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| Agenda Item No: | 6 |  |
| Committee: | Cabinet/Investment Board | |
| Date: | 19 May 2025 | |
| Report Title: | Grounds Avenue – Development and Lease – to support Housing Duties | |

Cover sheet:

1 Purpose / Summary

- 1.1 To consider proposal to commission Cornerstone Place to develop land at Grounds Avenue, March and enter into relevant legal documentation to lease the land to a Registered Provider (RP) for 125 years with the Council providing directly the required management and support to the residents in the properties.

2 Key Issues

- 2.1 The Council currently accommodates at any one time around 30 households that require assistance under homelessness legislation in accommodation that is not Housing Benefit Subsidy compliant which places significant additional pressure on the Council's budgetary provision.
- 2.2 Therefore, in accordance with the Medium-Term Financial Strategy it is a financial priority of the Council to reduce this pressure by providing a housing benefit subsidy compliant alternative.
- 2.3 The Council has commissioned Cornerstone Place to deliver a solution to make a significant saving to support the Council's duties and responsibilities in relation to housing. In summary:
- 2.4 At risk costs to the Council is circa £92k based on 12 units (refunded to the Council on progression of the scheme post planning)
- Final numbers may adjust subject to grant levels, borrowing rates and availability of other grant pots.
 - Annual savings to the Authority circa £188k
 - FDC to retain nomination rights with the properties let through a partner RP.
 - FDC would hold all repairs, void and administration responsibility – recoverable through exempt rents as part of the benefit system
 - Still some unknowns (eg ground conditions, local ecology) to manage as part of the planning process. Site has an existing planning permission.

- FDC retains option to remove RP at any time for the cost of any outstanding debt plus fees
 - Transparent process – built at cost – FDC in control of decisions
 - Capital funding for delivery of the project not required from FDC and no requirement for FDC to borrow money from Public Works Loan Board
- 2.5 A project plan has been produced with the aim to have the properties in place by October 2026.
- 2.6 In terms of legal agreements, the Council will enter into the following agreements with Cornerstone Place / RP:
- 125-year Lease agreement with the RP.
 - Management agreement for FDC to have 100% nominations and directly provide the support and management.

3 Recommendations

- 3.1 Cabinet is recommended to delegate to the Section 151 and Monitoring Officer in consultation with the Portfolio Holder for Housing and the Leader to:
- Agree to enter into agreement with Cornerstone to develop the Grounds Avenue site to provide 12 properties to support our Housing Duties
 - Agree to enter into a 125-year lease with an RP for the land.
 - Agree to enter into a management lease with the RP to enable the Council to control the nominations into and undertake the management and support responsibilities.
 - Agree to the at-risk costs of circa £92k dependent on a planning permission, securing an RP and the relevant grant funding and private finance, all to be refunded at funds drawdown.

| | |
|------------------------|---|
| Wards Affected | All |
| Forward Plan Reference | KEY/04APR25/01 |
| Portfolio Holder(s) | Cllr Chris Boden – Leader and Portfolio responsibility for Finance Cllr Sidney Imafidon – Portfolio Holder for Assets Cllr Sam Hoy – Portfolio Holder for Housing |
| Report Originator(s) | Dan Horn – Assistant Director |
| Contact Officer(s) | Dan Horn – Assistant Director Carol Pilson – Corporate Director & Monitoring Officer Peter Catchpole – Corporate Director & Section 151 Officer |

4 BACKGROUND AND INTENDED OUTCOMES

- 4.1 Cornerstone Place have previously supported the Council in partnership with the YMCA to bring a hostel in Wisbech back into use after being a long-term empty property.
- 4.2 The Council have been working on a range of projects to reduce the penalties through the benefit subsidy system on the Council's finances in meeting its housing duties. Projects have included purchase of properties through the Local Authority Housing Fund programme, as well as the purchase of additional properties throughout the district.
- 4.3 With the new focus on capital financing required for the Fenland Inspire! programme, brought about from the Local Government Reform, the Cornerstone Place "Impact First Social Housing Model" (IFSHM) at Grounds Avenue allows the Council to have control on 12 more properties to support homeless households without the Council having to provide the capital finance.

5 REASONS FOR RECOMMENDATIONS

- 5.1 The IFSHM allows the development on Council assets and buildings where the Council retains the freehold and control and is funded through eligible rents and grants.
- 5.2 The Council has land at Grounds Avenue, March with existing permission for 6 units. Following a marketing exercise, there was no interest from the market. In light of this priority focus to reduce the pressure financially through undertaking our housing duties, the site is therefore perfect to achieve significant Council savings with no capital outlay.
- 5.3 The IFSHM model also:
 - Delivers Net Zero New Build properties:
 - Triple glazing
 - Air Source Heat Pumps
 - Mechanical Ventilation and Heat Recovery system
 - Solar Panels
 - Extensive insulation
 - Modern Methods of Construction (MMC) using a panelised offsite system or category 1 manufacturing and local employment where possible
 - Will work with psychologists and interior designers to create psychologically informed environments

- Building Management System which will enable monitoring in each room of multiple data points including:
 - Moisture levels Temperature Energy usage
 - Volatile airborne compounds levels
 - Lighting levels
 - Movement within the property
- Delivered at cost – no developer profit

6 ALTERNATIVE OPTIONS CONSIDERED

- 6.1 The other option would be for the Council to do the project in house, including planning, raising the finance, project management and raising the capital financing.
- 6.2 Finance colleagues commissioned MUFG Corporate Markets Treasury Services to look at the implications to FDC's balance sheet to the Cornerstone model. The document from MUFG Corporate Markets is attached at Schedule 1 along with a summary from the FDC accountancy team at Schedule 2. Please note the example is not the Grounds Avenue site, another site used for illustrative purposes.
- 6.3 In summary there is little difference to how each model would be accounted for on the Council's balance sheet.
- 6.4 Therefore, it is whether FDC want to project manage delivery of the scheme and raise the capital / relevant loans directly or we commission Cornerstone to project manage and deliver the same scheme with FDC having equivalent control as if we did the scheme ourselves.
- 6.5 Clearly the latter option eases the competing requests for finance from "Fenland Inspire!" funding requests. There is no need for FDC to put any capital in or raise loans. The model means FDC will manage the scheme (staffing and full nomination rights) so have complete control on the lets and performance of the scheme.
- 6.6 The proposal is subsidy compliant.
- 6.7 Cornerstone are proposing to use an established MMC construction to speed up delivery.
- 6.8 Also, it recognises to project manage this scheme in house as well as other projects underway and the Fenland Inspire! work, it is felt that the Cornerstone model will achieve the units more quickly than an inhouse solution.
- 6.9 The "at risk" circa £92k costs for the planning permission that is refunded when successful permission is achieved as funds draw down would be the same for either the Cornerstone model or the Council directly delivered model. There is already an existing permission at this site which is of comfort for this risk.

- 6.10 The Cornerstone project is delivered at cost with the project management fee, with full transparency.
- 6.11 Therefore, on the basis that the Cornerstone model can deliver all the benefits as if the scheme was directly delivered by the Council (direct FDC control of the management and support) but without the need to raise the capital finance, it also provides the capacity to deliver the planning and new build construction through being managed by Cornerstone. This allows FDC capacity to focus on the Fenland Inspire! work and other existing projects already in the pipeline. In summary, with this established approach the project will be done at a speed that is quicker than an in-house model along with the other benefits highlighted above.

7 IMPLICATIONS

7.1 Legal Implications

- 7.2 The following legal agreements will be required:
- 125-year Lease agreement with the Registered Provider
 - Management agreement for FDC to have 100% nominations and directly provide the support and management.
- 7.3 The Council took legal advice regarding the procurement. Direct awards are allowed under the Procurement Act as:
- In accordance with paragraph 13.2 items b and g of the Council's Code of Procurement, you can request an exemption from the procurement.
 - Only one supplier can supply the goods, works or services due to the absence of competition for technical reasons and there are no reasonable alternatives
 - This Direct Award is below the key threshold levels (services under £214,904 and works will be under £5,372,609) and therefore the council can use its internal code of procurement exemption criteria as below.
 - b) specialist suppliers, consultants, agents or professional advisers are required and:
 - there is no satisfactory alternative; or
 - evidence indicates that there is likely to be no genuine competition; or
 - circumstances are such that a specialist needs to be assigned with urgency to mitigate against a legal, regulatory and/or financial claim and delay would worsen the claim.
 - g) a decision is taken by the Corporate Director and Chief Finance Officer, which is supported by the relevant Portfolio Holder, to suspend formal tendering procedures. All reasoning surrounding this decision must be clearly minuted and copied to the Procurement Manager.

7.4 Financial Implications

- 7.5 The General Fund Budget Estimates and Medium-Term Financial Strategy (MTFS) Report, agreed by Cabinet and Council in February, projects a financial shortfall for 2025/26 of £1.432m increasing year on year amounting to around £3.4m by 2027/28. This proposal is developed to reduce pressure on the MTFS by reducing costs for the provision of emergency accommodation that falls on the general fund
- 7.6 Although there are currently many uncertainties regarding the budget for 2025/26 and the MTFS, there remains a significant structural deficit which the Council will need to address.”
- 7.7 No capital outlay from the Council’s capital programme or a loan from Public Works Loan Board.
- 7.8 At risk costs of circa £92k to undertake the planning permission required. This cost gets refunded at the drawdown of funds. This financial risk is the same if the Council did the project directly and this risk is minimised in that the principal of development has already been given through the current planning permission.
- 7.9 Project will be accounted for on the balance sheet as shown at Schedule 1 and Schedule 2
- 7.10 The model means the Council must guarantee the full rent to be paid over to the RP. The Council will also charge an Intensive Housing Management charge on the lets to pay for the support that will be provided. This will be paid back to the Council from the RP.
- 7.11 The Council can minimise risks relating to repairs and maintenance and void costs through eligible charges through the benefit system.
- 7.12 Savings forecast based on a reduction of 3,624 nights of placing households in emergency interim hotel accommodation @ £51.81 subsidy penalty per night = £187,759.44 per annum.

7.13 Equality Implications

Project is part of the Council’s Homelessness and Rough Sleeping Strategy and action plan which has undertaken an Equality Impact Assessment

8 SCHEDULES

Schedule 1 – Treasury services report

Schedule 2 – FDC finance summary from the treasury services report



Report for FENLAND DISTRICT COUNCIL

Edinburgh Drive – Development
Appraisal
November 2024

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1. Introduction

1.1 Report brief

Fenland District Council (“the Authority”) are considering developing a site in partnership with a social enterprise Cornerstone Place and a Registered Housing Provider (“RP”) to construct 34 modular homes. The proposed structure of the agreement is to lease land to an RP for a period of 125 years. The development of the modular units would be completed by the RP at an estimated cost of £6.4m, which would be funded through 50% Social Housing Grant, and potentially a contribution from the Local Authority Housing Fund Grant with the remainder funded by borrowing from a market lender for 25 years.

Although, the Authority would not be responsible for the debt repayment, it would provide a guarantee for the rental income and voids which is estimated at £221k per annum to the RP for the period of the 25-year loan. The Authority would retain 100% nomination rights to the units and have the right (but not the obligation) to acquire the site from the RP for the cost of any remaining debt at any time, or if there was no debt for a notional amount (plus reasonable transaction costs).

The Authority have requested Link Treasury Services Limited (“Link”) to provide advice on the accounting treatment for the 125-year lease liability and guarantee for the rental income and voids over 25 years and the associated issues which may need to be considered for the proposed investment.

This report will include the following:

- An assessment of the proposed lease / development and guarantee structure proposed and a summary of the key financial risks.
 - Including considerations which could impact the Authority when entering into the proposed structure – e.g.: Indexation, Covenant/Securitisation, and potential impact / risks to future revenue budget.
- An evaluation of the accounting implications and consideration of the legal and regulatory status applicable.*
- Financial due diligence on all financial data contained within the investment proposal from the Authority.
- A high-level assessment of alternative options available to the Authority (PWLB comparator only).
 - This will be limited to an initial analysis.
- A high-level review of the implications for Capital Financing Requirement and the Minimum Revenue Provision and borrowing limits.
- Implications for the Authority’s Treasury Management Strategy and Prudential Indicators.
- Set out the requirements for the accounting treatment and measurement of the guarantee.
- Outline the requirements to determine the gross cash equivalent of the loan guarantee as required under the Subsidy Control Regulations.

*The report will provide a high-level summary of the legal powers for this type of funding structure.

1.2 Purpose of the report

The purpose of this report is to provide Link's view on the proposed lease arrangements and determine the appropriate accounting treatment.

Link does not give any guarantees or warranties as to the information in this report. To this extent, Link does not warrant the accuracy of this information and can only warrant the accuracy and completeness of the report in so far as it correctly presents and analyses the information provided by other sources. This report can only be used to inform investment decisions with this caveat and does not absolve any party from any requirement to undertake further due diligence. In addition, this report does not represent a formal legal opinion nor constitute investment advice. The decision to execute any transaction remains the sole responsibility of the Authority.

Statements made in this report must not be relied upon as statements of representation of fact and Link shall not be responsible for any error, omission or miss-statement. This report is strictly confidential and is supplied on the understanding that it is solely for the use of the Authority and for the purposes set out herein. It should not be referred to or reproduced in whole or in part for any other purpose without the prior written consent of Link.

1.3 Information provided

Link has used the following information provided by the Authority:

- [Proposal structure – Cornerstone Place Edinburgh Drive \(Structuring\) 24.08.28.pdf](#)
- [Edinburgh Drive Review – Cornerstone Place Edinburgh Drive and Fenland Update 24.08.20.pdf](#)
- [Financial model - Edinburgh Drive CP DA Version 3.08 24.08.19 FENLAND.xlsx](#)
- [Management of New Properties on 24 High Street Table Appendix A.doc](#)

2. Executive Summary

Link have carried out a review of the proposal for the Authority to use land to deliver 34 modular homes for temporary accommodation ("TA"). Section 3 provides an overview of the proposed arrangements and considers the relevant legislation relating to the provision of TA which determines the maximum lease period for a General Fund("GF") lease is 10 years.

