury returns and commercial income that is not received from Reside. The Reside contribution to the IAS is the net of:

- the forecast Reside return (the expected profit in the Reside accounts) and
- the loan principal repayments that start two years after a site has handed over (5 years for Gascoigne phase one) and act as a proxy for the minimum revenue contribution required in the Council's accounts;
- capital receipts from Shared Ownership sales; and
- lease payments.

The net contribution to the MTFS, excluding any interest margin, and the number of homes managed by Reside is below:

Forecast Reside Income	2021/22	2022/23	2023/24	2024/25	2025/26
Surplus Rents Payable to the Council (after costs)	£637,000	£1,387,000	£1,287,000	£2,905,000	£2,446,000
Number of homes	1,057	1,435	2,361	3,109	3,495

The MTFS surplus decreases in 2025/26 when loan principal repayments / MRP is required for all the pipeline sites.

5.2 The Reside business plan sets out several financial risks that could potentially impact the return forecast. These forecasts, both for the surplus and for the number of homes being built are subject to several assumptions and risks including:

(i) That Be First can build the pipeline sites at the cost and to the deadlines assumed in their scheme viability assessments. As with any building project there is a risk that costs and / or timescales will change, especially given the additional safety requirements emerging following the Hackitt review. If costs are higher or development takes longer than forecast, then Reside will not be able to deliver the returns shown below.

(ii) Financial allowances for planned and cyclical repairs for the pipeline sites (lifecycle costs). There is a risk that assumptions are either insufficient or the timing of the payments is incorrect, and returns will be lower than forecast. Bespoke lifecycle cost modelling has been completed for a number of the schemes and this is now reflected in the Reside assumptions.

(iii) The financial return is sensitive to changes to rent assumptions, if rent increases or the market rents used as a basis for the affordable rented homes are lower than assumed then the return will be lower than forecast. Reside have amended the rent assumptions (these are included in the report and repeated below). The rent assumptions are more prudent but are still a challenging target to meet. Specifically, the rent assumptions are:

- for existing homes (save for Reside Ltd) rise at CPI+1% for 5 years before reverting to CPI.
- for Reside Ltd's 477 homes there is a "special" assumption of RPI+ ½% based on the assumptions made in the original model. The core assumption for Reside Ltd rent increases has been modelled as RPI+1/2% for 5 years with RPI thereafter (noting RPI and CPI are assumed to converge in 2030).
- for affordable and market rented homes in the development pipeline, as these rents assume an element of "new home" premium these have been frozen at present values until 2023 or for affordable rents handover if this is earlier.
- Affordable (80%) rents increase in the first year after handover at CPI+1%, with this rate of increase continuing until 1st April 2026 when increases revert to CPI.
- Market rents are frozen until 1st April 2023, then then increase at CPI+1% each year until 1st April 2026 when they revert to CPI increases (so allowing for some market catch-up before reverting to a long-term CPI increase)
- Rents have been based on the most recent market appraisal received from Savills, note these are not Red Book valuation.

(iv) Reside is working with Be First to receive regular updated rental valuations for pipeline schemes to ensure any issues with income are highlighted promptly and any adjustments to the assumptions are made.

(v) The numbers are sensitive to changes in sales values for shared ownership homes. Sales values are affected by the housing market in London and other macro-economic factors. Any reduction in sales values both reduces the initial surplus / increases the loss made on the initial shared ownership sale and the amount of rent charged on the retained equity.

(vi) The financial returns have been modelled based on the existing management costs charged to Reside by MyPlace and BDMS. There is a risk real costs maybe lower or higher than these recharges and an accurate understanding of the real cost of delivering these services in the future to Reside is required to ensure the Council fully understands and maximises returns.

5.3 Covid has resulted in greater uncertainty within the rental market, especially around inner-city flats, although the market has continued to grow in and around LBBD. As the country, hopefully, returns to a new normal, a better understanding of both the short- and medium-term impact on the strategy will be known and may require adjustments to the underlying assumptions. Reside have already made the adjustments to the rental assumptions but have also increased the short-term bad debt assumptions. Should these assumptions prove to be overly prudent then there is potentially higher surpluses to the Council but if the level of bad debts does increase significantly, then part of this increase has been factored into the Reside returns.

