Business Plan 2016-2019

Merton Development Company Ltd

IN HOUSE

Contents

Background

In October 2015 the regeneration team, Future Merton, started the initial business plan work to develop the concept of building to rent (PRS) as an option to help develop out council owned sites. The objective, to generate the council income and deliver a quality housing product for the private market to rent.

The team researched and visited other borough's and found the most efficient way of delivering this concept is through a wholly owned council company whose specific business purpose is to build out council owned or purchased sites for either housing or commercial rent. The rationale behind the choice to set up a company was to give the company the agility and expertise to respond to a buoyant housing market where property values have increased significantly in recent years and created, a healthy, but still immature housing rental market.

The growth of the local rental market brings its own challenges as most landlords are individuals. Theinconsistencies with quality, overcrowding, and rogue land lords creates the perfect opportunity for a high quality rental product to intervene in to the local market and deliver better quality residential properties with high quality and responsive management.

The council no longer has a housing revenue account (HRA). The London Borough of Merton transferred all its housing stock to Circle Housing Ltd in 2010. The Local Authority Property Company (LAPC) as part of the business plan will develop sites to be as policy complaint as viably possible and these will then be sold on to registered providers (RP's).

Introduction

Merton Development Company Ltd(name to be confirmed) is the council's wholly owned company that will specialise in developing high quality housing (and commercial property) for market rent.

Merton Development Company Ltd will be a commercially driven vehicle looking to maximise profits and income back to the council, assisting the council in delivering additional housing and stimulating growth and investment opportunities through delivering commercial property in the form of office, retail, and industrial where the opportunity presents itself.

The company will be a wholly owned company with the council as the single (golden share) shareholder, however the company will act like a commercial entity, competing for market segment by delivering a better quality product to customers then traditional private landlords. Merton Development Company Ltd will have a competitive advantage by being the council's preferred residential (PRS) developer.

The relationship with the council will be based on a sound commercial footing. The Council will act as Banker for Merton Development Company supplying working capital and development finance (on commercial terms) for the development and acquisition of sites (council or private).

The council, to begin with, will provide the loan finance to the company to fund the construction of the sites where schemes have demonstrated to being commercially viable through the company's financial model and will deliver a sound return on investment to the council.

As the sole shareholder the council will receive:

- A margin on the interest financing of the company
- An equity stake in the company (the development land value) that can be released when required
- A Shareholder dividend
- The benefit of capital growth in the portfolio over time
- A contribution through planning agreements to affordable housing
- Cash windfalls where market conditions are commercially advantageous

This business plan outlines the development pipeline that the council will allow the company access to. The initial business plan will aim to deliver 77 units for its first projects. Once the company gains momentum the regeneration of Morden town centre will be the company's major project with a potential 600 units being developed in the town centre.

The primary purpose of the company is to deliver the council a sound return on investment through rental on private or commercial properties, however where market sale supports cash flow and financial viability, this will be included to ease any financial burdens the company or the council may face in the current macro environment.

Current Market conditions

The London housing market temporarily slowed during the 2008 recession however it was fairly well insulated due the level of demand for housing in the capital; prices temporarily dropped but quickly returned within a year. The effect of the crash slowed sales and development. Government spending since the crash has been severely curtailed, with councils facing unprecedented cuts to funding and no longer able to offer stimulus investment into the sector, which has heightened the sectors commercial approach resulting in very low levels of affordable housing supply being provided from the sector.

The government's recent changes to the right to buy rules has seen housing supply reduce even further with Registered Providers (RPs) now included in this new government's legislation many developments created by RPs have been halted temporarily whilst they reconfigure there company's business plan to allow for the new legislation.

The government's recent changes to stamp duty for buy to lets and new tax rules on buy to let properties has slowed the investment in private rental market.

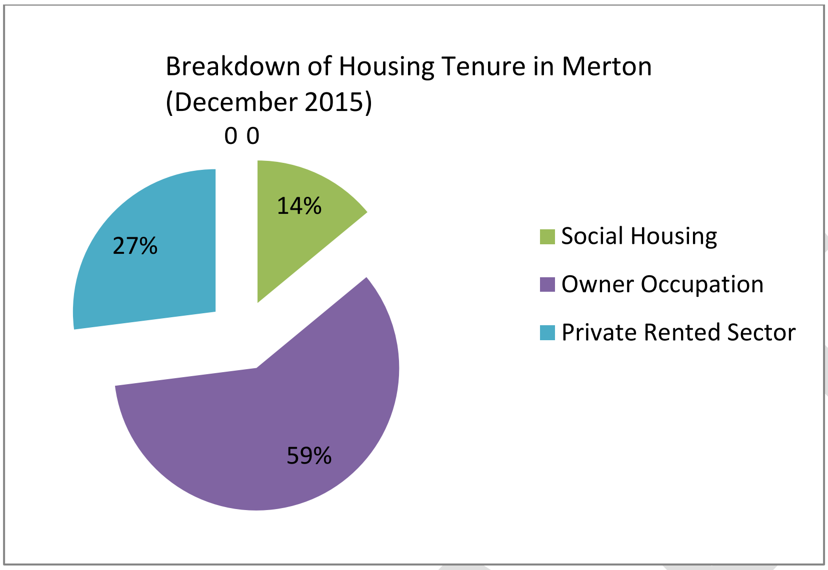
The financial sector has seen stricter rules imposed on banks by government which has had a knock on impact on the accessibility of mortgages, with lenders being stricter and requesting higher deposits for individual mortgages this has made purchasing more difficult for first time buyers with average deposits in London ranging from £40-50,000.

These factors have contributed to accelerate trends away from owner occupation and fuelled the rental market.

The government have put in place help to buy to enable first time buyers to get on the ladder, however due to the level of deposit required by the bank and rent accounting for 60% of the average Londoners salary, saving for a deposit is still a challenge for first time buyers. Property prices are also being driven up by foreign investment into the sector.