Based on the information provided it appears that the substance of the arrangement is that the Authority would be contractually obligated to pay the RP rent for the 34 modular homes for 25 year, which means there is an accounting requirement to recognise a lease. The Authority is not a guarantor for the borrowing taken out by the RP to finance the construction. For the purposes of this report there is no financial guarantee as the arrangement does not meet the definition of a financial guarantee contract¹.

The lease is for TA assets for a period over 10 years which must be accounted for within the HRA unless a Secretary of State direction is granted. The Authority does not currently have a HRA. To allow the housing stock to be accounted for within the GF, the Authority will need to write to the Secretary of State for a direction to approve this. The direction must cover each individual unit and is limited to 199 homes. If the Authority were to own 200 or more dwellings it would be required to open and account for them within a HRA.

The proposed arrangements are based on the modular homes being delivered as exempt accommodation, as a result the Authority would then secure full subsidy loss recovery on each home, which would help to reduce revenue budgetary pressures resulting from the TA provision.

Local authorities are mandatorily required to implement IFRS16 from 1 April 2024 and the Chartered Institute of Public Finance and Accountancy ("CIPFA") Code of Practice on Local Authority Accounting for 2024/25 ("the Code") incorporates the requirements. Section 4 provides an overview of the lessor and lessee arrangements under IFRS16 including where a contractual arrangement meets the definition of a lease and is required to be accounted for as a lease.

The detailed accounting treatment and entries under IFRS16 for each of the lease arrangements has been assessed in Section 5. Lease 1 will be classified as an operating lease under IFRS16, resulting in no impact to revenue as the lease is a peppercorn.

Under IFRS 16 a lessee is required to recognise a right of use asset and a lease liability for **all** leases with a term of more than 12 months unless the underlying asset is of low value. As a result, the Authority will need to recognise a right of use asset and a lease liability on the Balance Sheet for Lease 2, with the revenue impact being the interest payable element of the lease rental and an MRP charge. Because the rentals under the proposed arrangement will increase by an indexation factor, the lease liability must be remeasured each time there is a change in the index. The detailed remeasurement and accounting requirements are set out in section 5.2.

The sub lease classification will depend on the length of each sub lease. Under IFRS16 the classification of the sublease depends on the nature of the head lease (lease 2) so a relatively short sub lease life results in an operating lease under which all the sub lease rental income will be recognised in the CIES. A sub lease life representing the majority of the 25 year head lease duration would result in a finance lease classification, and therefore only the interest element of the sub lease rental income will be recognised in the CIES. For the purposes of this report Link

¹ Paragraph 7.1.2.13 of the CIPFA Code of Practice on Local Authority Accounting for 2024/25

have assumed that the modular homes will be let as TA on a short-term basis and recognised as an operating lease.

Section 6 provides financial analysis and identifies the key risks associated with the proposed arrangements. This highlights the need to confirm future increases in rent payable to the RP aligns to funds received by the Authority from the Department for Works and Pensions (“DWP”).

An outline of the requirements under the Subsidy Control Regulations has been provided in section 7 including the guidelines for calculating a gross cash equivalent, however the proposed occupancy guarantee does not align to the provisions for financial guarantees. In terms of Subsidy Control Regulations, a financial guarantee refers to a public authority providing a ‘loan guarantee’ to a lender which means if the person in receipt of the loan does not repay the loan the public authority will make a contingent payment to the lender.

Section 8 summarises the Balance Sheet and revenue implications and also gives the prudential indicators impact. The main impact on the Prudential Indicators is a result of Lease 2 which will require the inclusion of the lease in the Authority’s borrowing and capital expenditure indicators. The interest payable and MRP costs will need to be included in the financing costs of the “financing costs to net revenue stream” indicator.

There will be no impact on the financing costs from the sub lease as interest income is not included in this indicator. However, where the rental income is received as a result of a service investment then the actual net income from commercial and service investments to net revenue stream indicator should be used to include net income from rents.

This report covers the issues included in the service brief discussed with officers and has been prepared in a manner which highlights the key matters the Authority may wish to consider.

3. Proposed arrangements

3.1 Proposal

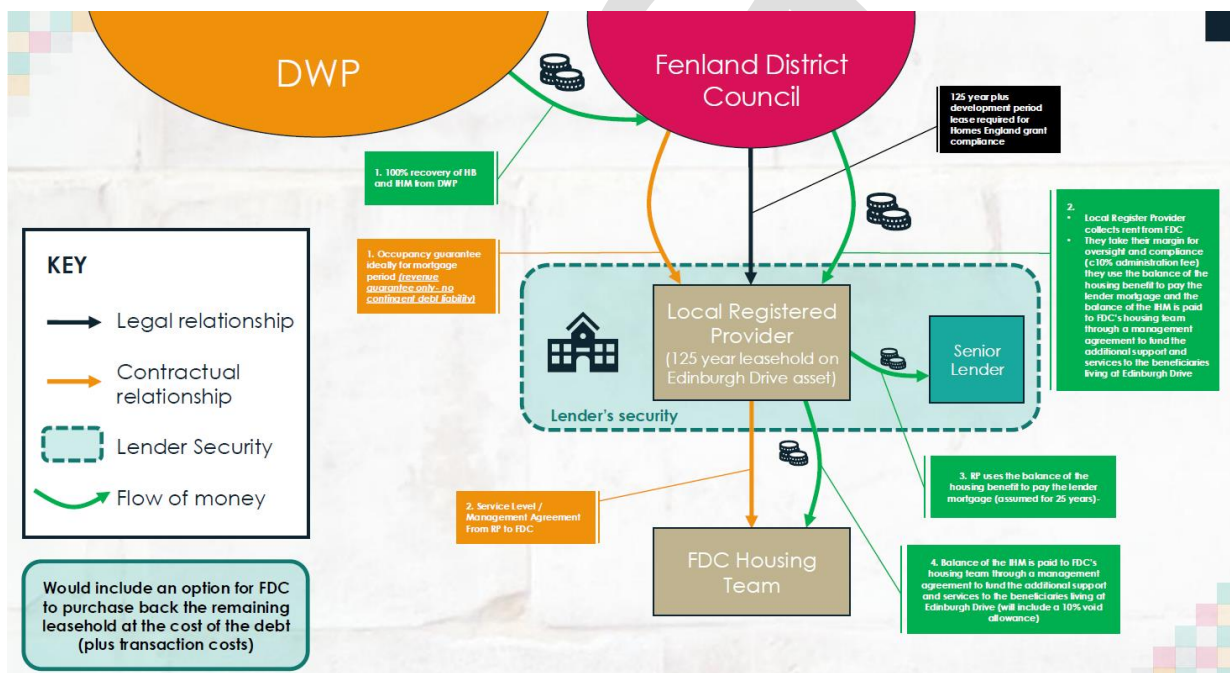
The proposal requires the Authority to provide a 125-year lease of land to a local RP. The RP will then construct 34 modular homes on this land. The RP plans to fund the construction by a mix of 50% Social Housing Grant, and potentially a contribution from the Local Authority Housing Fund Grant with the remainder funded by borrowing from a market lender for 25 years.

The Authority would retain 100% nomination rights to the units and have the right (but not the obligation) to acquire the site from the RP for the cost of any remaining debt at any time, or if there was no debt for a notional amount (plus reasonable transaction costs).

The Authority would be required to provide a guarantee for the rental income and voids which is estimated at £221k per annum to the RP for the period of the 25-year loan. The Authority is not a guarantor of the debt repayments.

The Authority provided the following illustration on the structure and funds flow for the proposed development.

Illustration 1 – Proposed structure and funds flow



The financial model² provided supports the Cornerstone Place Edinburgh Drive Review dated 20 August 2024 ("the Cornerstone review") that outlines the proposed development and covers the following key points:

- The Authority to fund planning costs estimated at £0.287m
 - The planning costs are at risk until completion when the RP will 'refund' the Authority. The nature of this repayment is unclear.

² Edinburgh Drive CP DA Version 3.08 24.08.19 FENLAND.xlsx

- The initial rent payable to the RP is equal to the Local Housing Allowance (“LHA”) receivable from the DWP.
 - The income is assumed to increase by 2% per annum and is based on a 100% occupancy rate.
 - The flow of funds illustration shows the DWP paying Housing Benefit (“HB”) and Intensive Housing Management (“IHM”) direct to the Authority rather than the tenants. This structure reduces the risk of bad debts and rent collection costs.
- The rental income guarantee structure has not been provided; however, it has been assumed that future rents are based on forecast LHA income rates and a 100% occupancy rate.
- The review highlights £0.532m annual revenue savings for the Authority on TA costs.
 - The savings are based on the Authority using its nomination rights to place citizens that are in existing TA into the 34 modular homes.
- The Authority has no exposure to post planning development costs meaning it has no direct risk of overspends on the construction of the modular homes.
- The Authority would hold all repairs, void and administration responsibility.
 - The review states “this is recoverable through exempt rents”. This may refer to Intensive Housing Management (“IHM”) payments from DWP.
 - The repairs and maintenance costs over the life of the assets would need to be assessed. These are likely to result in an additional revenue cost to the Authority.
 - The Authority Housing Team will have a Service Level Agreement (“SLA”) with the RP to be paid to provide ‘additional services’ to residents. This is likely to include the Authority providing supported living arrangements and services.
- The Authority have an option to purchase back the remaining leasehold at the cost of the outstanding debt plus transaction costs. Where there is no debt remaining, the cost will be a nominal fee plus transaction costs.
 - The Authority should seek confirmation that a re-purchase would not trigger a clawback of Homes England grant funding used for the development.

3.2 The guarantee

The rental income guarantee structure is to be confirmed, however based on the information provided it appears that the substance of the arrangement will be the Authority becoming contractually obligated to pay the RP the rent on the 34 modular homes for 25 years.

The definition of a financial guarantee contract is shown in paragraph 7.1.2.13 of the Code.

A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

The proposed arrangement does not appear to involve the RP incurring a loss due to debtors failing to make payments, because the structure states the RP will collect the rents directly from the Authority. Although, the RP is proposing to borrow from a market lender to finance the construction, the Authority is not a guarantor for this borrowing.

For the purposes of this report the occupancy guarantee arrangement will be accounted for based on its substance, a contractual obligation to make payments to the RP, as it does not meet the definition of a financial guarantee contract.

3.3 Legislation

The proposed lease arrangements will help to address the service demand for TA that is causing a significant revenue budgetary issue for the Authority. The primary purpose will need to be formally determined and documented alongside the legal powers that the Authority will rely upon to incur costs and liabilities.

The Authority does not currently have a HRA so before looking at the lease arrangements it is therefore necessary to look at the relevant legislation relating to homelessness and the provision of TA as this will determine the maximum lease period for a GF lease.

An authority's duties in respect of homelessness fall outside the scope of the HRA as they are provided for under Part VII of the Housing Act 1996 ("the 1996 Act") rather than Part II of the Housing Act 1985 ("the 1985 Act"). Therefore, any homeless administration services must be funded out of the GF.

However, Section 9 of the 1985 Act gives authorities the power to provide housing accommodation by erecting or acquiring houses (and "houses" for these purposes includes lodging-houses and hostels). This could include erecting or acquiring houses to be used for TA. Any such TA erected or acquired using the Section 9 power would need to be accounted for within the HRA by virtue of Section 74(1) of the Local Government and Housing Act 1989 ("the 1989 Act") unless the accommodation was leased to the Authority for a period of 10 years or less (in which case the Housing Revenue Account (Exclusion of Leases) Direction 1997 excludes these dwellings from the HRA).

This means that where a TA lease is for a period of 10 years or less then it must be accounted for in the GF and leases for periods greater than 10 years must be accounted for in the HRA.

Where a local authority plans to build or own housing stock within the GF it will need to write to the Secretary of State for a direction to allow this. The direction must cover each individual unit and is limited to 199 homes. A local housing authority that owns 200 or more dwellings are required to account for them within their HRA.

3.4 Lease arrangements

The Authority have not provided the proposed lease documentation therefore the review is based on the information contained within the Cornerstone review. The proposed leasehold for the Authority's land to be granted to the RP is for a period of 125 years plus the development period. The lease period is a requirement of Homes England Grant funding. The leasehold has been assumed to be a peppercorn lease.

Section 4 considers the accounting for leases under IFRS 16 and the Code. This section includes where other leases are identified based on the substance of the proposed arrangements. Section 3.4.2 below supports the determination that the proposed arrangements in substance include the Authority leasing the 34 modular homes to deliver its service objectives.

3.4.1 Rental payments

The Authority have not provided the detailed structure of the proposed 'occupancy guarantee' therefore the Link report is based on the high level information contained within the Cornerstone review. The proposal includes the Authority guaranteeing that the rental paid to the RP will be based on 100% occupancy of the 34 modular homes. The substance of this arrangement is the Authority is contractually obligated to pay 100% rent to the RP for the 34 modular homes for 25 years.

The financial model provided indicates the RP has an income based on rents at 100% occupancy and linked to the LHA rate in 2024, however this income is assumed to increase by

2% annually. It is vital that the Authority seeks confirmation that the rent payable to the RP is contractually linked to the published LHA rates meaning the 2% annual increase is a forecast of future LHA increases. In this case where the Authority achieves full occupancy it will receive income from the DWP that increases at the same rate therefore limiting its financial exposure. For the purposes of this report the forecast LHA rate increases are deemed an indexation event, however the RP rents could alternatively be linked to movements in CPI inflation or another variable.