5.4 **Interest Surplus**

5.4.1 As each scheme complete, the Council retains the freehold / head lease and leases the homes, predominately on 130-year leases to the relevant Reside vehicle. The leases include debt repayment over between 52 and 55 years and a market interest rate, which can vary depending on the tenure type the lease is against. As the interest rate is a market rate, there is a surplus between the cost the Council incurs from borrowing and the return it receives from lending to Reside. This surplus can vary depending on the Council's weighted average cost of borrowing.

5.4.2 The Council's weighted average cost of borrowing has steadily decreased over time as new borrowing made over the past two years has been lower than the council's average borrowing costs. As a result, the interest margin has also steadily increased, resulting in a greater surplus potentially being paid back to the Council.

5.4.3 The rent surplus, while potentially providing additional income to the Council, also provides protection to the Council should returns from Reside be lower than forecast.

5.5 2021/22 and into 2022/23 will see a large increase in properties being managed by Reside and work is being carried out by the Council, Be First and Reside to ensure the handover of these properties is completed in a professional and timely manner to ensure that the properties are fully let or sold within the current model assumptions. In addition, work is being carried out to increase the resources for property management and progressing an asset management strategy. These changes, if fully implemented, should result in Reside providing a more complete and professional Landlord Service and, in turn, this could lead to improved financial performance of the assets.

5.6 The report also covers the management of Private Rent Sector Schemes (PRS), which is a new asset category for Reside. This requires a more focused and commercial approach to letting and work is being carried out with specialists to ensure that Reside is able to compete with more established competitors in this market. It is essential that PRS is managed professionally as they do provide additional surpluses to schemes that support the provision of more social housing but also the market for these types of property is more competitive but also more risky than the provision of social housing.

6. Legal Implications

Implications completed by: Dr. Paul Feild, Senior Governance Lawyer and Ian Chisnell, Major Projects Solicitor

6.1 The Council has a number of relevant powers concerning the formation of trading companies, borrowing and investment activities. Cabinet is requested to:

a) Approve the Business Plan for Reside;
b) Delegate authority to the Managing Director to approve any changes.

6.2 Section 1 of the Localism Act 2011, the general power of competence ("GPC") empowers local authorities to do anything that an individual can lawfully do provided that the activity is not expressly prohibited by other legislation. Activities authorised by the GPC can include investment, trading or charging decisions which may be undertaken through commercial (corporate) vehicles with the primary aim of benefiting the authority, its financial management, its area or its local communities. The power is wide and provided that the specific activity is not expressly restricted or proscribed by other legislative provisions, it will be within the parameters of the GPC power. Caution should be exercised in making decisions to ensure that any investments or loans financed with borrowing further the functions of the Council and are consistent with the prudent management of the Council's financial affairs and associated prudential guidance.

6.3 Reside is a 100% owned company owned by the Council and it manages the other companies in that group. On creation it was a special form of company called a Teckal company which meant it enjoyed a special status within the Council under the Public Contract Regulations 2015 as if it were a department of the Council and dealings between it and the Council are not subject to the UK procurement regime. This status remains post the UK leaving the EU last year.

6.4 The company and the Council have entered into a shareholders agreement. These reserves certain decision making to the Council as shareholder rather than with the directors of the company. That agreement also controls the activities of the other companies.

6.5 Resides business is predominately that of a housing landlord which returns an income to the Council on its investments. That is to say the Council retains the freehold interest and grants a lessor interest to Reside who then in turn grant leases to tenants. The asset including the shares in Reside are within the General Fund of the Council and are to provide a positive rate of return indeed it is a requirement it does so as the Council must not be providing a subsidy (previously called "state aid").

6.6 The business plan is the road map for Reside to deliver its objectives which are set by the Council as shareholder.

7. Other Implications

7.1 **Contractual Issues -** Development of Business Plans is a contractual commitment for all of the Companies and is designed to set the framework by which the strategic direction of each Company is considered and approved or endorsed by the Council as either a major or minor Shareholder.

7.2 **Health Issues -** The proposed Business Plans will have a positive impact on the local community in terms of affordable housing to working households.

Public Background Papers Used in the Preparation of the Report: None

List of appendices:

- Appendix A: Reside Business Plan 2021-2026 (exempt document)