The Merton context

The London Borough of Merton has very few company based landlords with predominantly social housing providers selling the service in Merton.



According to the Greater London Authority (GLA) London data store the London Borough of Merton has approximately 207,000 residents living in approximately 83,400 properties. In terms of employment the GLA data store shows the Borough has some healthy economic statistics, with 88% of the residents in the borough being of working age, with 79% of that total being gainfully employed.

For one of London's smallest populations and one of the lowest housing stocks across London it has a strong local economy with 87,000 employed people working within 11,225 active businesses within the borough. In the London Borough of Merton the Public sector only accounts for 12% of the boroughs jobs, this is very healthy statistic when compared to other London Borough's such as Newham which has 23% employed by the public sector.

The salaries earned in the borough are in line with the London average for women and above the London average for Males earning an average salary of over £36,000. The median household income for the borough is approximately £57,000, which is a reasonable income and explains how 29% (GLA 2016) of the borough can afford to privately rent with the percentage of people buying their home just above at 32%. With house prices increasing steadily the average first time buyer deposit in London is now approximately £91,000 according to research carried out by Halifax Bank (2016), potentially strengthening demand for Private rented properties being likely to continue as Londoners struggle to save large deposits.

The above statistics demonstrate the conditions for a new entry into the PRS market locally.

The Private Rented Sector (PRS)

The Private rented sector is growing in the UK , and more significantly in London. The private rented sector consists of 2.7m dwellings in the United Kingdom or 10% of the total housing stock, of this total, 2.4m is in England, representing 12% of the English housing stock.

The sector has grown by over 10% in the last ten years and, according to the Centre for Economics and Business Research, and forecast to grow by a further 40% over the coming ten years.

In 2010 the government ran a large scale survey of the Private Rented Sector and analysed the social and economic spread of private landlords. Some key findings were:

- Eighty-nine per cent of landlords were private individual landlords responsible for 71% of all private rented dwellings, with a further 5% of landlords being company landlords responsible for 15% of dwellings.
- More than three quarters (78%) of all landlords only owned a single dwelling for rent, with only 8% of landlords stating they were full-time landlords.
- Over three-quarters (77%) of all dwellings in the PRS were purchased by the landlord, 9% were inherited and 8% were built by the landlord.
- Eighty-nine per cent of landlords were private individual landlords, 5% were company landlords, and 6% were 'other organisation' landlords. These were responsible for 71%, 5% and 14%, respectively, of all dwellings in the sector.
- Twenty-two per cent of landlords had let properties for three years or less with two-thirds (69%) for 10 years or less. Only 5% had let for more than 40 years.
- In terms of formal letting and management practices, nearly all landlords and agents (97%) made use of a written tenancy agreement, with 91% requiring a deposit, and 84% requiring tenants to provide a reference.

Since 2002, the private rented sector has almost doubled, from 10% to 19% in 2014-15. By contrast, the social rented sector has nearly halved, from 31% of all households in 1980, to 17% in 2014-15.

The decrease in social housing is due to the government's refresh of right to buy, with few houses sold being replaced. The increase in the private rental sector is also partly attributable to right to buy, a recent Central Government select committee report revealed 40% of properties bought through right to buy are now in the private rented sector (English Housing Survey 2016).

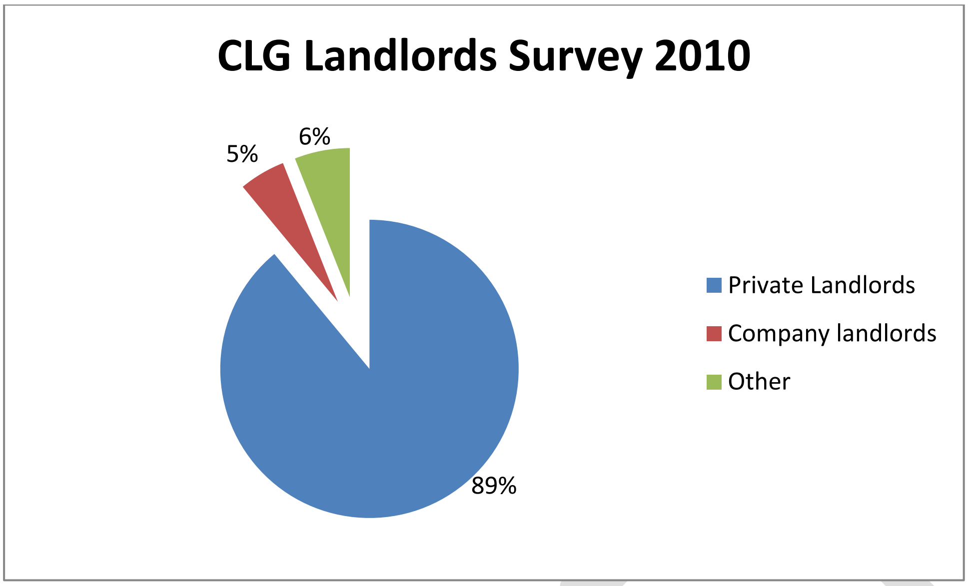


Figure 1 – CLG Landlords survey 2010

The above chart (Figure 1) demonstrates that the bulk of PRS is currently provided by private individuals acting as "amateur landlords", so much so that many local authorities have set up and implemented a property licensing scheme for these landlords to ensure minimum standards are met on health and safety and property management.

The introduction of licensing schemes is an indicator that PRS is a relatively immature market in parts, with plenty of space to enter with a much better product which is professionally run and well managed.

The table on the next page is a description of each of the different types of landlord in the market.