The Authority will need to consider that where the rent payable to the RP increases independently to increases in LHA, this would expose the Authority to an unmitigated long term revenue cost in addition to the costs for repairs and maintenance on the modular homes.

The Authority will receive an income stream from the DWP based on actual occupancy and linked to the actual LHA for each year. Link have assumed the income from DWP will match the rents payable to the RP where all properties are occupied which limits the Authorities financial exposure to void properties, repairs and maintenance.

3.4.2 Identifying a lease

Lease accounting is not limited to arrangements that have the legal form of a lease. They apply to any arrangement that meets the Code's definition of a lease as a contract (or part of a contract) that conveys the right to use an asset for a period of time. Contracts that might have the same effect as a formal lease in passing control over the use of property or appropriate intangible assets to another party will need to be analysed to determine whether the relevant assets are part of what is effectively a lessee/lessor relationship.

Paragraph 4.2.2.11 of the Code provides the following definition of a lease:

A lease is a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time.

Paragraph 4.2.2.15 of the Code provides the following definition of a lessee within a lease.

A lessee is an authority that obtains the right to use an underlying asset for a period of time.

The following illustration shows the analysis of the proposed arrangements used to determine whether the Authority will need to account for a lease in relation to its control and use of the 34 modular homes to deliver its service objectives.

Illustration 2 – Assessing the arrangements

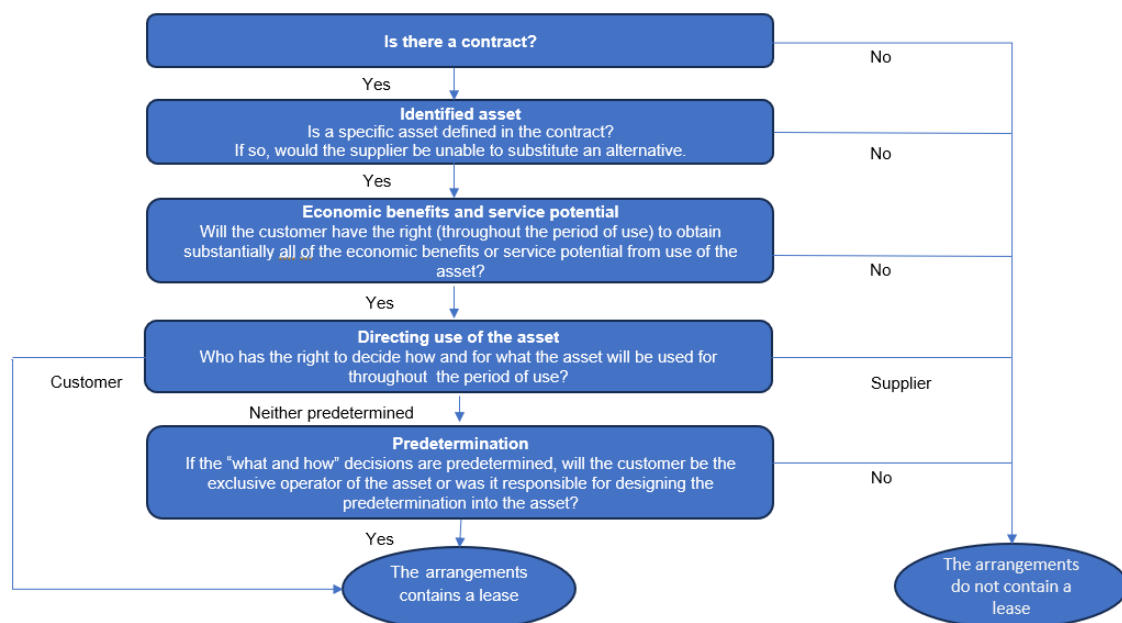


Table 1 – Application to the proposed arrangements

| Assessment | Identified factors |
|--|---|
| Is there a contract? | Yes – it is expected that the whole arrangement will be part of one or more interrelated contracts. |
| Is a specific asset defined in the contract? If so, would the supplier be unable to substitute an alternative | Yes - the assets are the 34 modular homes permanently sited. |
| Will the customer have the right (throughout the period of use) to obtain substantially all of the economic benefits or service potential from use of the asset? | Yes - the Authority has management function and nomination rights for the modular homes. |
| Who has the right to decide how and for what the asset will be used for throughout the period of use? | Customer - should the Authority enter into the contractual arrangements it will be on the basis the 34 modular homes are used to house citizens of its choosing. |
| If the “what and how” decisions are predetermined, will the customer be the exclusive operator of the asset or was it responsible for designing the predetermination into the asset? | Yes , the Authority has management function and nomination rights for the modular homes. |
| Conclusion | The arrangements contain a lease |

Although there is no lease in place, this arrangement appears to meet the criteria that would mean it would be accounted for as a lease. Section 4 of this report considers the accounting treatment for the Authority as a lessee of the 34 modular homes. In addition, the provision of subleases to the tenants is also considered on the basis that the Authority will be required to operate a management function for the modular homes.

3.5 Exempt accommodation approach

The amount the Authority can normally claim back from the DWP as housing benefit subsidy is limited to 90% of the LHA rates from January 2011. As the 2011 rates are now much lower than the actual cost of housing benefit paid out to temporary accommodation tenants, the Authority incurs a subsidy loss.

Exempt accommodation is a category of supported housing that is exempt from locally set caps on housing benefit. Supported housing encompasses a wide range of housing that combines housing with support for people with different needs, such as older people, people with disabilities, people with complex needs and those who have formerly been homeless. Exempt accommodation takes its name from the fact that it is exempt from housing benefit regulations that limit local housing allowance levels. The reason for this exemption is that this housing costs more to run than general needs tenancies, for example having higher costs for administration, insurance, and repairs and maintenance. Rent is set by the provider and paid for by the resident's housing benefit.

The proposed arrangement would see the RP and the Authority provide 34 modular homes delivered as exempt accommodation. The Authority would then secure full subsidy loss recovery on each home that is occupied on this basis.

An investment proposal for the Edinburgh Drive units has not been provided therefore the Link report only covers the lease implications and does not include any verification or analysis of subsidy savings resulting from this option.

4. IFRS16

4.1 Introduction

IFRS 16 *Leases* was issued by the IASB in 2016, replacing IAS 17 and IFRIC 4, with an effective date for annual reporting periods beginning on or after 1 January 2019. After several deferrals, local authorities are now mandatorily required to implement IFRS 16 from 1 April 2024 and the CIPFA Code of Practice on Local Authority Accounting for 2024/25 ("the Code") incorporates the requirements. Earlier voluntary adoption as of 1 April 2022 or 1 April 2023 was however encouraged by CIPFA and Local Authority (Scotland) Accounts Advisory Committee ("LASAAC").

The main objective of IFRS 16 is to report information that:

- Faithfully represents lease transactions and
- Provides a basis for users of financial statements to assess the amount, timing and uncertainty of cash flows arising from leases.

To meet that objective, IFRS 16 introduces significant changes to lessee accounting through a single lessee accounting model that requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months unless the underlying asset is of low value.

In contrast, IFRS16 does not include significant changes to the requirements for accounting by lessors.

4.2 Lessor accounting arrangements under IFRS16

Lessors are required to follow an accounting model that separates leases into two types, based on the extent to which the lease transfers substantially all the risks and rewards incidental to ownership of an underlying asset:

- Finance leases – substantially all the risks and rewards transfer to the lessee.
- Operating leases – substantially all the risks and rewards are not transferred to the lessee.

Finance leases are then accounted for as if they were disposals – the asset is written out of the Balance Sheet, a gain or loss on disposal is recognised, and an asset for the net investment in the lease is established, based on the discounted value of the lease payments.

Operating leases are accounted for similar to hire agreements. The asset is kept on the Balance Sheet and rentals are accounted for as income when they become due. The only adjustments that might normally be made are where rent is received in advance as a premium or rent-free or reduced rent periods are granted, where income would be spread over the term of the lease to reflect the pattern of benefits transferred to the lessee.

4.3 Lessor - operating lease versus finance lease

The key determinant of the status of a lease is the extent to which risks and rewards incidental to ownership of the leased asset lie with the lessor or the lessee. This is dependent on the substance of a transaction, rather than the form of the contract. Paragraph B53 of IFRS 16 gives examples of the risks and rewards that might be relevant:

- Risks – possibilities of losses from idle capacity or technological obsolescence; variations in return because of changing economic conditions.
- Rewards – expectation of profitable operation over the underlying asset's economic life; gain from appreciation in value or realisation of residual value.

Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Paragraph 63 of IFRS 16 and the Code paragraph 4.2.2.71 gives examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease:

- The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.
- The lessee has the option to purchase the underlying asset at a price that is expected to be sufficiently lower than the *fair value* (at the date the option becomes exercisable) for it to be reasonably certain, at the *inception date*, that the option will be exercised.
- The lease term is for the major part of the *economic life* of the underlying asset even if title is not transferred.
- At the inception date, the present value of the lease payments amounts to at least substantially all of the fair value of the underlying asset; and
- The underlying asset is of such a specialised nature that only the lessee can use it without major modifications.

Where leases of assets are provided on non-commercial terms, such as for a peppercorn, then the 4th bullet above will not apply, and authorities will need to consider the substance of the transaction by considering other transactions or arrangements involving the parties that need to be taken into account.

Paragraph 64 of IFRS16 and the Code paragraph 4.2.2.73 then gives indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease:

- If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee.
- Gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and
- The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

Lease classification is made at the inception date and is reassessed only if there is a lease modification. Changes in estimates (for example, changes in estimates of the economic life or of the residual value of the underlying asset), or changes in circumstances (for example, default by the lessee), do not give rise to a new classification of a lease for accounting purposes.

4.4 Lessor – sublease classification

Where an authority is letting out an asset that it has itself leased, the classification of the sublease will depend on the nature of the head lease.

- If the head lease is short-term having applied the exemption in paragraph 4.2.2.32 of the Code and not recognised a right-of-use asset, the sublease will automatically be an operating lease.
- If a right-of-use asset has been recognised under the head lease, the sublease is to be classified by reference to the right-of-use asset, rather than by reference to the underlying asset – for instance, if an authority leases a building that has a remaining economic life of 40 years for a 10 year term, any assessment of whether a sublease term

is for the major part of the economic life of the asset will reference the 10 year head lease term, excluding the additional 30 years of economic life of the underlying asset.

4.5 Lessee accounting arrangements under IFRS16

Under IFRS 16 there is a single lessee accounting model that requires a lessee to recognise assets and liabilities for **all** leases with a term of more than 12 months unless the underlying asset is of low value. The Code and IFRS16 requires a lessee to recognise a right of use asset and a lease liability at the commencement date of the lease.

The initial measurement of the lease liability is calculated in accordance with paragraph 4.2.2.49 of the Code:

At the commencement date, a lessee shall measure the lease liability at the present value of the lease payments that are not paid at that date. The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate.

Paragraph 4.2.2.50 of the Code then sets out the lease payments to be included in the lease liability measurement:

At the commencement date, the lease payments included in the measurement of the lease liability comprise the following payments for the right to use the underlying asset during the lease term that are not paid at the commencement date:

- a) fixed payments (including in-substance fixed payments as described in paragraph B42 of IFRS 16), less any lease incentives receivable.
- b) variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date (see paragraph 28 of IFRS 16)
- c) amounts expected to be payable by the lessee under residual value guarantees.
- d) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option (assessed considering the factors described in paragraphs B37 to B40 of IFRS 16), and
- e) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

The initial measurement of the right of use asset is at cost, comprising of the following, as per paragraph 4.2.2.46 of the Code:

The cost of the right-of-use asset shall comprise:

- a) the amount of the initial measurement of the lease liability, as described in paragraph 4.2.2.49
- b) any lease payments made at or before the commencement date, less any lease incentives received
- c) any initial direct costs incurred by the lessee, and
- d) an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories. The lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the underlying asset during a particular period.

5. Lease application for the Authority

5.1 Lease 1 – Authority land

Lessor - the Authority

Lessee - RP

The Authority have not provided lease documentation therefore the review is based on the high level information contained within the Cornerstone review.

The proposal is to lease Authority owned land to the RP for 125 years. The arrangement includes an option for the Authority to purchase back the remaining leasehold at the cost of any outstanding debt (plus transaction costs). The lease payments are not known and so the lease has been assumed to be a peppercorn. There are no rights to transfer ownership or rights to purchase the asset assumed within the lease for the land.

An assessment is required as to whether the lease is a finance lease or operating lease as per the information provided.

| | |
|--|---|
| Does the ownership of the asset transfer to the lessee at the end of the lease term? | No |
| Does the lessee have the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the end of the lease? | No |
| Is the lease term for the major part of the economic life of the asset? | No, also the Authority has option to repurchase leasehold at any point. |
| <i>Life of Asset - land - indefinite</i> | |
| <i>Length of Lease - 125 years</i> | |
| Does the Present Value of the lease payments equal substantially all of the Fair Value? | No, assumed peppercorn |
| Are the leased assets of a specialised nature such that only the lessee (or a limited number of other parties) can use them without major modifications being made? | No |
| If the lessee is able to cancel, does the lessee bear the lessor's losses? | No |
| Will the lessee gain or lose from any fluctuations in the market value of the residual amount? e.g. the lessee could receive a rental rebate equalling most of the sales proceeds at the end of the lease. | No |
| Does the lessee have the ability to continue to lease the asset for a secondary term at a nominal rental? | n/a unknown |
| Are there any other factors to consider? | No. |

None of the indicators provide evidence that the arrangement has the substance of a finance lease.

This lessor arrangement would therefore be classified as an operating lease.

For an operating lessee paragraph 4.2.2.82 to 4.2.2.84 of the Code requires:

A lessor to recognise lease payments as income on either a straight-line basis or another systematic basis. The lessor shall apply another systematic basis if that basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished. A lessor shall add initial direct costs incurred in obtaining an operating lease to the carrying amount of the underlying asset and recognise those costs as an expense over the lease term on the same basis as the lease income.

