Manchester City Council
Report for Resolution

Report To: Executive – 18 January 2012
Subject: Housing investment and mortgage support within Manchester
Report of: The Chief Executive and the City Treasurer

Summary

Demand for housing in Manchester and Greater Manchester continues to increase due to household and population growth. Along with the forecast economic and employment growth in the city these factors will continue to generate further need for additional homes, and extended choice of housing type and tenure. The reduction in the levels of available development and mortgage finance is currently having a serious impact on the pace of housing delivery and housing supply is at an all time low. This report sets out how Manchester City Council is responding to these issues through a new and innovative housing delivery model and exploring opportunities to support home-ownership through a mortgage guarantee scheme.

Recommendations

The Executive is recommended to:

1. Note the progress made to date in developing the Housing Investment Model and the proposals for the Phase 1 Pilot of four Manchester City Council sites/one Homes and Communities Agency (HCA) site and the joint venture with Greater Manchester Pension Fund (GMPF).

2. Delegate authority to the Head of Corporate Property and Strategic Development and the City Solicitor to agree with the GMPF a Memorandum of Understanding that sets out the principles for the Joint Venture (JV).

3. Delegate authority to the City Solicitor and City Treasurer to finalise and complete all the legal documentation for the JV.

4. Authorise the Head of Corporate Property and Strategic Development to agree terms for the disposal of the Council owned sites in connection with the JV.

5. Delegate authority to the Head of Corporate Property and Strategic Development and the City Treasurer for the City Council to invest its land at fair market value for an equity share in the model, with the City Council receiving a capital payment on the sale of houses and an annual revenue return.

6. Delegate authority to the City Treasurer to defer a proportion of the receipt mentioned in 5 above, to support the equity share mortgages to support sales on selected sites.
7. Delegate authority to the City Solicitor to agree terms for a Collaboration Agreement with the Homes and Communities Agency in connection with the one site, which will be part of the JV.

8. Authorise the Head of Corporate Property and Strategic Development and Director of Housing in consultation with the City Treasurer in partnership with the GMPF to enter into a procedure to procure a house builder and sales and marketing team using the HCA Delivery Partner Panel and procure a property manager subject to a lease arrangement, with a view to the JV appointing the successful organisations.

9. Delegate authority to the Director of Housing and City Treasurer in consultation with the Leader and Executive Members for Finance and Neighbourhood Services to enter into negotiations with relevant lending organisations on the development of an unfunded mortgage guarantee scheme. A further report will brought back to the Executive on the final proposals.

Wards Affected:

Ardwick, Gorton North, Chorlton Park, and Brooklands wards.

<table>
<thead>
<tr>
<th>Community Strategy Spine</th>
<th>Summary of the contribution to the strategy</th>
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<tbody>
<tr>
<td>Performance of the economy of the region and</td>
<td>Delivery of the project will contribute to meeting the new build housing targets for the City and city region and thereby play a key role in the City’s economic development</td>
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<td>sub region</td>
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<tr>
<td>mutual respect</td>
<td></td>
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<tr>
<td>Neighbourhoods of Choice</td>
<td>The provision of these homes will increase housing choice within the city and contribute to the availability of neighbourhoods of choice</td>
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Full details are in the body of the report, along with any implications for:

- Equal Opportunities Policy
- Risk Management
- Legal Considerations
Financial Consequences – Revenue

It is anticipated that there will be some set up costs associated with the establishment of a formal partnership between MCC and the Greater Manchester Pension Fund. Should the project be successful, these costs will be recovered from the project otherwise they will be managed within existing budgets. Wherever possible costs will be shared with the GM Pension fund.

The City Council, through the partnership arrangements will receive an income stream in the form of rent from a head lease. This rent will be a guaranteed rent, and will be subject to market review.

The City Council will also enter into a collaboration agreement with the Homes and Communities Agency (HCA). This agreement will set out the arrangements for the payment by the City Council to the HCA of their share of the income stream in relation to the site that they will put into the delivery vehicle.

Any implications for VAT and other tax issues are being considered alongside the development of the preferred delivery option

Financial Consequences – Capital

The City Council will be investing its land into the partnership at fair market value for an equity share in the model. The value of the equity share is still to be calculated and the City Council and the Greater Manchester Pension Fund are considering the most tax efficient options for this type of investment.

The City Council will receive capital payments from the partnership arising on the sale of houses. To aid in achieving the Council’s objectives of a mixed tenure estate the proposal is for a proportion of this receipt to be offered to support an equity share mortgage to support sales on selected sites. and the detail of this is under discussion.

Deferred equity would delay the capital payment to the Council but financial modelling has been carried out to ensure that the net income flows over time and the capital payments represent a fair return for the Council’s land interests. Under the terms of the collaboration agreement with the City Council, the Homes and Communities Agency will adopt the same approach to the equity share mortgage, therefore it is not expected that there will be any requirement for additional funding from the City Council.