Type of landlord	Description
Private individuals and couples	The largest group of landlords in the PRS. This will include those that have chosen to purchase a single property for buy-to-let purposes, chosen to let a property that they no longer need to live in or have over time developed small portfolio of properties to let. The quality of landlords within this group will vary significantly. At the top end will be those who are letting high quality apartments and houses, through to exploitative landlords offering sub-standard properties.
Partnerships	Partnerships will typically include those private individuals that have chosen to set up a small business to manage their property portfolio. Similar comments on the quality of accommodation let by the private individual group of landlords will apply to partnerships.
Private and listed companies	Accounting for around 5% of the landlords in the PRS this group will include large publically listed companies (e.g. Grainger) as well as other private companies. Large organisations such as Grainger have national large portfolios (e.g. circa 4,000properties) of stock. There are however very few of these types of landlords in the UK. Other private landlord companies may specialise in specific types of accommodation e.g. student housing, hospital related accommodation etc. A number of developers and Registered Providers have entered this market in London in recent years (see key competitors below)
Public sector and charitable organisations	This group of landlord covers housing associations that have become involved in the PRS. It will also include other parts of the public sector that have legacy property portfolios which they let out to residents (e.g. universities, hospitals etc.). A number of Housing associations have recently expanded their portfolios of stock rented at market rent levels. They already have strong housing management practices and believe there are significant benefits to be achieved through expansion into the sector.

PRS tenants Market segments

PRS in London typically accommodates those that are aged between 18-35 and are unable to afford the purchase of their own home, however this is simplifying a more complex picture of individual market segments which are set out below, along with the key features of each of the PRS market segments. (Table 1 – PRS Market Segments)

Market segment	Description
Students	Aged 18 – 21 and attending College / University. Properties are typically located near to an education establishment. The PRS offers this segment affordable housing costs alongside flexible tenancies, which landlords have adapted to meet the specific needs of students. Households in this market segment are typically characterised as being cost effective and includes sharers.
Young professionals (singles / couples and sharers)	This group has largely been created through an increase in mobility and affluence at an earlier age. This group tends to relocate aware from the family home soon after university to seek employment elsewhere. This means, that compared to 20 or 30 years ago, new households are now being formed earlier. And then as home ownership becomes increasingly difficult to access, this group remains in rented accommodation for longer. This group will typically live in accommodation that has a location close to a range of local amenities (transport, nightlife etc.) and will include individuals living along, couples and sharers.
Generation rent	People typically aged under 35 and have good incomes and choose to live in rented accommodation due to lifestyle choice. People typically aged under 35 (but can be older), with good incomes but are unable to raise a deposit to gain a mortgage or are seeking to remain mobile for career reasons.
Young families	Parents aged in their 20s or 30s with children aged under 10. Renting may not be a first choice to this group, but they may not be able to access / afford a mortgage to buy a property. Traditionally this group may have attempted to seek some form of social housing but are now unable to access it. One major concern for this group is on the lack of stability around renting, where 6 months tenancy agreements with private landlords are the norm.
'Empty nesters'	A smaller market segment, it includes couples (usually over the age of 50 – 55) who are looking to downsize as their children have left home. They may be looking to swap a large family home for more modern accommodation close to town centres, or are looking for temporary accommodation to meet the needs of a job / specific phase in life / to provide greater freedom in an attempt to sell a family home. The PRS therefore offers flexibility and choice to this market segment.
Housing benefit	This is a diverse group of residents and for example will include; pensioners, families, singles, those unable to access work through sickness / disability etc. Not all PRS landlords will let their properties to this market and those that do tend to provide a specific focus on this group.
Migrants	For new migrants to UK, the PRS is typically the only accessible form of housing available – social housing will not apply and homeownership may be out of reach for many. An increase in this market segment has also been observed as migration in recent years from the EU has increased. Although this segment is highly diversified - due to pressures on costs a large part of this market segment typically has less choice and may as a result live in less desirable properties in the PRS.

Merton Development Company Target groups

Merton Development Company's target customers are highlighted in Table 1 above. They are young professionals and families looking to rent property that is of a good standard and willing to pay full market rent for this security and comfort.

The majority of our target market is below the age of 35 who are looking for modern facilities to come as part of the property, this includes features such as:

- Broadband/Wi-Fi
- Bike/sports equipment storage
- Resident Gym's - Advanced
- Concierge services – Advanced
- Good on site security arrangements
- TV packages such as freeview and Sky on discount

The above list of features is a general list and certain advanced items e.g. concierge and gym services can only be achieved if the property itself has over 100 units in the same development or adjacent developments.

The first tranche of sites will deliver 77 homes across four sites. The initial developments are unlikely to offer the advanced items to prospective tenants, however the remaining items could become standard as part of the PRS offer from Merton Development Company.

The introduction of Wi-Fi and TV package deals as standard items saves time on management administration costs, and stops residents from sourcing their own solutions and thus making the building look untidy as different customers start to use different providers for different products e.g. Sky satellite dishes etc

This target market group, apart from young families, are sharers, whom will often be looking for equal sized bedrooms and ensuite facilities as part of the standard offer.

Competitors

Merton Development Company's key competitors are the 6% that are private limited companies and 5% which are charities and other public organisations such as registered providers who are now changing their business model to enable them to operate in the market rent part of the PRS market.

These main competitors are:

Be:here

About / Experience

- Established in early 2013, be:here is a principle subsidiary of Wilmott Dixon operating within its regeneration division. It represents its PRS business.

Rent strategy

- Be:here plans to create over 5,000 PRS homes over the next few years.

Development/purchase pipeline

- be:here has two schemes. It's fist scheme, East India in Tower Hamlets, offers 158 studio, 1 and 2 bed apartments and is due for completion in early 2015. It forms part of the multiphase Aberfeldy regeneration project. This development was undertaken with Poplar HARCA, who retains the freehold but has granted a 250-year leasehold on the land to M&G Investments. The latter are funding the development through be:here but the units will be let under the be:here brand. Poplar HARCA will be responsible as the landlord for the management of the tenancies, including all outgoings, maintenance and repairs during the lease term.
- More recently be:here has teamed up with Invesco Real Estate (IRE). The latter will acquire 118 PRS units for £32.5m in Hayes, West London, on behalf of a UK local authority pension fund. IRE's client will purchase the site's freehold from be:here and fund the development of the scheme. be:here will manage the units following completion in 2016.
- be:here in the process of acquiring further sites across London and at central locations in Manchester, Birmingham, Bristol and Leeds; each capable of accommodating single developments of 100 to 400 apartments.