The depreciation policy for depreciable leased assets shall be consistent with the lessor's normal depreciation policy for similar assets.

For the Authority this will mean:

- The land will remain on the Authority's Balance Sheet
- The rental payments received by the Authority are assumed to be a peppercorn. It has been assumed these will be recognised on a straight-line basis.
- The initial estimate of the anticipated term of the lease is likely to be 25 years as the Authority can purchase back the leasehold for a nominal sum at that point.
- If there are any initial direct costs incurred, then these will be expensed over the 25 year anticipated lease term on a straight line basis.

5.2 Lease 2 - 34 Modular homes (no formal lease – implied lease based on substance of the arrangement)

Lessee - the Authority

Lessor - RP

The RP is financing and building 34 modular homes on the land leased from the Authority. The Authority retains the housing management function, nomination rights and has responsibility for all repairs. The arrangement includes the Authority providing an occupancy guarantee for the period of the RP borrowing. The substance of this arrangement means the Authority will have a contractual obligation to pay the RP a rental income based on full occupancy, meaning it retains the financial risk of void units. The duration of this arrangement is expected to align to the period of the RP's borrowing which is 25 years at which point the Authority is assumed to purchase back the leasehold for a nominal fee.

Under IFRS 16 a lessee is required to recognise a right of use asset and a lease liability for **all** leases with a term of more than 12 months unless the underlying asset is of low value.

For this lessee arrangement the Authority will therefore need to recognise a right of use asset and a lease liability.

Initial measurement of the lease liability:

This is measured at the present value of the lease payments that are not paid at the commencement date, using:

- The interest rate implicit in the lease, or
- The lessee's incremental borrowing rate

The lease payments to be taken into account include:

- Fixed payments
- Variable payments that depend on an index – where the variation is dependent on an index, the variable payments are to be measured using the index at the commencement date. This means that future inflation is estimated based on current rates, so initial liabilities are measured assuming no inflation.

The financial model uses an assumed annual increase in income of 2%. It has been assumed the actual income increases will be linked to the annual published LHA rates and these are forecast to increase by 2% annually. Each annual movement in the published LHA rates is deemed to be an indexation event. In order to measure the lease liability, the annual lease costs in table 4 have used the current LHA income of £126 per week per unit which excludes any assumed annual increase. This approach aligns to the CIPFA IFRS16 leases guidance.

The interest rate implicit in the lease is unknown, however a calculation based on the information available is shown in the table below.

An incremental borrowing rate is only used where the implicit interest rate is not readily determinable.

It is assumed that the residual value of the modular units is £2,417,722 at the end of the lease period based on an estimated useful life of 40 years³ and a straight-line depreciation calculation from the initial cost estimate⁴ of £6,447,258.

Table 2: Calculation of implicit interest rate

| | Annual lease costs excluding estimated annual increase £ | Residual value £ | Total amount to be discounted £ | Discount rate @ 1.4% | NPV £ |
|----|---|---------------------|------------------------------------|----------------------|----------|
| 1 | 223,681 | - | 223,681 | 1.000 | 223,681 |
| 2 | 223,681 | - | 223,681 | 0.986 | 220,554 |
| 3 | 223,681 | - | 223,681 | 0.972 | 217,470 |
| 4 | 223,681 | - | 223,681 | 0.959 | 214,429 |
| 5 | 223,681 | - | 223,681 | 0.945 | 211,430 |
| 6 | 223,681 | - | 223,681 | 0.932 | 208,474 |
| 7 | 223,681 | - | 223,681 | 0.919 | 205,559 |
| 8 | 223,681 | - | 223,681 | 0.906 | 202,684 |
| 9 | 223,681 | - | 223,681 | 0.893 | 199,850 |
| 10 | 223,681 | - | 223,681 | 0.881 | 197,056 |
| 11 | 223,681 | - | 223,681 | 0.869 | 194,300 |
| 12 | 223,681 | - | 223,681 | 0.857 | 191,583 |
| 13 | 223,681 | - | 223,681 | 0.845 | 188,904 |
| 14 | 223,681 | - | 223,681 | 0.833 | 186,263 |

³ <https://apse.org.uk/index.cfm/apse/members-area/briefings/2018/18-36-modular-housing-its-historical-role-and-current-use-in-local-government/>

⁴ Cornerstone Place - Edinburgh Drive Review dated 20 August 2024

| | | | | | |
|----------------|---------|-----------|-----------|-------|------------------|
| 15 | 223,681 | - | 223,681 | 0.821 | 183,658 |
| 16 | 223,681 | - | 223,681 | 0.810 | 181,090 |
| 17 | 223,681 | - | 223,681 | 0.798 | 178,558 |
| 18 | 223,681 | - | 223,681 | 0.787 | 176,061 |
| 19 | 223,681 | - | 223,681 | 0.776 | 173,599 |
| 20 | 223,681 | - | 223,681 | 0.765 | 171,172 |
| 21 | 223,681 | - | 223,681 | 0.755 | 168,779 |
| 22 | 223,681 | - | 223,681 | 0.744 | 166,418 |
| 23 | 223,681 | - | 223,681 | 0.734 | 164,091 |
| 24 | 223,681 | - | 223,681 | 0.723 | 161,797 |
| 25 | 223,681 | - | 223,681 | 0.713 | 159,534 |
| End of year 25 | - | 2,417,722 | 2,417,722 | 0.713 | 1,700,260 |
| | | | | | 6,447,258 |

The discounted value of the payments to be made by the lessee is £4.747m calculated using the total shown above £6.447m, less the £1.700m element for the discounted unguaranteed residual value (£6.447m less £1.700m).

The accounting entry for the resulting lease liability is shown below.

| | |
|---|------------|
| Debit: Property Plant and Equipment (PPE) | £4,746,998 |
| Credit: Lease liability | £4,746,998 |
| <i>Re: Initial measurement of the lease liability</i> | |

Subsequent measurement of the lease liability

The lease liability will then be accounted for using amortised cost principles:

- Increased by interest on the lease liability.
- Reduced by lease payments made.

The carrying amount of the lease liability will reduce to zero over the term of the lease as shown in the following table. This assumes that lease payments are made at the start of the financial year:

Table 3: Lease repayment schedule

| | Opening lease liability | Lease payment | lease liability after payment | Financing cost for the year | Closing lease liability | Principal |
|------|-------------------------|---------------|-------------------------------|-----------------------------|-------------------------|-----------|
| | £ | £ | £ | £ | £ | £ |
| Year | A | B | A-B=C | C x 1.4%=D | A-B+D | B-D=E |
| 1 | 4,746,998 | 223,681 | 4,523,316 | 64,147 | 4,587,463 | 159,534 |
| 2 | 4,587,463 | 223,681 | 4,363,782 | 61,884 | 4,425,666 | 161,797 |
| 3 | 4,425,666 | 223,681 | 4,201,985 | 59,590 | 4,261,575 | 164,091 |
| 4 | 4,261,575 | 223,681 | 4,037,893 | 57,263 | 4,095,156 | 166,418 |
| 5 | 4,095,156 | 223,681 | 3,871,475 | 54,903 | 3,926,378 | 168,779 |

| | | | | | | |
|----|-----------|------------------|-----------|----------------|-----------|------------------|
| 6 | 3,926,378 | 223,681 | 3,702,696 | 52,509 | 3,755,206 | 171,172 |
| 7 | 3,755,206 | 223,681 | 3,531,524 | 50,082 | 3,581,606 | 173,599 |
| 8 | 3,581,606 | 223,681 | 3,357,925 | 47,620 | 3,405,545 | 176,061 |
| 9 | 3,405,545 | 223,681 | 3,181,864 | 45,123 | 3,226,987 | 178,558 |
| 10 | 3,226,987 | 223,681 | 3,003,305 | 42,591 | 3,045,896 | 181,090 |
| 11 | 3,045,896 | 223,681 | 2,822,215 | 40,023 | 2,862,238 | 183,658 |
| 12 | 2,862,238 | 223,681 | 2,638,557 | 37,418 | 2,675,975 | 186,263 |
| 13 | 2,675,975 | 223,681 | 2,452,294 | 34,777 | 2,487,071 | 188,904 |
| 14 | 2,487,071 | 223,681 | 2,263,389 | 32,098 | 2,295,487 | 191,583 |
| 15 | 2,295,487 | 223,681 | 2,071,806 | 29,381 | 2,101,187 | 194,300 |
| 16 | 2,101,187 | 223,681 | 1,877,505 | 26,626 | 1,904,131 | 197,056 |
| 17 | 1,904,131 | 223,681 | 1,680,450 | 23,831 | 1,704,281 | 199,850 |
| 18 | 1,704,281 | 223,681 | 1,480,599 | 20,997 | 1,501,596 | 202,684 |
| 19 | 1,501,596 | 223,681 | 1,277,915 | 18,123 | 1,296,038 | 205,559 |
| 20 | 1,296,038 | 223,681 | 1,072,356 | 15,207 | 1,087,564 | 208,474 |
| 21 | 1,087,564 | 223,681 | 863,882 | 12,251 | 876,133 | 211,430 |
| 22 | 876,133 | 223,681 | 652,452 | 9,253 | 661,705 | 214,429 |
| 23 | 661,705 | 223,681 | 438,023 | 6,212 | 444,235 | 217,470 |
| 24 | 444,235 | 223,681 | 220,554 | 3,128 | 223,681 | 220,554 |
| 25 | 223,681 | 223,681 | 0 | 0 | 0 | 223,681 |
| | | 5,592,035 | | 845,037 | | 4,746,998 |

The accounting entries for the lease payments will be as follows:

| | | |
|----------------------------------|---|---|
| DR | CIES – financing and investment income and expenditure (interest) | D |
| DR | Lease liability (principal) | E |
| CR | Cash | B |
| <i>Re: Annual lease payments</i> | | |

The debit to PPE for the initial measurement of the lease liability will increase the Authority's capital financing requirement ("CFR") which will need to be written down through an annual Minimum Revenue Provision ("MRP") charge.

The Statutory MRP Guidance suggests that the MRP requirement for leases would be regarded as being met by a charge equal to the element of the rent/charge that goes to write down the balance sheet liability. An additional accounting entry is therefore required for the annual MRP charge as follows:

| | | |
|------------------------------|--|---|
| DR | General Fund balance – Movement in Reserves Statement (MIRS) | E |
| CR | Capital adjustment account | E |
| <i>Re: Annual MRP charge</i> | | |

Subsequent measurement of the lease liability - indexation

In this case there will be a change in future lease payments resulting from a change in an index, the published LHAs. Paragraph 4.2.2.61 of the Code requires that:

The lessee shall remeasure the lease liability to reflect those revised lease payments only when there is a change in the cash flows (i.e. when the adjustment to the lease payments takes effect). A lessee shall determine the revised lease payments for the remainder of the lease term based

on the revised contractual payments. In applying this paragraph, a lessee shall use an unchanged discount rate.

This means that the Authority will need to remeasure the lease liability each year once the change in the index actually occurs. As an example, if a 5% indexation event occurs prior to the year 2 rental payment happening, then the lease liability is remeasured applying the 5% indexation to all future payments as follows:

Table 4: Indexation - remeasurement of lease liability

| Year | Annual lease costs excluding index estimate £ | actual indexation applied for year 2 payments (5%) £ | Annual lease costs with actual index for year 2 £ | Discount rate @ 1.4% | NPV £ |
|------|--|---|--|----------------------|------------------|
| 2 | 223,681 | 11,184 | 234,865 | 1.000 | 234,865 |
| 3 | 223,681 | 11,184 | 234,865 | 0.986 | 231,581 |
| 4 | 223,681 | 11,184 | 234,865 | 0.972 | 228,343 |
| 5 | 223,681 | 11,184 | 234,865 | 0.959 | 225,150 |
| 6 | 223,681 | 11,184 | 234,865 | 0.945 | 222,002 |
| 7 | 223,681 | 11,184 | 234,865 | 0.932 | 218,898 |
| 8 | 223,681 | 11,184 | 234,865 | 0.919 | 215,837 |
| 9 | 223,681 | 11,184 | 234,865 | 0.906 | 212,819 |
| 10 | 223,681 | 11,184 | 234,865 | 0.893 | 209,843 |
| 11 | 223,681 | 11,184 | 234,865 | 0.881 | 206,909 |
| 12 | 223,681 | 11,184 | 234,865 | 0.869 | 204,015 |
| 13 | 223,681 | 11,184 | 234,865 | 0.857 | 201,163 |
| 14 | 223,681 | 11,184 | 234,865 | 0.845 | 198,350 |
| 15 | 223,681 | 11,184 | 234,865 | 0.833 | 195,576 |
| 16 | 223,681 | 11,184 | 234,865 | 0.821 | 192,841 |
| 17 | 223,681 | 11,184 | 234,865 | 0.810 | 190,145 |
| 18 | 223,681 | 11,184 | 234,865 | 0.798 | 187,486 |
| 19 | 223,681 | 11,184 | 234,865 | 0.787 | 184,864 |
| 20 | 223,681 | 11,184 | 234,865 | 0.776 | 182,279 |
| 21 | 223,681 | 11,184 | 234,865 | 0.765 | 179,731 |
| 22 | 223,681 | 11,184 | 234,865 | 0.755 | 177,217 |
| 23 | 223,681 | 11,184 | 234,865 | 0.744 | 174,739 |
| 24 | 223,681 | 11,184 | 234,865 | 0.734 | 172,296 |
| 25 | 223,681 | 11,184 | 234,865 | 0.723 | 169,887 |
| | 5,368,353 | 268,418 | 5,636,771 | | 4,816,836 |