Whilst the LAMS scheme is only at discussion stage, it should be noted that if negotiations are successful the Council will be required to put money into a reserve reflecting the fair value of the guarantee provided. The value of this guarantee will vary according to the number of mortgages in question and assumptions made around default rates and the average indemnity level. The detail of any LAMS scheme proposal will revert to Executive before finalisation.
Manchester City Council
Executive 18 January 2012

Contact Officers:

Name: Sir Howard Bernstein  Name: Richard Paver
Position: Chief Executive  Position: City Treasurer
Telephone: 0161 234 3006  Telephone: 0161 234
E-mail: h.bernstein@manchester.gov.uk  E-mail: r.paver@manchester.gov.uk

Name: Paul Beardmore  Name: Helen Jones
Position: Director of Housing  Position: Head of Corporate Property and Strategic Development
Telephone: 0161 234 4811  Telephone: 0161 234 4232
E-mail: p.beardmore@manchester.gov.uk  E-mail: h.jones4@manchester.gov.uk

Background documents (available for public inspection):

The following documents disclose important facts on which the report is based and have been relied upon in preparing the report. Copies of the background documents are available up to 4 years after the date of the meeting. If you would like a copy please contact one of the contact officers above.

1. Equity Investment Funds – A framework for investment - Report to Executive, July 2010

2. Local Authority Mortgage Scheme – March 2011
1.0 Introduction

1.1 Demand for housing in Manchester and Greater Manchester continues to increase due to household and population growth. Along with the forecast economic and employment growth in the city these factors will continue to generate further need for additional homes, and extended choice of housing type and tenure. Ensuring that the supply of housing meets the demands of a growing, mobile workforce and population is a fundamental requirement if the supply side of the economy is to function effectively. Lack of market access for first time buyers, and lack of finance for development are seriously affecting the house building industry. It is because of these financial constraints that we have had to look at alternative methods of residential delivery, which reflect the increased demand for high quality private rented accommodation as part of a true mixed tenure development. In keeping with the aspiration for affordable home ownership across Manchester we have also looked into the development of our equity share product and the introduction of a mortgage guarantee scheme.

2.0 Background

2.1 The Government has strengthened its cities agenda acknowledging the critical role that cities have in delivering economic growth and rebalancing the economy. The appointment of a Minister for Cities and establishing the Cabinet Office Unit provides a platform for taking forward a radical and high impact programme to ensure that cities have the tools and accountability to drive growth across the UK. Greater Manchester is in the best position of any of the city regions outside London and the southeast to assist the Government in achieving its objectives. The Manchester Independent Economic Review, conducted by leading economists from Harvard, LSE and Goldman Sachs, concluded that “outside London, the Manchester City Region is the area which, given its scale and potential for improving productivity, is best placed to take advantage of the benefits of agglomeration and increase growth.”

2.2 However, the ongoing financial crisis and subsequent reduction in the levels of available development and mortgage finance, together with major reductions in regeneration funding are currently having a serious impact on the pace of housing delivery. Greater Manchester has seen a dramatic recent reduction in housing completions. The number of new completions has dropped from a high of over 13,300 in 2007-8 to just over 3000 in 2010-11, equivalent to a 76% reduction. The number of sites under construction and contacts with developers indicates that this figure is not likely to increase significantly in the foreseeable future.

2.3 Revised forecasts from the Greater Manchester Economic Forecasting Model, taking into account the recent recession, predict that employment will return to pre-recession totals by 2014 with strong growth thereafter. The majority of the employment growth is forecast to take place in the Regional Centre and City of Manchester. It is projected that this growth will lead to a requirement of some 10,000 additional homes each year in Greater Manchester in the period to 2031.
2.4 The previous housing delivery strategies which involved encouragement of home ownership based on borrow, build and sell models have not been replaced by any convincing alternative and as development finance and mortgage finance continue to be squeezed there is little prospect of a quick return to the old model. This is especially the case in many major urban areas away from London and the southeast where areas of market failure are still commonplace and where, for development to proceed, an element of gap funding is still often required. In Greater Manchester as elsewhere, many neighbourhoods are not yet at the tipping point at which the private sector alone can be relied on to drive their transformation forward. The withdrawal of public funding from these areas means that new models need to be developed which aim to deliver the right type of housing in the right places.

2.5 This issue was acknowledged in the Government’s recently published National Housing Strategy, which focuses on housing growth and includes a range of policies, which will now be enacted:

- A £500m ‘Growing Places Fund’ to support infrastructure that unblocks housing and economic growth
- A £400m ‘Get Britain building’ investment fund to support builders in need of development finance
- The government’s intention to free up public sector land to deliver 100,000 new homes
- A national new build indemnity scheme
- Support for areas that want to deliver large scale development

2.6 The following section discusses in detail proposals to address the under supply of housing through cash investment by the Greater Manchester Pension Fund and use of our land as an equity asset.