Units in management -All schemes are currently in the development phase.

Indicative Rents – Their first properties are not due to be let until January 2015, but be: here anticipate a 1 bed studio at their East India scheme will be roughly £1000-1300 per month, and a 2 bed between £1500-1900 per month.

Target market & Services

"Flexible apartments, designed to work for singles, sharers and families"

Be: here is developing homes specifically designed for young professionals, targeting 'in-betweeners' who want to live in high quality homes close to their work but cannot afford to buy and don't qualify for social housing. Its services have been developed using feedback from this target group, including:

- Ample storage space, with additional secure storage available on-site to rent
- High-speed broadband, cable TV and telephone ready to use
- Sharers enjoy large, equal-sized bedrooms and a bathroom each
- Rent, rent increases and charges that are fair, reasonable and transparent
- Flexible communication methods - online, phone, text, email or on-site manager
- Flexible approach to tenancies
- Support finding a flat-mate
- Taking in parcels and dry cleaning

Finances

- Its model is predicated on sale and lease back financing, working on a “develop build and sell continuum”. As its income is brought in progressively over successive construction phases, its benefit to Wilmott Dixon will not be felt for a while.
- be:here’s agreement with M&G Investments on its East India scheme represents one of the first examples of institutional investment in the PRS. There is growing recognition among institutional funds of the PRS market’s investment potential.

Fizzy Living

About

- Fizzy Living, a commercial Subsidiary of Thames Valley Housing association (TVH), launched in early 2012 and has made a genuine effort to capture a modern brand position.

<u>Rent Strategy</u>

- Fizzy plans to buy 1,000 new build properties over three years. It buys blocks between 60 and 150 units, all to be let at market rents. Currently its preferred area of operation is London and the South East, but there are plans to take the product nationwide in the mid-term.
- In the future it will deliver mainly 2-3 bedroom units, with the bedrooms around the same size. They will be designed for sharers, which will reduce the cost of the tenancies.
- Plans are to re- invest income into social housing.TVH intends to hold onto the portfolio but the option of selling will be there; in the future it may consider selling it into a real estate investment trust.
- Their full portfolio will be managed and let by Fizzy

<u>Development/purchase pipeline</u>

- Fizzy’s fifth acquisition in Lewisham recently took place; acquiring 136 units. The acquisition takes their portfolio to 382 apartments and moves it closer to its target of 1,000 units.
- Fizzy has launched schemes in Epsom, Stepney Green and Canning Town.

Units in management (as at today) –They currently manage approximately 180 units.

Indicative Rents - A one bed flat in Poplar costs from £1,325 per month. A two bed from £1,560 per month, and three bed from £2,000 per month.

Target Market& Services

"Re-inventing renting"

Fizzy has marketed its product at aspirational young professionals, referred to as 'rentysomethings'. Its offer has been developed with this client group in mind, for instance:

- Each block has its own property manager called 'Bob', the equivalent of an American "super", who arranges access for repairs and takes deliveries
- Two weeks free rent is available on some schemes. They also offer discounts to tenants who accept longer term tenancies to increase retention
- A resident's gym and concierge free of charge
- Self-serve (rent statements available online etc.)
- Fizzy manages utility charges on behalf of tenants at some buildings, recharged at cost and there are no middlemen or agency fees
- Social media and IT to help tenants find flat mates and free WiFi for the life of the tenancy &Free TV set top box / Freeview channels

Finances

- Plans are to fund this £200m investment programme with £120m debt (from banks) and £80m equity, with £30 million of equity from TVH. Fizzy plans to attract a further £50 million of equity from institutions such as pension funds and smaller private investors. It will be grown into a £15 million-a-year turnover business.
- Fizzy has a forecasted internal rate of return of 15 per cent. In February 2013 Fizzy obtained £40 million of finance from Macquarie Capital. In March 2014 it secured £200m from Silver Arrow, an investment entity ultimately owned by the Abu Dhabi Investment Authority (ADIA).

Grainger plc.

About

- Grainger has been in operation since 1912 starting in Newcastle, and is the UK's largest listed specialist residential landlord and property manager. It manages a good portion of its property, but outsources much of its stock to RP partners, as it is unable to sustain a national management presence.

Rent Strategy

- A good part of its successful growth is based on property trading – buying when the market is low or adding value through investment and trading when property prices rise. For this reason the Grainger product is not a settled PRS product. It has to saleable to non-renters.

- Part of its current strategy consists of leading the residential market and creating new business opportunities, as well as maximising returns by actively managing assets and ensuring they are located in the best economic areas. Grainger are actively increasing the size of their market rented portfolio, as the business focuses on increasing their rental income.

Development/purchase pipeline

- Grainger are currently developing an array of mixed tenure schemes (e.g. 197 private units in Haringey due for completion in 2015).
- In terms of build to rent, they are currently active in the 'doughnut' zones around central London to acquire large-scale build to rent opportunities. Their first build to rent scheme is under construction in Barking.
- APG, the Dutch pension fund group, has recently invested in a £430m fund with Grainger, for developments amounting to 1,700 homes.
- Grainger are actively looking to expand their PRS portfolio in Newham, having already teamed up with Bouygues UK to begin work on a site in November 2014.

Units in management (as at today) – Across the UK Granger owns and manages 4,007 market rented assets that have a market value of £446 million.

Indicative Rents – unavailable

Target Market& Services

"For our tenants we are a local, responsible and professional landlord"

- Grainger provides a generic rental offer and doesn't appear to have a specific target market.
- Properties are usually let on a fixed term, usually on an annual basis, but they may also agree a minimum term of six months in some circumstances and periods of five years for some tenancy types.