This results in an increase in the lease liability as follows:

| | £ |
|---|----------------|
| Lease liability as end of year 1 | 4,587,463 |
| Remeasured lease liability after indexation event | 4,816,836 |
| Difference (increase / (decrease)) | 229,373 |

The accounting entries for the remeasurement and increase in the liability is:

| | | |
|---|------------------------------------|----------|
| DR | Property Plant and Equipment (PPE) | £229,373 |
| CR | Lease liability | £229,373 |
| <i>Re: Remeasurement of the lease liability</i> | | |

The lease write down schedule now becomes:

Table 5: Amended lease schedule after remeasurement of liability

| | Opening lease liability | Lease payment | actual indexation applied for 2026/27 payments (5%) | Lease payments known from 2026/27 onwards | Additional lease liability from indexation | lease liability after payment and additional | Financing cost for the year | Closing lease liability | Principal |
|------|-------------------------------|------------------|--|---|--|---|-----------------------------------|-------------------------------|------------------|
| year | £ A | £ B | £ F | £ B+F=G | £ H | £ A-G+H=C | £ C x 1.4%=D | £ A-G+H | £ G-D |
| 1 | 4,746,998 | 223,681 | | 223,681 | | 4,523,316 | 64,147 | 4,587,463 | 159,534 |
| 2 | 4,587,463 | 223,681 | 11,184 | 234,865 | 229,373 | 4,581,971 | 64,979 | 4,646,950 | 169,887 |
| 3 | 4,646,950 | 223,681 | 11,184 | 234,865 | | 4,412,084 | 62,569 | 4,474,654 | 172,296 |
| 4 | 4,474,654 | 223,681 | 11,184 | 234,865 | | 4,239,788 | 60,126 | 4,299,914 | 174,739 |
| 5 | 4,299,914 | 223,681 | 11,184 | 234,865 | | 4,065,049 | 57,648 | 4,122,697 | 177,217 |
| 6 | 4,122,697 | 223,681 | 11,184 | 234,865 | | 3,887,831 | 55,135 | 3,942,966 | 179,731 |
| 7 | 3,942,966 | 223,681 | 11,184 | 234,865 | | 3,708,101 | 52,586 | 3,760,687 | 182,279 |
| 8 | 3,760,687 | 223,681 | 11,184 | 234,865 | | 3,525,821 | 50,001 | 3,575,822 | 184,864 |
| 9 | 3,575,822 | 223,681 | 11,184 | 234,865 | | 3,340,957 | 47,379 | 3,388,336 | 187,486 |
| 10 | 3,388,336 | 223,681 | 11,184 | 234,865 | | 3,153,471 | 44,721 | 3,198,191 | 190,145 |
| 11 | 3,198,191 | 223,681 | 11,184 | 234,865 | | 2,963,326 | 42,024 | 3,005,350 | 192,841 |
| 12 | 3,005,350 | 223,681 | 11,184 | 234,865 | | 2,770,484 | 39,289 | 2,809,774 | 195,576 |
| 13 | 2,809,774 | 223,681 | 11,184 | 234,865 | | 2,574,908 | 36,516 | 2,611,424 | 198,350 |
| 14 | 2,611,424 | 223,681 | 11,184 | 234,865 | | 2,376,559 | 33,703 | 2,410,261 | 201,163 |
| 15 | 2,410,261 | 223,681 | 11,184 | 234,865 | | 2,175,396 | 30,850 | 2,206,246 | 204,015 |
| 16 | 2,206,246 | 223,681 | 11,184 | 234,865 | | 1,971,381 | 27,957 | 1,999,338 | 206,909 |
| 17 | 1,999,338 | 223,681 | 11,184 | 234,865 | | 1,764,472 | 25,023 | 1,789,495 | 209,843 |
| 18 | 1,789,495 | 223,681 | 11,184 | 234,865 | | 1,554,629 | 22,047 | 1,576,676 | 212,819 |
| 19 | 1,576,676 | 223,681 | 11,184 | 234,865 | | 1,341,811 | 19,029 | 1,360,839 | 215,837 |
| 20 | 1,360,839 | 223,681 | 11,184 | 234,865 | | 1,125,974 | 15,968 | 1,141,942 | 218,898 |
| 21 | 1,141,942 | 223,681 | 11,184 | 234,865 | | 907,076 | 12,864 | 919,940 | 222,002 |
| 22 | 919,940 | 223,681 | 11,184 | 234,865 | | 685,075 | 9,715 | 694,790 | 225,150 |
| 23 | 694,790 | 223,681 | 11,184 | 234,865 | | 459,924 | 6,522 | 466,447 | 228,343 |
| 24 | 466,447 | 223,681 | 11,184 | 234,865 | | 231,581 | 3,284 | 234,865 | 231,581 |
| 25 | 234,865 | 223,681 | 11,184 | 234,865 | | 0 | 0 | 0 | 234,865 |
| | | 5,592,035 | 268,418 | 5,860,452 | | | 884,082 | | 4,976,371 |

As the lease liability has increased the financing cost (interest) for the year increases.

The annual principal payment also increases, meaning the MRP also increases as that is equivalent (the debit to PPE above increases the CFR by £229,373 so needs to be written down by additional MRP).

The Authority will then need to repeat the remeasurement of the lease liability each year once the change in the index actually occurs.

Initial measurement of the right of use asset

Paragraph 4.2.2.45 of the Code requires the initial measurement of the right of use asset to be at cost as shown in the following diagram:



The lease liability will be £4,746,998 as calculated above.

Link is not aware of any lease payments made before the commencement date, lease incentives receivable or initial direct costs payable by the Authority. The Cornerstone review indicates the Authority would incur planning costs, however because these initial direct costs are to be refunded by the RP they have been excluded from the lease calculations.

The modular units are expected to remain at the end of the lease period and the Authority has the ongoing responsibility for repairs and maintenance, therefore no dismantling and removal costs have been included in the initial measurement of the right of use asset. There must be a legal or constructive obligation, rather than a likelihood that such costs will be incurred.

The Authority will therefore need to ensure that, as the lease term progresses, the condition of the right of use asset and the extent of dismantling, removal and restoration costs expected to be incurred at the end of the lease period are assessed.

For the purposes of this report no dismantling, removal and restoration costs are included, so the initial measurement of the right of use asset will therefore be £4.747m. The accounting entry will be the double entry for the initial measurement of the lease liability discussed above, along with a cash entry for initial direct costs that are incurred by the lessee.

| | | |
|--|------------------------------------|--------------|
| DR | Property Plant and Equipment (PPE) | £4,746,998 * |
| CR | Lease liability | £4,746,998 |
| CR | Cash | - * |
| <i>Re: Initial measurement of the right of use asset</i> | | |
| <i>* Where initial direct costs are payable by the Authority these would increase these figures.</i> | | |

Subsequent measurement of the right of use asset

The Code requires that right of use assets should be measured on the same basis that the underlying asset would be valued if it were owned by the Authority. In this case the underlying asset would be classed as property, plant and equipment and a current value will need to be established in line with paragraph 4.2.2.52 of the Code.

After the commencement date a lessee shall measure the right-of-use asset in accordance with Section 4.1 for property, plant and equipment at current value in accordance with the following:

- a) On an asset-by-asset basis, for right-of-use assets that are classified to be measured at current value per Section 4.1, as a practical expedient the cost model in b) shall be used as a proxy for current value unless inappropriate, in which case paragraph c) applies.
- b) Where a cost model is appropriate, a lessee shall measure the right-of-use asset at cost as defined in this section of the Code:
 - i) less any accumulated depreciation and any accumulated impairment losses, and
 - ii) adjusted for any remeasurement of the lease liability specified in paragraph 4.2.2.56c).
Note that the latter adjustment would follow the same accounting treatment (including the statutory accounting requirements) as subsequent expenditure (ie additions to cost) on owned assets under Section 4.1 of the Code.
 - iii) adjusted for any changes in the estimated costs of dismantling, removal or restoration as specified in paragraph 4.2.2.46 d) and 4.2.2.47.
- c) For some right-of-use assets the use of the cost model in b) as a proxy for current value will be inappropriate. This is anticipated to be the case where both of the following conditions are met:
 - i) a longer-term lease has no provisions to update lease payments for market conditions (such as rent reviews), or there is a significant period of time between those updates, and
 - ii) the fair value or current value in existing use of the underlying asset is likely to fluctuate significantly due to changes in market prices. This is more likely to be the case with property assets.

The use of the cost model is unlikely to be a reliable proxy for current value in this case as the rent reviews do not necessarily reflect market conditions as the rents will be recalculated according to changes in the index.

The adjustment to the right of use valuation would be accounted for as follows:

An increase in the valuation:

| | | |
|---|------------------------------------|----|
| DR | Property Plant and Equipment (PPE) | £x |
| CR | Revaluation reserve | £x |
| <i>Re: Revaluation of right of use asset to current value</i> | | |

A decrease in the valuation:

| | | |
|---|------------------------------------|----|
| DR | CIES – relevant service | £y |
| CR | Property Plant and Equipment (PPE) | £y |
| DR | Capital adjustment account | £y |
| CR | General fund balance via MIRS | £y |
| <i>Re: Revaluation of right of use asset to current value</i> | | |

Depreciation will also apply to the right of use asset in accordance with the Authority's depreciation policy, for which the entries will be:

| | | |
|----|------|----|
| DR | CIES | £z |
|----|------|----|

| | | |
|---|------------------------------------|----|
| CR | Property Plant and Equipment (PPE) | £z |
| DR | Capital Adjustment Account | £z |
| CR | General fund balance via MIRS | £z |
| <i>Re: Depreciation of right of use asset</i> | | |

5.3 Subleases - 34 Modular homes to tenants

Lessor - the Authority

Lessee – the tenant

As part of the proposed arrangements the Authority retains the management function and nomination rights for the 34 modular homes. This indicates that the Authority will be responsible for subletting the properties to tenants. The Cornerstone review includes an estimated £0.532m of annual savings based on the 34 modular homes being made available to citizens that are housed in existing TA provision.

Where an authority is letting out an asset that it has itself leased, the classification of the sublease will depend on the nature of the head lease.

In this case the head lease is “lease 2” and a right-of-use asset has been recognised. The sublease is to be classified by reference to the right-of-use asset, rather than by reference to the underlying asset, so will reference the 25 year head lease term rather than the economic life of the modular homes.

An assessment is required as to whether the sublease is a finance lease or operating lease as per the indicators in section 3 and from the information provided in the Cornerstone review.

In this case the lessor will be the Authority and the lessee the tenants.

| | |
|--|--|
| Does the ownership of the asset transfer to the lessee at the end of the sublease term? | No |
| Does the lessee have the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the end of the lease? | No |
| Is the sub-lease term for the major part of the economic life of the asset (this will be the 25 head lease term)? | Unlikely |
| <i>Life of Asset – c.40 years</i> | |
| <i>Length of Lease – not yet known</i> | |
| Does the Present Value of the lease payments equal substantially all of the Fair Value? | ? – no details of sub lease payments |
| Are the leased assets of a specialised nature such that only the lessee (or a limited number of other parties) can use them without major modifications being made? | No |
| If the lessee is able to cancel, does the lessee bear the lessor's losses? | No |
| Will the lessee gain or lose from any fluctuations in the market value of the residual amount? e.g. the lessee could receive a rental rebate equalling most of the sales proceeds at the end of the lease. | No |
| Does the lessee have the ability to continue to lease the asset for a secondary term at a nominal rental? | Possibly, but unlikely to have rights included within this contract. |
| Are there any other factors to consider? | No |

Link do not have details of the possible sub lease payments, so cannot assess this lease test. The life of the sublease to the tenants is as yet unknown, however it is assumed that these will be short term and therefore will not represent the major part of the head lease term. If the other lease indicators are all “no”, then the arrangement would not have the substance of a finance lease and would be classified as an operating lease.

Where the sub lease arrangement is classified as an operating lease:

The underlying asset would remain on the Authority’s Balance Sheet throughout the sublease term and income from the lessee would be credited as financing and investment income to the CIES as it falls receivable.

A summary of the lease arrangements , classification and revenue impact and the Balance Sheet is shown in Table 1.

Table 5a – Lease arrangements

| Lease | Lease description | Authority | Lease classification | Balance Sheet impact | Revenue impact (General fund) |
|---------|---|-----------|----------------------------------|---|---|
| Lease 1 | Authority land leased to the RP at a peppercorn for 125 years | lessor | operating lease | none - land remains on Authority's Balance Sheet | none |
| Lease 2 | The arrangement in substance means the RP leases 34 units to the Authority for 25 years | lessee | single lessee model under IFRS16 | recognise lease liability and right of use asset | CIES - interest payable element of lease rental, MIRS - MRP |
| Lease 3 | Authority sublets units to tenants for an assumed relatively short duration | lessor | operating lease | Right of use asset under lease 2 remains on Authority's Balance Sheet | CIES – full sub lease rental income receivable |

6. Financial analysis and risks

6.1 Investment proposal

Link have not been provided with an investment proposal for the Edinburgh Drive scheme, therefore the analysis that follows is based on the information provided in the Cornerstone review and the Cornerstone financial model.

The financial model appears to be based on the funding scenario showing 50% proportion funded by grant, however although the figures are similar there appears to have been some inconsistencies as the debt required, the annual financing payment and the interest rate on the borrowing all do not align to the Cornerstone review dated 20 August 2024.

The Authority has provided financial information⁵ on the 24 High Street scheme which has six, single bedroom flats. The assumptions for maintenance costs and voids are expected to be similar to those used for the Edinburgh Drive investment proposal.