3.0 The Housing Investment model

3.1 The concept of combining publicly owned land assets with development finance from an institutional investor to provide new homes has been discussed in detail with the Greater Manchester Pension Fund and the National Housing Strategy cited the proposed housing investment model we are developing as an example of positive emerging practice.

3.2 The proposal is for Manchester City Council and the Greater Manchester Pension Fund to enter into a partnership to bring forward a new and innovative delivery model for residential development. This model will be run as a pilot project across 5 sites in the City which will see in the region of 244 new homes delivered for sale and high quality market rent. If successful this approach could attract further institutional investment into the City and across Greater Manchester. This section sets out the model in further detail, describes the potential to extend this model across a number of potential residential development sites in which the City Council has an interest and summarises the issues to be addressed in taking this work forward. It is anticipated that these could form a pipeline of development through the model over the next 5 – 10 years.
3.3 There are five main elements within the Housing Investment model:

- The investor (Greater Manchester Pension Fund) to fund the construction costs of the development
- The Landowner (Manchester City Council) to provide the sites to build the units upon
- The Contractor to design and build the properties.
- The Property Manager to manage the privately rented units
- The Sales and Marketing team to market and sell a specified number of homes for home ownership on the selected sites

3.4 The basic premise of the model is very simple:

- There are two investment partners, the council with land to invest and the pension fund with cash to invest.
- Together the partnership procure a Contractor and a Property Manager
- By choosing to employ a Contractor we will minimise their overheads and profit, as they have no sales risk because the partnership will be the owners of the completed units. This will equate to approximately 8 - 10% of construction costs compared to traditional developer rates in excess of 20%.
- The rental guarantee will be a proportion of the gross rent charged by the Property Manager it will cover costs associated with management, maintenance, voids and bad debts, after deducting these costs there will be the net rental income, which will be shared between the partnership according to the agreed equity share.
- Both investors are able to take a revenue return on their investment and a share in capital return. The revenue return is generated through market rentals and the capital return through house sales.
- The land is valued and invested into the fund as an equity share. The percentage of the share is dependent upon the value of the land in relation to the total cost of the development.
- The new build housing is targeted at economically active households and will be offered at market rent and market value for sales

4.0 Soft-Market Testing

4.1 In order to check that the assumptions made in the development of the housing delivery model a soft market testing exercise was carried out. There were three main areas of the model that were tested with delivery partners, which were construction, property management and sales. A number of organisations from the Homes and Communities Agency’s Delivery Partner Panel that included a wide range of expertise across national house building, contracting and property management were invited to take part in the exercise.

The model was very well received and some of the organisations were already looking into the build to rent concept. The detailed feedback from the
sessions has been gathered and will be incorporated into a detailed brief, which, subject to approval of the Executive, will form part of the procurement information.

4.2 Site Selection and tenure mix

Four sites in Council ownership and a HCA site have now been identified for the pilot and a location plan and more detailed site plan for each site is attached at appendix 1 and 2. An assessment of numbers for each site has been made based on existing planning briefs or existing master planning work. Further refinement on numbers and property types will occur as the briefs are firmed up and consulted on locally as part of the planning and development brief process.

An initial tenure mix on the sites has been developed to ensure that the right regeneration outcomes are delivered and that appropriate levels of owner occupation can be achieved along with an appropriate number of private rented units across the portfolio of the sites. This starting point has been agreed with the Assistant Chief Executive (regeneration) and the feedback through the soft market testing is that is appears broadly appropriate and deliverable for each locality. Local ward members have been briefed on the proposals and are all supportive of this approach.

4.3 The 5 sites identified and the proposed number of units and tenure mix is outlined in the table below:

<table>
<thead>
<tr>
<th>Site</th>
<th>Number of Units</th>
<th>Tenure Mix</th>
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</thead>
<tbody>
<tr>
<td>Former Oakwood, Darley Avenue, Chorlton Park</td>
<td>86</td>
<td>43 Rental 43 for Sale</td>
</tr>
<tr>
<td>Site of former Ossington Court, off Hawkswick Drive, Brooklands</td>
<td>30</td>
<td>30 Rental</td>
</tr>
<tr>
<td>Site of Woodwise Nursery, off Woodwise Lane, Brooklands</td>
<td>17</td>
<td>17 Rental</td>
</tr>
<tr>
<td>Site off Clowes Street, West Gorton, Ardwick</td>
<td>35</td>
<td>26 Rental 9 for Sale</td>
</tr>
<tr>
<td>Gorton Monastery, off Gorton Lane, Gorton North.</td>
<td>76</td>
<td>57 Rental 19 for Sale</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>244</strong></td>
<td><strong>71 for sale 173 for rent</strong></td>
</tr>
</tbody>
</table>

The residential units will be built to a minimum of Code for Sustainable Homes Level 4. The highest possible quality of design and specification will be sought using the efficient method of procurement as set out in this report. As a minimum, lifetime homes standard will be achieved and where practical properties will be compliant with the Councils DFA2 policy and the current approach to implementation of that policy.

