

Financial Appraisal Report - PUBLIC

HRA Capital Project – Construction of 6 new affordable homes at Highams Close, Rowley Regis

Date Issued: 26th May 2022

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Report to Cabinet

1 Executive Summary

Introduction

Regeneration & Economy are seeking approval for a capital project to provide 6 new 4-bedroom houses, on land at Highams Close, Rowley Regis.

The proposed development site is in council ownership and is currently vacant. The site had previously been used for residential housing until demolition in the late 1970s.

There are currently over 9,800 people on the Council's Housing Register, of which approximately a third are existing tenants requesting property transfers. There are around 4,054 applicants eligible for a 1 bed property, 3,175 eligible for 2 beds, 1,693 for 3 beds and 638 waiting for a 4 bedroom home. In Rowley Regis, there are 735 people on the Housing Register, with 48 households eligible for a 4-bedroom house. Forecasts suggest that the need for housing over the next 18 years will increase further, with a projected 32% increase for 1 bed homes, 17% for 2 bed homes, 14% for 3 bed homes & a 40% increase for 4 bed homes.

Strategic Finance has been asked to carry out an appraisal of the funding application, which has been evaluated against HM Treasury Green Book guidance. The appraisal process recorded a score of 77%, with some areas of risk identified.

Project Objectives

- To increase the number of authority owned stock and reduce the amount of under-utilised land within council ownership.
- To support the Council's Vision 2030, where Sandwell has many new homes to meet a full range of housing needs, in attractive neighbourhoods and close to key transport routes.

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Project Details

The proposed residential site will provide the following:

- 4-bedroom semi-detached house (103 sqm) x 4
- 4-bedroom detached house (115-118 sqm) x 2

The proposed development site is currently held as an asset in the Council's General Fund Account and will require appropriation to the Council's Housing Revenue Account. Planning approval for the proposal is expected by July 2022, with project completion due by October 2023.

Total project costs have been estimated by Urban Design & Building Services. The Council's Right to Buy Receipts will be used to fund 40% of the total cost, with the remaining funding to be provided by the Council's Housing Revenue Account via prudential borrowing. This will incur additional borrowing costs of £0.852m over a 40-year period, with an assumed interest rate of 2.66%. However, it is advised that alternative internal funding options will be explored in order to reduce borrowing costs further.

The proposed project is expected to generate a net rental income of £2.619m over a 40-year period.

Scope and objectives of financial appraisal

The purpose of financial appraisals is to consider the guidance provided by HM Treasury in evaluating business case proposals and assessing the potential risk to the Council in achieving its objectives. The following components and risks are assessed:

HM Treasury Green Book	Potential Risks
<u>Strategic Case</u> Objective, need, demand and reasonableness	Insufficient justification for project/will not meet strategic objectives
<u>Economic case</u> Option analysis and risk	Poor use of council resources & excessive risk to Council
<u>Commercial Case</u> Legal and statutory implications	Project may contravene legal/statutory regulations
<u>Financial Case</u> Affordability	Proposals are not affordable or realistic
<u>Management Case</u> Governance, project management, monitoring and evaluation	Non-delivery of project and outputs

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LEVEL OF ASSURANCE GAINED FROM FINANCIAL APPRAISAL

Limited (0%-65%)	Satisfactory (66%-80%)	Substantial (81%-100%)
There is a high risk of objectives not being met due to insufficient assurance within the project proposals. There is limited evidence to confirm that the risks to the Council could be adequately mitigated.	There is adequate assurance that objectives could be met, but further actions are required to adequately mitigate the risk to the Council.	There is good assurance that objectives will be met, with little risk to council resources.

Overall Conclusion

The appraisal scored 77% and provides **satisfactory assurance** over the adequacy of the proposals.

Financial appraisals will identify the following levels of issues:

Fundamental

Action is imperative to ensure that the objectives of the project are met

Significant

Action is required to avoid exposure to significant risks in achieving objectives

Merits Attention

Action is advised to enhance operational efficiency

Summary of key issues identified

- The financial appraisal has identified NO ‘fundamental’ issues
- The financial appraisal has identified 1 ‘significant’ issue
- The financial appraisal has identified 1 ‘merits attention’ issue

2 **Issues Arising**

Action is required to avoid exposure to significant risks in achieving objectives
Significant

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2.1 Economic Case – Value for Money & Option Analysis

(a) Construction costs average £0.372m per property, although it is acknowledged that the use of HRA balances will reduce the level of borrowing to £0.223m per property. Whilst estimated construction costs have been measured against the Building Cost Indices for the West Midlands region and it is recognised that there has been a significant increase in construction costs in recent months, the following should be noted:

- i. The unit cost does not include the value of the land, which if included, would increase average unit costs by a further £0.032m.
- ii. It is understood that the site has never been marketed for sale and therefore the level of market interest from private developers is unknown.
- iii. A contingency of 10% has been included within the estimated costs but it is unclear how reasonable this is due to the recent and continual increase in construction costs.
- iv. Construction costs for 4-bedroom houses appear high in relation to current property prices within the area, where prices range from £0.235m for an ex-council owned semi-detached 4 bed to £0.425m for a detached 4-bedroom house. However, it is acknowledged that high construction costs per unit will be partly due to abnormal ground conditions of the site, current market conditions within the construction industry and the development of small sites, which do not offer economies of scale.

Whilst local authority housing generally provides larger homes with a higher build quality than those of private developers, and privately purchased homes potentially require adaptations/modifications for council house use, it is still not clear whether all other options have been fully explored to deliver the Council's objectives at a lesser cost.

Such options may include site disposal, purchase of privately owned properties, alternative house types/construction methods or a temporary delay to construction to develop other sites at a lower cost.

Implication:

That the proposed option may not optimise value for money for the Council.

Recommended Action:

That Cabinet consider the alternatives and are satisfied that the proposal to construct the new build homes will meet the Council's objectives in the most appropriate manner.

(b) A list of sites for the Council's house building programme was provided, identifying council owned sites with potential for future development. Whilst

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the proposed site was included within the programme, it was unclear how sites are prioritised for development or the process for evaluation and approval.

Implication:

That development of the proposed site may not offer the most effective use of the Council's resources.

Recommended Action:

That a process is developed to prioritise the development of sites against pre-determined criteria and alternative options for achieving the Council's housing objectives within each locality.

Action is advised to enhance operational efficiency
Merits Attention

2.5 Economic Case – Strategic Asset Implications

The proposed development site is currently held as an asset within the Council's General Fund. Local authority housing is required to be shown as assets within the Housing Revenue Account. The proposed site is currently valued at £0.190m on the General Fund Asset Register.

Implication:

If the site is not appropriated from the Council's General Fund to the Housing Revenue Account at the value held on the Council's Asset Register, the correct accounting treatment of council assets may not be undertaken.

Recommended Action:

That the site is appropriated from the Council's General Fund to the Housing Revenue Account and the corresponding adjustment to the Capital Financing Requirement made to reflect the appropriation.

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