The main assumptions are as follows:

Table 6: Assumptions

| Assumption | 24 High Street (6 units – one bedroom) | Edinburgh Drive 34 units– one bedroom) |
|---|---|---|
| Weekly rent | £126 per unit | £126 per unit |
| | | Annual rent £223,681 (year 1) |
| Annual void loss (£) / percentage of annual rents (based on year 1) | £1,968 / 5% | £11,184 / 5% |
| Maintenance cost | £900 per property | Unknown |
| | | £30,600 per annum based on £900 per property |

The financial model reflects the RP's forecast costs and income streams. The income from rents is £0.224m in year 1 based on 100% occupancy which is guaranteed by the Authority. The forecast income from rents includes a 2% annual increase, meaning the Authority will have a contractual obligation to pay the RP £0.267m in year 10 increasing to £0.360m in year 25.

The following table provides some sensitivity analysis on the main financial variables for the Authority.

⁵ Management of New Properties on 24 High Street Table Appendix A.doc

Table 6: Sensitivity analysis

| | | Rent guarantee (£) | | |
|--|------------------------|--|----------------------|----------------------|
| | | 2% per annum (Cornerstone model) | 3% per annum | 5% per annum |
| Rent inflation | Rents at year 5 | 242,120 | 251,755 | 271,886 |
| | Rents at year 10 | 267,320 | 291,853 | 347,003 |
| | | Void cost (£) | | |
| | | 5% base case | 10% average voids | 20% average voids |
| Void cost on rents with 2% annual increase | Based on year 1 rents | 11,184 | 22,368 | 44,736 |
| | Based on year 5 rents | 12,106 | 24,212 | 48,424 |
| | Based on year 10 rents | 13,366 | 26,732 | 53,464 |
| | | Maintenance cost (£) | | |
| | | £900 per property base case | 10% cost increase | 20% cost increase |
| Annual maintenance cost | Based on 34 units | 30,600 | 33,660 | 36,720 |

6.2 Key Financial risks

KEY FINANCIAL RISKS

The investment proposal

Based on the information provided there appears to be material uncertainty in a number of key areas including:

- Who will perform the landlord function?
- The Authority is not a registered provider of social housing. The terms of AHP grant funding from Homes England include a requirement for the landlord to be a registered provider of social housing.
- The Authority holds responsibility of the management function, repairs and voids. The financial summary shows a minimal amount of surplus available to fund management costs and 100% of the costs associated with any void units will impact the GF.
- What is the Authority's anticipated average void rate for the 34 modular homes? The investment proposal should include supported assumptions and sensitivity analysis on affordability.
- Has the Authority identified funds that could be used to create a reserve to mitigate the financial impact of unplanned costs such as excess voids and repairs.
- Are the amounts chargeable for rents contractually linked to published LHA rates? The Authority will have financial exposure for any difference between the rents chargeable and the amounts recoverable from the DWP.
- The Authority will need to be certain that the 34 modular homes meet the exempt accommodation criteria and get more certainty around the amounts that will be recoverable from the DWP.

- The likely costs for performing repairs and maintenance will need to be assessed with associated funding being identified and included in an investment proposal.
- The interest rate associated with the RP's borrowing of 6.21% is 0.46% lower than the rate calculated using the PWLB's published rates on 21 November 2024.
- Will the RP be able to secure borrowing from the market at rates equivalent to the PWLB plus 0.50%.

Cost of planning

The Authority are required to fund planning costs estimated at £0.287m. These costs are to be refunded by the RP once the project is in the construction phase and funding is being drawn down. The planning fees will remain at risk until repayment has been received. The nature of the transaction is unclear and should be clarified so it can be accounted for correctly.

Cost of goods (The Covid-19 Pandemic, Brexit, and Ukraine)

Although the Authority is not delivering the modular homes, an increase in the development's build costs remains a risk to the RP and to the Authority if the scheme becomes financially unviable. This would put at risk any planning fees incurred and the planned savings on TA budgets.

The cost of supply for housing and the latest construction price indices indicate that costs have stabilised over the last 12 months following a period of high inflation. The risk remains that external events could cause the cost of goods to increase and impact the viability of the proposed development.

Inflation

The Authority is responsible for the repairs to the properties for which the cost will be impacted by the level of inflation and cost increases may not be covered by increases in available revenue.

Inflation has eased following a period that saw a surge in costs for components, labour, and freight as the world economy bounces back from the coronavirus pandemic. This has been confirmed by the consumer price inflation including owner occupiers housing costs ("CPIH") rate in the United Kingdom which decreased to 2.6% in September y/y. It compares with a rate of 3.1% in July 2024, 6.3% in September 2023 and 9.2% in February 2023. During the peak the greatest upward pressures came from the housing and household services principally from electricity, gas and other fuels and food and non-alcoholic beverages.

Securitisation

The RP plans to borrow from the market for which the lender will look to secure the loans against the assets of the RP. The proposed arrangements do not include the Authority being a guarantor for the borrowing, however it will need to seek confirmation of any security pledged by the RP in relation to the 34 modular homes to determine the implications should the RP default on its borrowing.

The Authority should ensure it has right of use of these assets for the duration of the arrangements.



6.3 Alternative financing

The following section provides a high-level assessment for the direct delivery of 34 Modular homes on the Authority's land, financed by borrowing from the PWLB as an alternative to the proposed arrangements. This assessment assumes the Authority will be able to commission the construction at the same costs shown in the Cornerstone review.

The analysis is based on two scenarios including 50% grant funding which aligns to the current proposal and a costing based on 100% PWLB borrowing. It will be important for the Authority to consider the level of grant funding that it could attract to finance the project. The Authority is not listed as a registered provider of social housing as at 18 November 2024 which is likely to restrict

access to grant funding and its ability to act as landlord. The Homes England Affordable Homes Programme states:

“Landlords of rented homes built with AHP 2021 to 2026 funding must, by law, be a registered provider. This means you must be registered with the Regulator of Social Housing (RSH), a process which can take at least 6 months.”

6.3.1 PWLB

Traditionally, local authorities have predominantly funded long term projects with borrowing from the PWLB. This is the simplest method to access funds quickly because the borrowing procedure is straight forward with minimal paperwork. When the funding is needed, the loan is arranged by a phone call and the money transferred to the local authority bank account in five working days.

If the Authority wishes to borrow from the PWLB for the proposed acquisitions, it should satisfy itself that the purpose for doing so is not the acquisition of an investment asset primarily for yield as per the PWLB guidance⁶.

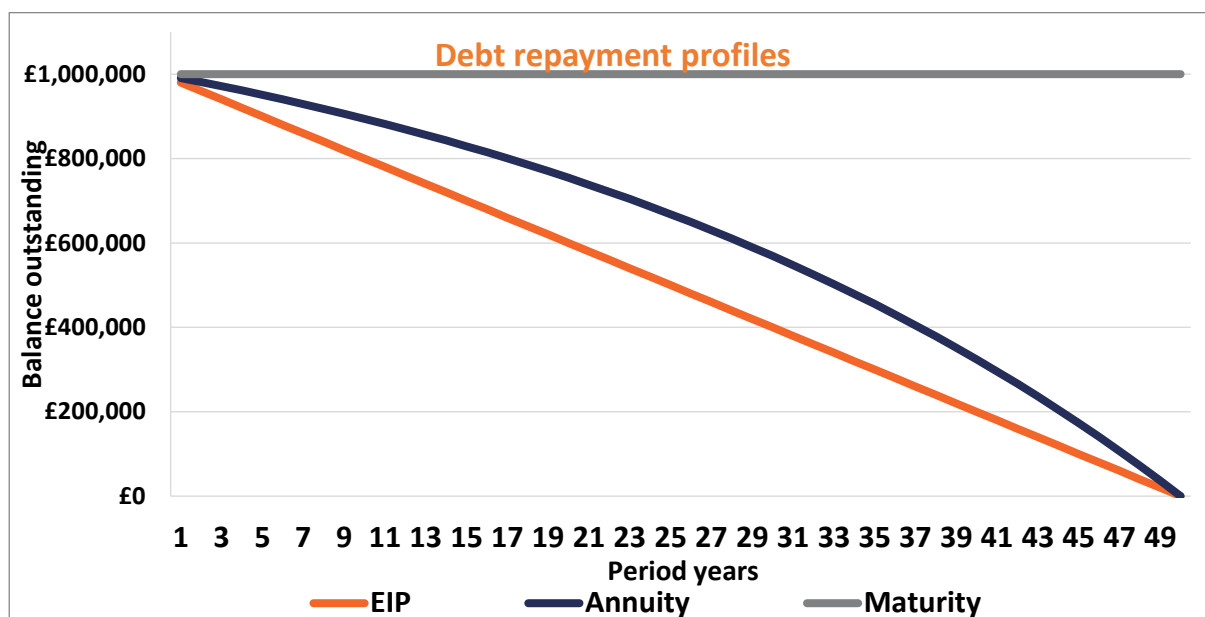
PWLB offer various repayment structures as detailed below:

- **Maturity loans** – require repayment of the full amount borrowed at the end of the term and semi-annual interest is charged.
- **Annuity loans** - equates to a loan structure of about 3/5th of the duration compared to that of a maturity loan. Interest is the primary element of any repayment sum in the first part of the loan's life, whilst principal takes on this facet in the latter part of the loan's life. The sum of half yearly interest and principal repayments come to the same total throughout the life of the loan despite the constituent components of each repayment varying over time.
- **Equal instalment of principal loans** - an Equal Instalment of Principal loan (“EIP”) is repaid in equal instalments, half yearly. Interest will reduce in line with the repayment of the outstanding principal.
- **Variable rate loans** - the PWLB also provides variable rate loans which are available for periods up to ten years.

The graph below illustrates the difference in principal repayments between each loan structure.

⁶ <https://www.dmo.gov.uk/media/qa2npqv/pwlb-guidance-for-applicants-for-publishing-november.pdf>

Illustration 2: borrowing repayment profiles



Fixed rate borrowing from the PWLB could mean that there is an exposure to a cost of carry, or increased interest rate risk depending on when borrowing is undertaken. The cost of carry is the cost of holding money in terms of interest payable before the money is due to be utilised.

The cost is the difference between the interest that can be earned on investing the money temporarily and the cost of paying the interest on the loans if it is not utilised immediately. There will also be an element of interest rate risk in the movement of interest rates in the market, depending on when the borrowing is taken, and this will depend on the economic and interest rate environment as well as the timing of any borrowing.

The table below illustrates the full finance costs for £2.923m over 25 years which aligns to the “50% proportion funded by grant” funding assumption shown in the Cornerstone review. The RP’s funding assumptions include a borrowing requirement of £2.923m repayable over 25 years on an annuity loan basis. The RP’s borrowing interest rate is shown at 5.75%, which applies a 0.50% margin above the PWLB standard rates on 23 August 2024. For comparison purposes, the equivalent annuity loan rate at 21 November 2024 would be 6.21% compared to 5.51% (PWLB CER rate) available to the Authority as shown below. This shows the RP would incur £0.378m additional interest over the 25-year term based on a borrowing requirement of £2.923m.

Table 7: Comparative borrowing costs

| Borrowing cost comparison for £2.923m annuity loan | Loan term (years) | Loan interest rate (%) | Interest repayment (£m) | Principal repayment (£m) | Total (£m) | NPV at 3.5% (£m) |
|--|-------------------|------------------------|-------------------------|--------------------------|------------|------------------|
| Authority at PWLB CER rate | 25 | 5.51% | 2.530 | 2.923 | 5.453 | 3.595 |
| RP at PWLB Std rate +0.50% | 25 | 6.21% | 2.908 | 2.923 | 5.831 | 3.844 |

The Authority should note the above table is based on PWLB CER rates which applies a 0.20% discount to the standard published rates, however authorities that have a Housing Revenue Account (“HRA”) currently have access to PWLB borrowing at the HRA rate which is equivalent to the PWLB standard rate less 0.60% for expenditure incurred in the HRA. If the Authority had access to the HRA concessionary rate this would result in a 1.1% reduction in the interest rate compared to the rates anticipated for the RP borrowing.

To illustrate the indicative borrowing costs where the Authority finances all of the capital expenditure from borrowing, a total of £6.235m has been used based on the Cornerstone review figures of £6.447m for the total cost less £0.212m to exclude the finance fees and interest costs. The table below shows the indicative borrowing costs for £6.235m representing the Authority using 100% debt financing from the PWLB. Borrowing options for maturity, annuity and EIP repayment methods over 25 & 40-year loan terms have been selected as they represent the lease duration and an estimate of the life of the modular homes. The table shows the total amount payable (interest and principal) and the Net Present Value ("NPV") of the repayments at 3.5%⁷.

Table 8: Indicative PWLB borrowing costs

| | | Option 1 100% debt £6.235m | | Option 2 50% Grant funded £2.923m | |
|------------------------|------------------------|----------------------------------|-----------|---|-----------|
| Loan type | PWLB certainty rate[1] | Total £m | NPV £m | Total £m | NPV £m |
| Loan duration 25 years | | | | | |
| Maturity | 5.68% | 15.09 | 8.48 | 7.07 | 3.97 |
| Annuity | 5.51% | 11.63 | 7.67 | 5.45 | 3.60 |
| EIP | 5.40% | 10.61 | 7.39 | 4.98 | 3.46 |
| Loan duration 40 years | | | | | |
| Maturity | 5.59% | 20.18 | 9.02 | 7.07 | 4.23 |
| Annuity | 5.68% | 15.91 | 8.50 | 5.45 | 3.98 |
| EIP | 5.64% | 13.44 | 8.01 | 4.98 | 3.76 |

Table 11 shows the total cost for the Authority for each borrowing requirement and term scenario. When the cashflow profiles and NPV for each option are taken into account, the EIP loans are shown as the cheaper option based on a 3.5% discount rate. The discounting approach reflects that in a maturity profile the full principal is repaid at the end of the borrowing period in comparison to EIP which equalises the interest and principal over the borrowing period and annuity which includes repayment of principal and interest on a reducing balance basis.