Finances

- Grainger owns a significant portfolio of residential property assets across the United Kingdom and Germany worth c. £1.8bn as at 30 September 2013. In the UK, 60% of their assets are located in London and the South East. Their assets provide strong and resilient cash flows through sales and rental income.
- In fact, their net rents equate to £48.5m, the second largest source of their income after profits from sales (£77.7m). Historically, the types of assets they owned provided strong sales income and relatively lower rental income, but as they deliver on their strategy, focusing on the private rented sector, a greater proportion of revenue will come from rents.

Essential Living

About

- Essential Living is a developer and operator of private rental homes in the UK.
- Backed by long-term institutional capital, Essential Living intends to "rewrite the rules on rental" by becoming the UK's first buyer, developer and operator of rented homes.

Rent Strategy

- They aim to deliver 5,000 units of private rental stock over the next decade
- They build to rent but also renovate office buildings
- Essential Living's strategy is based on replicating the successful multi-family lettings sector in the U.S. through buying up land to develop rental homes. Essential Living will directly manage these units over the long term.

Development/purchase pipeline

- At present Essential Living have a pipeline of 1,500 homes across London.
- They are currently developing 345 units in Canary Wharf – ready in 2017, as well as 149 residential units in Bethnal green, available in 2016. They also have high profile developments such as London 360 in Elephant & Castle, The Helix in Docklands and 100 Avenue Road in Swiss Cottage.
- It has bought its seventh site in Greenwich, SE8 and will submit a planning application later this year for a new scheme with more than 200 flats in a 17-storey tower.

Units in management (as at today) – All schemes are currently in the development phase.

Indicative Rents – unavailable (schemes not due for completion until 2015)

Target Market& Services

"Our vision is to bring exceptional quality, sustainability and customer service to our residents."

Essential Living recognizes that most renters are young but that many are increasingly likely to have families, and that there has been increase in single parent households. They have developed their brand with this in mind. Their core values are responsibility, inclusivity and commitment. Solutions are also developed on four key factors: time, space, freedom and trust. They encourage community and offer long-term tenancies

Their offer includes:

- Rooftop communal terraces, storage rooms, cold room storage
- Fitness centres
- Residents' bike stores & landscaped communal terraces
- Crèches and children's play space
- Professional, round the clock onsite service
- Quality IT services
- Sites are no more than a 10-minute walk to transport links

Finances

- Essential Living is backed by Evergreen Real Estate Partners in association with M3 Capital Partners who have given $200m of equity. The latter manage U.S. institutional funds.
- They claim their funding stream enables them to quickly acquire land without needing to raise debt.

Get Living London (GLL)

About experience

Rent strategy

- Get Living London launched its first scheme in May 2013 and is committed to *being the market leader in private rental in London.*

Development/purchase pipeline

- Currently GLL own and manage a new site in East Village located in Stratford, which used to be part of the Olympic Park. East Village has the following amenities on its doorstep: Westfield, Stratford International Station, Chobham Academy, and 27 hectares parkland
- East Village contains 2,818 homes in 11 distinct developments Get London Living own 1,439 units, and occupancy began in 2013.
- GLL has not released details of any future developments, however it is apparent that they have not been shortlisted for Round 2 of the Build to Rent Fund.

Units in management

- In June 2014 GLL had 500 units in management.

Indicative Rents

- 1 bedroom apartment-furnished£355 pw
- 1 bedroom apartment-furnished£380 pw
- 2 bedroom apartment-unfurnished£405 pw
- 2 bedroom apartment-furnished£410 pw
- 2 bedroom apartment-unfurnished£410 pw
- 3 bedroom apartment-unfurnished£518 pw
- 3 bedroom apartment-furnished£540 pw
- There are no 4 bedroom homes currently available

Target market & Services

"A better way of renting"

- GLL offer 1, 2, 3 & 4 bedroom properties, furnished or unfurnished. Their target market, with 1 and 2-bedroom apartments aimed at young professionals and couples. 3 and 4-bedroom apartments/ townhouses are designed for sharers and families.

Their offer includes:

- Eco-friendly living in London – marketed as greener place to live e.g. water recycling
- Flexible tenancy agreements: choose from one, two or three-year terms.
- Ability to up or downsize within East Village with no extra fees to pay
- Quality management - their team is located nearby, next to Stratford International Station and are available 7 days a week. They also have an emergency response team, located at East Village, who are available 24/7.
- Take parcel deliveries for tenants when they're out, give information about the neighbourhood and forthcoming events.

Finances

- GLL is owned by Delancey and Qatari Diar as part of a joint partnership Qatari DiarDelancey

Merton Development Company's Approach

The organised PRS market in London is very competitive with a very different product to traditional buy to let landlords. Merton Development Company's approach will be to focus on high quality developments that are maintained and managed to a good standard.

Some of the main strengths of Merton's Development Company will be:

Geography

The London Borough of Merton unlike other boroughs has a very under developed market for company run PRS. The company will start by focusing in the London Borough of Merton. Focusing locally to start with will allow the company to establish a branded product that is recognised for quality through reputation.

Finance

The LB Merton will finance the company at a commercial rate and enable the company to get established. The access to relatively low risk finance gives the company some shield against financial market pressures as the council is the guarantor of the loan. The company will only draw down finance as and when it's needed to ensure no additional borrowing charges are incurred to the company or the council.

Mixed Developments

Merton Development Company will develop both residential and commercial property as part of its remit, this mix in tenures will allow the company on smaller sites to establish facilities new renters look for such as cafes, gyms, dry cleaners etc in the form of retail units on the ground floor.

Extended Tenure

Merton Development Company will offer longer tenancies then traditional landlords with more security for renters. The longer tenancies will come with fixed increases which will give the customer comfort of no unexpected increases in rent and gives the company an even cash flow with less bad debt and void periods.

Pipeline

The company will have access to the council's pipeline of sites. The sites will be subject to viability testing and other council pressures on land, however having access to a pipeline that can be tested will allow the company to pursue only sites that are financially viable and reduces the risk the company would be exposed to if the company where to purchase a sites.

Merton Development Company’s Development Strategy

Pipeline

Merton Development Company has agreed access to a pipeline of potential council sites in order to create a development pipeline for both housing and commercial purposes. The first tranche of sites selected will all require planning permission for housing, with commercial property where necessary, and will look to develop units across four medium sized sites in the first tranche.

Merton Development Company will also transfer other smaller sites and one off properties into the company. The smaller sites are a mixture of houses that are currently rented commercially through a third party arrangement, and small pieces of land available for a single house development. The company will let, manage and maintain these individual properties giving the council a better return then what they currently achieve.

The company will take a pragmatic approach to providing additional services such as gyms, cafes, retail space within developments to ensure the rent prices can be set competitively and customers get a good deal. The focus will be on the quality of the internal furnishings of the properties to ensure the units are comfortable and contain all modern fixtures.

Affordable Housing

Merton Development Company Ltd will comply with the council’s affordable housing policy, subject to the planning requirements to demonstrate viability, however PRS development schemes do not offer an immediate cash return. PRS developments hold more risk and debt for longer, and the company is likely to go through two property cycles during the 30 year period that borrowing it is currently modelled on, therefore the way in which its assessed at planning stage needs to be reviewed and any affordable housing carefully negotiated to ensure viability of the company is maintained.

The company will sell any units developed for affordable housing to registered providers and will not retain any social or affordable housing within its business model. The retention of affordable housing puts the company at risk to current government legislation around the right to buy and any further changes. It’s the intention that the company will operate on a purely commercial footing and only offer discounts where as part of any incentives where, market conditions require.

Market Sale

Merton Development Company Ltd may sell a proportion of the units in some developments to boost the company's balance sheet by paying debt down quicker.If the opportunity presents itself in the market where the company can sell properties off at peak values, this will be considered and presented to the council on a development by development basis.

Development Pipeline

The tables below show the medium and small sites that the company could have access to.

Merton Development Company Pipeline – Medium sites pipeline			
Sites	Status	PRS/Affordable	Units
Raleigh Gardens	Pre Planning	PRS	22
Land at Canons	Pre Planning	PRS	22
Elm Nursery Car Park	Pre Planning	PRS	24
Farm Road Church	Pre Planning	PRS	9
West Barnes Library	Pre Planning	Affordable	21
Wilson Avenue Shops	Pre Planning	Affordable	20
Worsford House	Pre Planning	PRS	60
		Total	**178**

Merton Development Company - Small Sites Pipeline			
Kenilworth Road	Pre Planning	PRS	2
Land at Westside Common	Pre Planning	Sale	1
		Total	**3**

The first four sites have been modelled and will cost approximately £11.8 million to construct out based on current market costs. Construction inflation has risen in the last 18 months, this will need to be considered further and reviewed once prices are returned through the procurement process, as the financial model has estimated values that the properties can be built for per square foot, if these fall outside of the current envelope, the model will need to be reviewed and revisions made as appropriate.

Future sites

The below is a list of other larger sites that the Company could have first refusal on as future development sites.

Merton Development Company Pipeline - Future Sites			
Sites	Status	PRS/Affordable	Units
Morden Regeneration	Pre Planning	PRS	600-800
Leatherhead	Pre Planning	PRS	250
Chaucer centre	Pre Planning	PRS	40
Kenley Railway Car Park	Pre Planning	PRS	20
		Total	910-1110

The council also has a large portfolio of commercial sites (light industrial) in the western part of the borough located in Wimbledon. This site sits adjacent to the railway line and has huge potential to be redeveloped in to alternative uses such as high quality serviced office space similar to developments like prologis science parks that house hubs for high tech start ups and internet companies like Amazon.

High Quality Management

Merton Development Company Ltd is committed to providing a high quality management service to all customers. Merton Development Company's objectives are to take rental products to the next level, ensuring that customers are happy with the service and the word spreads quickly across our target market. The company will select a strong local agent through a competitive selection process, to manage the lettings process ensuring that all customers are vetted and the product is not compromised by poor processes from the outset.

The Agents responsibility will be:

- Lettings
- Negotiations
- Tenancy management
- Block management administration

As the company progresses, these may be changed and additional duties may be passed over to the agent after their track record has been proven.

Rents/Tenancies

The company is yet to agree a rental policy for the company, however rents are set at market rates in the model and increased only by inflation each year which is likely to be the stance the company takes to ensure customers get a fair and transparent rental product. The rents included in the business plan are estimates based on advice provided by BPP Regeneration.

Affordable rents will be something that will be passed over to registered providers as the company will not retain affordable properties.

Rentals will be set at market levels at their specific locations by the managing agents, based on existing rental levels, based on location, the below is expected;

- High value rental: Wimbledon
- Medium value rental: Morden/Colliers Wood
- Low to medium value rental: Mitcham

Merton Development Company will offer longer tenancies then what traditional landlords offer with less volatility on price increases and rental periods. Merton Development Company will be an exemplar landlord and ensure all customers have assured shorthold tenancy contracts for the specified period and notice periods that allow the tenant enough time to move. Merton Development Company may offer incentives for prospective tenants and tenants coming up for renewal.

Built to Last

Merton Development Company's mission is to develop a robust and sustainable PRS product which will require a higher specification during construction, ensuring that products purchased and installed are built to last and stand the test of time. The layout of the built product will be designed in a way that maximises the use of space without requiring further modification later on.

Sales

Merton Development Company's business model is based on developing a long term rental product. Sales may be built into the viability model to ensure more debt is paid earlier so the company is under less strain from debt recharges and produces a dividend earlier. However changes in the market may also require the company to sell some units in positive and negative market changes.

- Positive- if the market peaks and the opportunity presents itself for a dividend to be given back to the shareholder.
- Negative - or the market slumps and the sale of one or two units are required to ensure cash flow of the company is protected.