⁷ Based on HM Treasury Green Book – referenced in section 6

7. Subsidy Control

7.1 Occupancy guarantee

Where an authority provides a formal guarantee as additional security relating to the obligations of a third party this could be considered a subsidy. State guarantees, whether of loans, coverage of losses, or through unlimited liability or holdings in an enterprise, may be considered to be a subsidy where the guarantee has been provided on favourable terms and so provides an economic advantage, whether or not the guarantee is called upon. This is because the guarantee removes an element of risk that the third party would otherwise have to bear in the absence of the Authority's involvement.

An assessment of the financial assistance provided by the Authority will therefore be required to determine if there is a subsidy and if so whether there are any exemptions to the subsidy controls that may apply.

7.2 Subsidy Control Act 2022 ("the Act")

The Subsidy Control Act 2022 ("the Act") came into force on 4 January 2023 and replaced the interim regime set out in the UK Trade & Cooperation Agreement (the "TCA") that had been in place since the EU State aid rules ceased to apply to UK authorities on 1 January 2021.

Section 79 of the Act provides for the Secretary of State to issue guidance on the practical application of the regime, to which public authorities must have regard when granting a subsidy or making a subsidy scheme. The Department for Business, Energy and Industrial Strategy ("BEIS") issued the statutory guidance⁸ for the Act in November 2022 which was updated in June 2023.

Further guidance⁹ was issued on 11 November 2022 by the Competition and Markets Authority ("CMA") on the operation of its Subsidy Advice Unit ("SAU"). The SAU will be responsible for discharging the CMA's functions and powers under Part 4 of the Act and will support public authorities' decision making regarding the design and assessment of subsidies and how it will apply the guidance.

The Act and the associated statutory instruments set out the framework for public authorities to follow when considering the award of public funds, which is summarised in the flowchart in Appendix B.

7.3 Is it a subsidy?

If the financial support fails to satisfy the statutory definition of a "subsidy", authorities do not need to consider the subsidy control requirements further. The four tests to determine if the definition is met are detailed in S2 of the Act.

Financial support will be considered a subsidy where it satisfies all four of the 'limbs' of the test which are:

⁸ [UK subsidy control statutory guidance - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/statutory-instruments/subsidy-control-statutory-guidance)

⁹ [Guidance on the operation of the subsidy control functions of the Subsidy Advice Unit - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/statutory-instruments/subsidy-control-statutory-guidance)

| | |
|----------------|--|
| Limb A: | The financial assistance is given, directly or indirectly, from public resources by a public authority. |
| Limb B: | <p>The financial assistance confers an economic advantage on one or more enterprises. This test has two parts:</p> <ul style="list-style-type: none"> the recipient of the assistance must be an enterprise: any person, or groups of persons under common control that are engaged in an economic activity, which means offering goods and services on a market. The support must confer economic advantage, e.g., the financial assistance is provided on favourable terms. Financial assistance will not confer an economic advantage if it could reasonably be considered to have been given on the same terms on the market: this is known as the Commercial Market Operator (“CMO”) principle. |
| Limb C: | The financial assistance is specific, such that it benefits one or more enterprises over one or more enterprises with respect to the production of goods or services. |
| Limb D: | The financial assistance has, or is capable of having, an effect on competition or investment within the UK, or trade or investment between the UK and another country or territory. |

7.4 Seven principles

Public authorities need to ensure that the seven principles set out in the Act are considered when designing a subsidy:

| | |
|--------------------|---|
| Principle A | Subsidies should pursue a specific policy objective in order to remedy an identified market failure or address an equity rationale (such as local or regional disadvantage, social difficulties, or distributional concerns). |
| Principle B | Subsidies should be proportionate to their specific policy objective and limited to what is necessary to achieve it. |
| Principle C | Subsidies should be designed to bring about a change of economic behaviour of the beneficiary. That change, in relation to a subsidy, should be conducive to achieving its specific policy objective, and something that would not happen without the subsidy. |
| Principle D | Subsidies should not normally compensate for the costs the beneficiary would have funded in the absence of any subsidy. |
| Principle E | Subsidies should be an appropriate policy instrument for achieving their specific policy objective and that objective cannot be achieved through other, less distortive, means. |
| Principle F | Subsidies should be designed to achieve their specific policy objective while minimising any negative effects on competition or investment within the United Kingdom. |
| Principle G | Subsidies’ beneficial effects (in terms of achieving their specific policy objective) should outweigh any negative effects, including in particular negative effects on competition or and investment within the United Kingdom, and/or international trade or investment |

7.5 Prohibitions

The Act prohibits financial support for guarantees that falls within the following category and it is automatically deemed unlawful:

| | |
|-----------------------------|---|
| Unlimited Guarantees | A subsidy that would guarantee an unlimited amount of liabilities or debts, or which would guarantee a finite amount of liabilities or debts but over an indefinite period. |
|-----------------------------|---|

The Statutory guidance further confirms that “a guarantee by a public authority in respect of all a company’s debts and liabilities, however and whenever incurred, constitutes an unlimited guarantee and is prohibited, even if the guarantee is time limited”.

7.6 Exemptions

The following exemptions apply to the subsidy control requirements:

- any subsidy given as minimum financial assistance (“MFA”) under section 36 of the Act i.e., up to £315,000 (over 3 years).
- any subsidy given as an SPEI assistance under section 38 of the Act i.e., up to £715,000 (over 3 years).
- any subsidy given under a streamlined subsidy scheme (also known as a streamlined route).
- any subsidy given under an existing scheme including a legacy scheme.
- certain subsidies given in exceptional circumstances. These exemptions exist to allow public authorities to respond to natural disasters, national or global economic emergencies, national or global economic emergencies, or for reasons of national security and financial stability.

7.7 Services of public economic interest

The subsidy control system recognises that public authorities may support essential services provided to the public such as, postal services, social housing and certain transport networks, particularly in rural or less populated areas of the country. These essential public activities are referred to as Services of Public Economic Interest (“SPEI”). To designate a service as an SPEI, the public authority must be satisfied that:

- the service is provided for the benefit of the public and
- the service would not be provided, or would not be provided on the terms required, by an enterprise under normal market conditions.

Should a public authority wish to provide a subsidy to an enterprise for the purpose of the provision of SPEI, it must comply with certain substantive and procedural requirements in order to provide the subsidy, as detailed below:

- be satisfied that the subsidy is limited to what is necessary to deliver the service.
- ensure that the SPEI subsidy is assessed against the subsidy control principles.
- ensure that the subsidy is provided in a transparent manner.
- ensure that the subsidy is regularly reviewed; and
- comply with the duty to include information in the subsidy control database.

An assessment against the subsidy control principles needs to be undertaken by the public authority in relation to SPEI subsidies. However, the subsidy may still be given if it is inconsistent with the principles but where compliance with the principles would prevent the SPEI services from being carried out.

7.8 Subsidies or Schemes of Interest (SSoI), and Subsidies or Schemes of Particular Interest (SSoPI)

The subsidy control regime includes two distinct categories of subsidy or subsidy scheme that have been identified as having greater potential to lead to distortive effects: Subsidies or Schemes of Interest (SSoI), and Subsidies or Schemes of Particular Interest (SSoPI). For SSoI referral to the Subsidy Advice Unit (“SAU”) is voluntary prior to the scheme being made, and for SSoPI referral is mandatory before the scheme is made.

The criteria for identifying SSoI and SSoP are:

| | |
|-------|---|
| SSoPI | <ul style="list-style-type: none">• Subsidies given outside of sensitive sectors are SSoPI if they are over £10 million or if they are over £1 million and they cumulate to more than £10 million with other related subsidies given over the previous 3 financial years.• Subsidies granted in sensitive sectors will be SSoPI if they are over £5 million or if they are over £1 million and they cumulate to more than £5 million with other related subsidies given over the previous 3 financial years. |
| SSoI | <ul style="list-style-type: none">• Other subsidies of between £5 million to £10 million (individually or cumulatively) which do not meet the SSoPI criteria are SSoI. |

For subsidies given in cash, their values will be determined by reference to the Gross Cash Amount. For subsidies that are not in cash, their amount will be determined by reference to the Gross Cash Equivalent of the subsidy.

7.9 Gross Cash Equivalent (“GCE”)

The Subsidy Control (Gross Cash Amount and Gross Cash Equivalent) Regulations 2022 (SI 2022 no. 1186)¹⁰ specifies how the GCE amount of a subsidy is to be determined for the purposes of section 33(8) of the Act - Duty to include information in the subsidy database (amongst other purposes as set out in the regulations).

Where a subsidy is given by any other means than a grant, determination may be based on a reasonable estimate of the maximum foreseeable gross cash equivalent amount where it is not reasonably possible to calculate precisely the gross cash equivalent of the subsidy. Importantly, the regulations specify the discount rate which should be used to reflect the present value of a subsidy when it is given, this is updated annually and is currently 5.3%.

The Statutory guidance states that public authorities must calculate the **maximum** award given under the scheme. Authorities may wish to use existing reasonable estimates included in the business case/principles assessment to estimate the maximum award. Where there is uncertainty, or the public authority has to make analytical choices to calculate estimates, the public authority should be conservative in their estimate and err on over-estimating the maximum subsidy.

The first step is for the public authority to establish the terms of the guarantee in question, including any fees paid by the enterprise to the public authority and the total amount that is being guaranteed. Where the amount guaranteed is not explicitly set out in the guarantee agreement, the public authority may need to use estimates to establish the value of the liabilities being guaranteed.

In terms of Subsidy Control Regulations, a financial guarantee refers to a public authority providing a ‘loan guarantee’ to a lender which means if the person in receipt of the loan does not repay the loan the public authority will make a contingent payment to the lender.

¹⁰ [The Subsidy Control \(Gross Cash Amount and Gross Cash Equivalent\) Regulations 2022 \(legislation.gov.uk\)](https://www.legislation.gov.uk/si/2022/1186)

For financial guarantees to fall within the MFA the value of the guarantee is measured by its terms and conditions. If the guarantee has conditions within a set criteria range, it is deemed to have a “Gross Cash Equivalent Subsidy” value of £315,000 or less and is therefore exempt.

Statutory Instrument SI 2022 no.1186 includes supplementary provisions for determining the Gross Cash Equivalent of a small loan guarantee:

| Supplementary provisions | Conditions | Gross Cash Equivalent Subsidy value |
|--------------------------|---|--|
| Small loan guarantee | <ul style="list-style-type: none"> - guarantees not more than 80% of the loan, - not more than £2,350,000, and - for a duration of not more than 5 years. OR <ul style="list-style-type: none"> - guarantees not more than 80% of the loan, - not more than £1,175,000, and - for a duration of not more than 10 years. | Equal to £315,000 or reduced proportionately where amount or duration less than specified conditions |

Note: the £315,000 subsidy value will result in the subsidy meeting the minimum financial assistance exemption.

7.9.1 Guarantee to a person with strong, good or satisfactory creditworthiness

A commercial operator will usually charge for providing a guarantee, this is known as the financial guarantee premium.

In order to calculate the premium at which a guarantee of the same kind might reasonably have been expected to have been available on the market, the amount guaranteed is multiplied by the risk that a claim will be made under the guarantee.

| Level of creditworthiness | Risk that a claim will be made |
|---------------------------|--------------------------------|
| Strong | 0.1% |
| Good | 1.0% |
| Satisfactory | 7.5% |

Where the guaranteed borrower has a credit worthiness level of below satisfactory a further margin for credit risk will need to be added to the premium percentage used. The guarantee premium will need to be recalculated each year and revised for the outstanding liability at that time.

7.10 Application to the proposed arrangements

Although the RP plans to borrow, the Authority is not providing a loan guarantee. The substance of the arrangement is the Authority will be contracted to pay full rental income on the 34 units for the 25-year period. In summary there is no financial guarantee to be considered in relation to the Subsidy Control Regulations.

8. Financial Implications and Impact on Prudential Indicators

The impact on the Authority's Balance Sheet, revenue and prudential indicators for each lease is summarised below:

Table 9: lease implications

| Lease | Authority | Lease classification | Balance Sheet impact | Revenue impact (General fund) | Prudential indicators impact | Prudential indicators notes |
|--------------------------------|-----------|----------------------------------|---|---|--|---|
| Lease 1 | lessor | operating lease | none - land remains on Authority's Balance Sheet | none - peppercorn lease | no impact | |
| Lease 2 | lessee | single lessee model under IFRS16 | recognise lease liability and right of use asset | CIES - interest payable element of lease rental, MIRS - MRP | Non HRA Capital expenditure - Include right of use value | |
| | | | | | Non HRA CFR - include right of use value less MRP | |
| | | | | | Authorised limit - include lease liability plus headroom in other long-term liabilities | |
| | | | | | Operational boundary - include lease liability in other long term liabilities | |
| | | | | | Gross debt and the CFR - include lease liability in gross borrowing | |
| | | | | | Financing costs to net revenue stream - include interest payable & MRP in financing costs | |
| Lease 3 short sub lease | lessor | operating lease | Right of use asset under lease 2 remains on Authority's Balance Sheet | CIES – full sub lease rental income receivable | Actual net income from commercial and service investments to net revenue stream – include net rental income from 34 modular homes | Assumed income is assessed as a result of a service investment. |

The table above reflects assumptions made in relation to the lease arrangements, however Link have not seen the contracts or lease agreements for the proposed arrangement.

Based on the assumptions applied Lease 1 will be classified as an operating lease under IFRS16, resulting in no impact on the Balance Sheet or revenue as the lease is a peppercorn.

For lease 2 the Authority will need to recognise a right of use asset and a lease liability on the Balance Sheet, with the revenue impact being the interest payable element of the lease rental and an MRP charge.

The classification of the sub lease 3 will depend on the length of the sub lease. Under IFRS16 the classification of the sublease depends on the nature of the head lease (lease 2) so a short sub lease life results in an operating lease under which all the sub lease rental income will be recognised in the CIES. A sub lease life that represents the majority of the head lead duration would result in a finance lease classification, meaning that only the interest element of the sub lease rental income will be recognised in the CIES.

The main impact on the prudential indicators is from lease 2 which will require the inclusion of the lease in the Authority's borrowing and capital expenditure indicators. The interest payable and MRP costs will need to be included in the financing costs of the "financing costs to net revenue stream" indicator. If the sub lease is deemed a result of a service investment the net income will be included in the prudential indicator for the actual net income from commercial and service investments to net revenue stream. There will be no impact on the financing costs from the sub lease as interest income is not included in the financing costs to net revenue stream indicator.

9. Disclaimer

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Schedule 2

| | | |
|----------------------|---|--|
| Date: | 6th February 2025 | |
| Report Title: | Edinburgh Drive – Development Appraisal Briefing Note | |

1 Introduction

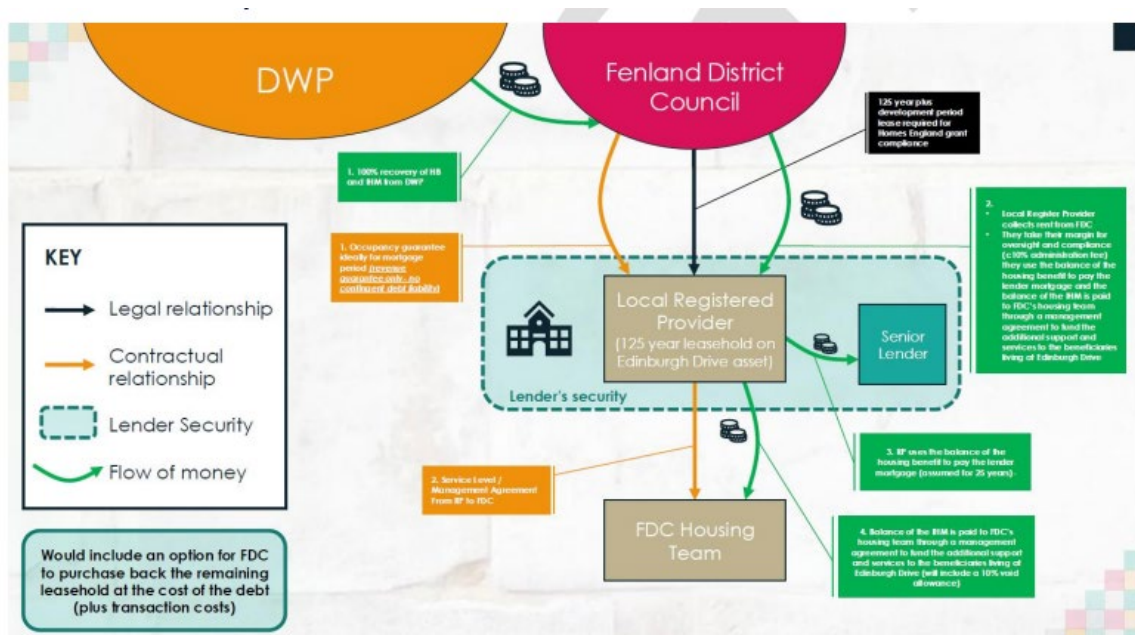
- 1.1 Fenland District Council are considering developing a site in partnership with a social enterprise Cornerstone Place and a Registered Housing Provider (“RP”) to construct 34 modular homes. The proposed structure of the agreement is to lease land to an RP for a period of 125 years. The development of the modular units would be completed by the RP at an estimated cost of £6.4m, which would be funded through 50% Social Housing Grant, and potentially a contribution from the Local Authority Housing Fund Grant with the remainder funded by borrowing from a market lender for 25 years.
- 1.2 Although, the Council would not be responsible for the debt repayment, it would provide a guarantee for the rental income and voids which is estimated at £221k per annum to the RP for the period of the 25-year loan.
- 1.3 The Council would retain 100% nomination rights to the units and have the right (but not the obligation) to acquire the site from the RP for the cost of any remaining debt at any time, or if there was no debt for a notional amount (plus reasonable transaction costs).
- 1.4 The Council requested Link Treasury Services Limited (“Link”) to provide advice on the accounting treatment for the 125-year lease liability and guarantee for the rental income and voids over 25 years and the associated issues which may need to be considered for the proposed investment. The report included the following:
 - An assessment of the proposed lease / development and guarantee structure proposed and a summary of the key financial risks. o Including considerations which could impact the Authority when entering into the proposed structure – e.g.: Indexation, Covenant/Securitisation, and potential impact / risks to future revenue budget.
 - An evaluation of the accounting implications and consideration of the legal and regulatory status applicable.*
 - Financial due diligence on all financial data contained within the investment proposal from the Authority.
 - A high-level assessment of alternative options available to the Authority (PWLB comparator only). This will be limited to an initial analysis.
 - A high-level review of the implications for Capital Financing Requirement and the Minimum Revenue Provision and borrowing limits.
 - Implications for the Authority’s Treasury Management Strategy and Prudential Indicators.
 - Set out the requirements for the accounting treatment and measurement of the guarantee.
 - Outline the requirements to determine the gross cash equivalent of the loan guarantee as required under the Subsidy Control Regulations.

*The report will provide a high-level summary of the legal powers for this type of funding structure.

2 Proposed Arrangements

- 2.1 The proposal requires the Council to provide a 125-year lease of land to a local RP. The RP will then construct 34 modular homes on this land. The RP plans to fund the construction by a mix of 50% Social Housing Grant, and potentially a contribution from the Local Authority Housing Fund Grant with the remainder funded by borrowing from a market lender for 25 years.
- 2.2 The Council would retain 100% nomination rights to the units and have the right (but not the obligation) to acquire the site from the RP for the cost of any remaining debt at any time, or if there was no debt for a notional amount (plus reasonable transaction costs).
- 2.3 The Council would be required to provide a guarantee for the rental income and voids which is estimated at £221k per annum to the RP for the period of the 25-year loan.
- 2.4 The Council is not a guarantor of the debt repayments.
- 2.5 Illustration 1 shows the structure and funds flow for the proposed development.

Illustration 1 – Proposed structure and funds flow



The financial model provided supports the Cornerstone Place Edinburgh Drive Review dated 20 August 2024 ("the Cornerstone review") that outlines the proposed development and covers the following key points:

- The Council will fund the planning costs estimated at £0.287m
 - The planning costs are at risk until completion when the RP will 'refund' the Council. The nature of this repayment is unclear.
- The initial rent payable to the RP is equal to the Local Housing Allowance ("LHA") receivable from the DWP. The income is assumed to increase by 2% per annum and is based on a 100% occupancy rate.

- The flow of funds illustration shows the DWP paying Housing Benefit (“HB”) and Intensive Housing Management (“IHM”) direct to the Council rather than the tenants. This structure reduces the risk of bad debts and rent collection costs.
- The rental income guarantee structure was not provided; however, it has been assumed that future rents are based on forecast LHA incomes rates and a 100% occupancy rate.
- The review highlights £0.532m annual revenue savings for the Council on TA costs. The savings are based on the Council using its nomination rights to place clients that are in existing TA into the 34 modular homes.
- The Council has no exposure to post planning development costs meaning it has no direct risk of overspends on the construction of the modular homes.
- The Council would hold all repairs, void and administration responsibility.
 - The review states “this is recoverable through exempt rents”. This may refer to Intensive Housing Management (“IHM”) payments from DWP.
 - The repairs and maintenance costs over the life of the assets would need to be assessed. These are likely to result in an additional revenue cost to the Authority.
 - The Council’s Housing Team will have a Service Level Agreement (“SLA”) with the RP to be paid to provide ‘additional services’ to residents. This is likely to include the Authority providing supported living arrangements and services.
- The Council have an option to purchase back the remaining leasehold at the cost of the outstanding debt plus transaction costs. Where there is no debt remaining, the cost will be a nominal fee plus transaction costs. The Council should seek confirmation that a re-purchase would not trigger a clawback of Homes England grant funding used for the development.

3 Options Appraisal

There are a series of both revenue and capital options involved with this project.

Option 1

- 3.1 There are three leases involved in this option, but it is the second lease - 34 Modular homes - which needs to be considered by the Council due to the impact on the Council’s Balance Sheet and both capital and revenue budgets.
- 3.2 The Council would not be responsible for the debt repayment but would need to ensure that the RP receives the rental income which is estimated at £221k per annum to the RP for the period of the 25-year loan.
- 3.3 As the Council would retain 100% nomination rights to the units and have the right (but not the obligation) to acquire the site from the RP under IFRS 16 a lessee is required to recognise a right of use asset and a lease liability for all leases with a term of more than 12 months unless the underlying asset is of low value. For this lessee arrangement the Authority will therefore need to recognise a right of use asset and a lease liability on the Council’s Balance Sheet.

- 3.4 This means that the value of the lease of £4.7m which is the original value of the project of £6.4m less the £1.7m residual value of the asset will need to be added to the Councils assets values but also increase the liabilities by this amount.
- 3.5 The Council will also receive a management fee from the RP, which has not been agreed to date, which will be used to reduce the liability of the lease over the 25 year lease to the RP.
- 3.6 **Options Appraisal summary table**

Table 3: Lease repayment schedule

| Year | Opening lease liability £ A | Lease payment £ B | lease liability after payment £ A-B=C | Financing cost for the year £ C x 1.4%=D | Closing lease liability £ A-B+D | Principal £ B-D=E |
|------|-----------------------------------|-------------------------|---|--|---------------------------------------|-------------------------|
| 1 | 4,746,998 | 223,681 | 4,523,316 | 64,147 | 4,587,463 | 159,534 |
| 2 | 4,587,463 | 223,681 | 4,363,782 | 61,884 | 4,425,666 | 161,797 |
| 3 | 4,425,666 | 223,681 | 4,201,985 | 59,590 | 4,261,575 | 164,091 |
| 4 | 4,261,575 | 223,681 | 4,037,893 | 57,263 | 4,095,156 | 166,418 |
| 5 | 4,095,156 | 223,681 | 3,871,475 | 54,903 | 3,926,378 | 168,779 |
| 6 | 3,926,378 | 223,681 | 3,702,696 | 52,509 | 3,755,206 | 171,172 |
| 7 | 3,755,206 | 223,681 | 3,531,524 | 50,082 | 3,581,606 | 173,599 |
| 8 | 3,581,606 | 223,681 | 3,357,925 | 47,620 | 3,405,545 | 176,061 |
| 9 | 3,405,545 | 223,681 | 3,181,864 | 45,123 | 3,226,987 | 178,558 |
| 10 | 3,226,987 | 223,681 | 3,003,305 | 42,591 | 3,045,896 | 181,090 |
| 11 | 3,045,896 | 223,681 | 2,822,215 | 40,023 | 2,862,238 | 183,658 |
| 12 | 2,862,238 | 223,681 | 2,638,557 | 37,418 | 2,675,975 | 186,263 |
| 13 | 2,675,975 | 223,681 | 2,452,294 | 34,777 | 2,487,071 | 188,904 |
| 14 | 2,487,071 | 223,681 | 2,263,389 | 32,098 | 2,295,487 | 191,583 |
| 15 | 2,295,487 | 223,681 | 2,071,806 | 29,381 | 2,101,187 | 194,300 |
| 16 | 2,101,187 | 223,681 | 1,877,505 | 26,626 | 1,904,131 | 197,056 |
| 17 | 1,904,131 | 223,681 | 1,680,450 | 23,831 | 1,704,281 | 199,850 |
| 18 | 1,704,281 | 223,681 | 1,480,599 | 20,997 | 1,501,596 | 202,684 |
| 19 | 1,501,596 | 223,681 | 1,277,915 | 18,123 | 1,296,038 | 205,559 |
| 20 | 1,296,038 | 223,681 | 1,072,356 | 15,207 | 1,087,564 | 208,474 |
| 21 | 1,087,564 | 223,681 | 863,882 | 12,251 | 876,133 | 211,430 |
| 22 | 876,133 | 223,681 | 652,452 | 9,253 | 661,705 | 214,429 |
| 23 | 661,705 | 223,681 | 438,023 | 6,212 | 444,235 | 217,470 |
| 24 | 444,235 | 223,681 | 220,554 | 3,128 | 223,681 | 220,554 |
| 25 | 223,681 | 223,681 | 0 | 0 | 0 | 223,681 |
| | | 5,592,035 | | 845,037 | | 4,746,998 |

- 3.7 Therefore, over the 25 year lease the Council will need to budget for £224k of revenue every year to ensure that the Council reduces the lease liability but will be off set by the management fee received from the RP.
- 3.8 The debit to PPE for the initial measurement of the lease liability will increase the Authority's capital financing requirement ("CFR") which will need to be written down through an annual Minimum Revenue Provision ("MRP") charge. The Statutory MRP Guidance suggests that the MRP requirement for leases

would be regarded as being met by a charge equal to the element of the rent/charge that goes to write down the balance sheet liability. Therefore a MRP budget of £224k will also need to be included in the revenue budget to write down the increased capital financing which can be off set by reduced costs of bed and breakfast.

Option 2

3.9 The second option is for the Council to complete this project themselves which means that the Council would need to borrow the £6.4m and then make the necessary arrangements as to how it would be run plus calculate the additional costs to both capital and revenue budgets.

3.10 At this time the only figures we know is the costs of building the 34 Modular Homes which is currently £6.4m.

3.11 Options Appraisal summary table

| Impact on Revenue | | |
|-------------------|---------------|------------------|
| MRP £ | INTEREST £ | REV. IMPACT £ |
| 260,000 | 299,650 | 559,650 |

3.12 If the Council were to borrow this capital over a 25 year period, the impact on the revenue budget would be £600k a year but the Council should receive income from either an RP as a management fee or the income from the Housing Benefits system for the clients using the facility or reduced costs of bed and breakfast.