Asset management strategy

Merton Development Company's asset management strategy is to maintain the stock to a good standard to ensure tenants are kept happy, the assets are always in an attractive condition and up to date with the most modern features to attract renters. To retain its exemplar landlord status, the company will do via its retained managing agents, by:

- A highly responsive repairs and maintenance service allowing customers to report online and having a repairs response line active for the longest period of the day possible.
- Planned preventative maintenance, ensuring facilities do not fall below an acceptable level before being serviced, this also avoids higher costs further down the line when the product fails.
- Annual inspections of properties to ensure the terms of the tenancy agreement are being adhered to, to spot early any condition issues and breeches of tenancy.

Governance

Merton Development Company will be structured in a way that allows flexible and agile decision making to ensure the company can take advantage of market opportunities.

The company will consist of three directors to start with, as recommended by the South London Legal Partnership (SLLP) legal team. As the company grows the company will have the flexibility to add additional directors.

The Board of Directors will initially meet monthly to discuss matters arising from the company.

As the sole share holder the council will set up a shareholder sub-committee through the cabinet process to discuss shareholder matters. The sub-committee will nominate a shareholder representative who will then represent the council at board meetings to ensure that the company is on target to deliver the anticipated returns to the council.

All Major financial and resourcing decisions will require sign off by the council's shareholder sub-committee or shareholder representative. A list of the key decisions is captured as reserved matters in the company's shareholder agreement.

Resourcing

The company will have part time seconded employees from the council to start with to get the company and projects up and running providing strong project management, financial and design and planning skills. Professional skills we be brought in on an ad hoc basis. The company will have a service level agreement with the council to provide support services, such as financial, IT and legal. Once the initial scheme is up and running and further sites are agreed, additional time will be required to manage the existing portfolio and to work up the next tranche of sites.

Finances

Introduction

The financial model utilised by Merton Development Company, has been constructed using Price Waterhouse Coopers (PWC) housing model. PWC have supplied Models to various other councils and are now the market leader for financial advice around wholly owned council housing/property company set ups in the country. The inputs to the model have been supplied by the council's independent regeneration surveyors BPP Regeneration Ltd.

Further information and additional financial tables can be found at the back in Appendix 1.

BPP Regeneration reviewed the existing information that was compiled together previously with other advisors and internal staff. They also visited the sites to check the original assumptions that were made. The site visits resulted in a reduction in the numbers of units assumed at each site to be cautious as some of the sites are very difficult construction sites where higher densities may be difficult to achieve due to the layout of the site. Once the sites have been fully designed it may be possible to achieve some additional units.

The first financial estimates below are based on the first four sites. The first four sites below produce 77 units:

- Raleigh Gardens (22)
- Elm Nursery Car Park (24)
- Land at Cannons (22)
- Farm Road Church (9)

The model is based on a 30 year loan period with the sale of any affordable housing units going to registered providers.

Below are the various funding tables showing the loan required, interest and debt repayments, cash flow from the company to the council and a sales and income position the modelling is based on.

Financial Tables

Table 1: LAPC Balance Sheet Years 1 to 5	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
	£000s	£000s	£000s	£000s	£000s
Land	8,190	4,074	0	0	0
Cash	(0)	(0)	(0)	(0)	(0)
Capitalised interest	20	272	851	668	682
WIP/Stock	136	3,379	4,567	0	0
Investment properties	337	9,295	19,097	19,097	19,097
Corporation tax creditor	0	0	0	0	0
Long term loan	(640)	(7,373)	(13,966)	(10,301)	(10,315)
Equity cash element	155	1,775	3,256	3,256	3,256
Equity land element	8,190	8,190	8,190	8,190	8,190
P&L Reserve	(301)	(318)	(897)	(1,982)	(1,982)

Table 2: LAPC Balance Sheet - in 5 year periods	**Year 5**	**Year 10**	**Year 15**	**Year 20**	**Year 25**	**Year 30**
	£000s	£000s	£000s	£000s	£000s	£000s
Land	0	0	0	0	0	0
Cash	(0)	33	54	(0)	(0)	9,328
Capitalised interest	682	682	682	682	682	(0)
WIP/Stock	0	0	0	0	0	0
Investment properties	19,097	19,097	19,097	19,097	19,097	0
Corporation tax creditor	0	(33)	(89)	(169)	(281)	(9,328)
Long term loan	(10,315)	(9,881)	(8,298)	(5,540)	(905)	0
Equity cash element	3,256	3,256	3,256	3,256	3,256	3,256
Equity land element	8,190	8,190	8,190	8,190	8,190	8,190
P&L Reserve	(1,982)	(1,548)	0	2,624	7,147	(11,446)

Table 3: LAPC Income and Expenditure - Years 1 to 5

	Year 1	Year 2	Year 3	Year 4	Year 5
	£000s	£000s	£000s	£000s	£000s
Profit/(Loss) on sales	(200)	0	(1,001)	(800)	0
Net rental income	(101)	(17)	422	622	655
Net Interest/(Cost)	0	0	0	(908)	(655)
Interest income on surplus cash balance	0	0	0	0	0
Profit/(Loss) before tax	(301)	(17)	(579)	(1,086)	0
Corporation tax	0	0	0	0	0
Profit/(Loss) after tax	(301)	(17)	(579)	(1,086)	0
Dividends	0	0	0	0	0

Table 4: LAPC Income and Expenditure Impact in 5 Year Periods

	Years 1-5	Years 6-10	Years 11-15	Years 16-20	Years 21-25	Years 26-30
	£000s	£000s	£000s	£000s	£000s	£000s
Profit/(Loss) on sales	(2,000)	0	0	0	0	51,126
Net rental income	1,581	3,838	4,949	6,350	8,110	10,343
Net Interest/(Cost)	(1,563)	(3,319)	(3,042)	(2,373)	(1,257)	(59)
Interest income on surplus cash balance	0	0	1	0	0	0
Profit/(Loss) before tax	(1,982)	518	1,908	3,977	6,853	61,410
Corporation tax	0	(85)	(324)	(676)	(1,165)	(10,687)
Profit/(Loss) after tax	(1,982)	434	1,583	3,301	5,688	50,723
Dividends	0	0	(35)	(676)	(1,165)	(69,316)

Table 5: LBM Income and Expenditure - Years 1 to 5

	Year 1	Year 2	Year 3	Year 4	Year 5
	£000s	£000s	£000s	£000s	£000s
Investment income	0	0	0	0	0
Interest payable	(13)	(158)	(416)	(550)	(419)
Interest receivable	20	252	672	908	670
Net I&E Surplus (excl MRP)	8	95	256	358	251

Table 6: LBM Income and Expenditure - In 5 year periods

	Years 1-5	**Years 6-10**	**Years 11-15**	**Years 16-20**	**Years 21-25**	**Years 26-30**
	£000s	£000s	£000s	£000s	£000s	£000s
Investment income	0	(0)	35	676	1,165	57,870
Interest payable	(1,554)	(1,951)	(1,581)	(964)	(161)	0
Interest receivable	2,521	3,319	3,042	2,373	1,257	59
Net I&E Surplus (excl MRP)	967	1,368	1,497	2,085	2,262	57,929

Sites

Farm Rd Church (9 Units)

Canons Leisure Centre (22 Units)

Raleigh Gardens (22 Units)

Risk Register

Risk ID	Risk Title	Risk Description	Likelihood	Impact	Risk Score	Mitigation Actions
1	**Deterioration of Relationship With Council**	It is anticipated that there will be challenges within the relationship between the company and the council. Whilst the shareholder agreement offers the company a good deal of autonomy it also retains key decisions for the Shareholder, which incentives the company to resolve any difficulties.	2	4	8	The management of the relationship will need to be reviewed particularly when key appointments are made.
2	**Collapse of the Residential Property Market**	The property market is susceptible to fluctuations. The risk is that the value of the company's portfolio will fall while the market is at a low.	2	2	4	The company is a long term venture and would expect to survive any fluctuations in the market. However, were market rent levels to fall substantially, the company could take a view on sales to ride the downturn or seek a greater subsidy input from LBM to utilize a greater proportion of properties at affordable rents.

3	**Loss of London as a World City**	London's residential property market is closely related to London as a world city therefore the loss of London as a city would greatly impact the company.	**1**	**4**	**4**	London's growth is key to the growth of the UK economy and therefore its global status is a matter of national priority.
4	**Severe Decline in Demand for Rental Properties**	Over recent years, there has been a shift in tenure patterns. Owner occupation has been in decline while renting has increased. It is possible that the market may see a reversal of this state.	**2**	**4**	**8**	In severe circumstances, the company can mitigate financial losses through a number of measures including converting properties to shared ownership and/or outright sale, and leasing properties to housing associations, LBM and/or other London councils.
5	**Skill Deficit of Local Authority Property Company (LAPC) Staff**	Skill Deficit of the company Staff will leave it unable to compete.	**2**	**4**	**8**	The company will develop a competitive pay commensurate with those offered by private sector competitors. Skills development will be a key objective of the company
6	**Failure to Secure Planning Consent**	There may be a failure to secure planning consent for viable schemes.	**2**	**3**	**6**	The company will work in partnership with LB Merton planners in order that pressures and priorities on both sides are understood.
7	**Cash Flow Crisis**	The company is a rental business, therefore it may suffer from issues that arise as a result of the slow influx of rental income.	**3**	**3**	**9**	Conversion of market rent properties to outright market sale to bridge cash flow difficulties
8	**Failure to Stay True to Mission**	A failure to stay true to their mission may lead to loss of community confidence, damage to reputation.	**2**	**2**	**4**	Always stay on top of market trends within PRS and target audience

9	**Tranche 2 Schemes Become Unviable**	It is possible that some sites can no longer be built on as a result of unknown elements. This is a greater concern if it occurs to multiple sites as opposed to single sites.	**3**	**2**	**6**	Monitor sites and ensure that there are alternative plans for the portfolio.
10	**Collapse of Contracts**	It is possible that the company may fall out of contract with architects, planners or constructors. This would result in loss of time and will affect progress.	**1**	**2**	**2**	Strong project management. Maintain constant communication with all teams in order to ensure that concerns are addressed before they become problematic.
11	**Changes in Policy**	Changes may occur to policy relating to private rented accommodation which would alter the organisation's mission.	**1**	**4**	**4**	Stay abreast of the political situation and ensure the companies interests are considered before any decisions are made.
12	**Fail of Loan Covenants**	The company may fall fail of loan covenants. This would put it in default so the loan would need to be paid back.	**2**	**4**	**8**	Renegotiate the loan.
13	**Deterioration of Stock Value**	The value of the stock may fall below long term value ratio. This would become an impairment to the accounts, as well as to the council's accounts.	**2**	**4**	**8**	Need to be constantly conscious of rental and sales values .
14	**Inability to Meet Viability Targets**	Mid-way through the development, a scheme may be unable to meet the assumed viability model.	**2**	**4**	**8**	Properties could be sold, however assistance from the council may be required.
15	**Working Capital**	Prior to funding approval, increasing working capital requirements which exceed LBM budget would lead to a reduction of activity on projects.	**4**	**4**	**16**	Working capital facility is set at a minimum of £4m. A recovery strategy has been implemented to maintain the solvency of the company

16	**Increasing Construction Costs**	Estimated construction costs may increase during the pre-construction stage. This will also result in an increase in the pre-construction professional fees.	**3**	**4**	**12**	Development of a robust cost control mechanism, with Gateway approval points for authorisation

Appendix 1 – Shareholder Agreement

Appendix 2 – Articles of Association

Appendix 3 – BBP Surveyors Report

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