5.0 Financial return and Best Value
5.1 The initial financial modelling of the pilot scheme has been undertaken. The assumptions within the model have been informed through the soft market testing exercise and subjected to peer review by the City Council’s advisors and GMPF’s advisors. The model assumes that the target number of sales is achievable over a realistic time frame and that the rental units are let subject to a minimum 10-year lease with an investor sale/lease renewal of the dwellings that remain within the model at the end of the lease period. The City Council’s land value represents approximately a 20% share in the partnership will be deferred until the properties are sold. The remaining 80% will be the construction costs funded by GMPF, although discussions are ongoing.

5.2 The Council can use this 20% share to take a financial stake in the properties for sale, known as equity share. Unlike shared ownership, the purchaser buys 100% of the property on completion. The equity share is a second charge on the property. (The equity share loan would be structured similar to agreements set up on developments in North Manchester and at Bowes Street). It is anticipated this share will be interest free (or at a reduced rate) for a defined period (say 5 – 10 yrs) and then at that stage the City has the option to call in the loan, or charge an interest rate on the outstanding sum for a short extended period if required).

Under the terms of the collaboration agreement with the City Council, the Homes and Communities Agency will adopt the same approach to equity share on the site that is currently in their ownership. The detailed structure of the equity share loan offer will be finalised closer to the time these are offered. The City will continue to work with lenders to inform the development of this product.

5.3 The Head of Corporate Property and Strategic Development is satisfied that on the basis of the initial financial modelling the flow of revenue income and capital returns across the 4 Council sites will represent best value. To simplify the contractual arrangements it is proposed that the City will receive all returns due to landowners from the partnership and in accordance with the terms of a collaboration agreement with the HCA distribute any returns due to HCA to them.

6.0 Establishing Delivery Options

6.1 Different governance models/legal structures can be used when entering into working relationships with external partners. Which model to be used for any particular project depends on which option would be best suited to the objectives of the Council. The City Council and the Greater Manchester Pension Fund are considering the most flexible, tax efficient options for a partnership arrangement to deliver the new housing model.

7.0 Procurement

7.1 Subject to approval by the Executive the procurement of a contractor house builder and sales and marketing team will be pursued by the City Council and
supported by GMPF using the Homes and Communities Agency Delivery Partner Panel. This will reduce the procurement time considerably as the panel has been through the necessary OJEU process. As there will be costs associated with forming the partnership this will only proceed once the procurement process is complete and the cost of the project is confirmed as viable. The partnership will then enter into a formal contract with the successful organisations and take the project forward. This will be made clear in the procurement documentation.

7.2 Separately a Property Manager will be procured through a straightforward lease arrangement using a range of Registered Providers selected with a mix of appropriate private sector managing agents.

7.3 Specifications for the two procurements are currently being drafted. The procurements will run concurrently to enable all three elements to be appointed together. One of the key considerations for appointment will be the bidder’s ability to work collaboratively with the other appointed agents. The Executive is recommended to authorise the Head of Corporate Property and Strategic Development and the Director of Housing in consultation with the City Treasurer to instigate the procurement of a house building contractor and a sales and marketing team using the HCA’s Delivery Partner Panel. Final appointment of any procured contractor will be by the proposed partnership organisation.

8.0 Supporting the mortgage market

8.1 To stimulate development activity such as that proposed by the Housing Investment model it is essential to build upon the equity mortgage schemes we have successfully introduced in the City and look to develop a number of further products to support mortgage lending across Manchester. To take this forward the City Council has met with a number of local and national lenders to look at opportunities for collaborative working in response to the problems with mortgage provision. All the lenders are positive about the City Council’s proposed approach to housing investment and would be willing to work collectively with the City Council to provide mortgage support on the specified sites. The proportion of lending any one lender is prepared to commit to on any one site varies from between 7% of sales through to 40%, hence the need to work with more than one lender.

8.2 They, and all of the developers we have soft marketed the scheme with are also very supportive of the equity share scheme the City Council is currently operating and see this as a key incentive to supporting mortgage lending in Manchester especially to bring forward sales on the pilot scheme.

8.3 Another proposal discussed was a form of Local Authority backed mortgage guarantee that has been developed by a national consultancy service, Sector Treasury Services. The scheme works by the Local Authority providing an indemnity guarantee on a proportion of the loan
The aims behind the scheme are:

- To increase the availability of mortgages for specific client groups or developments
- To minimise the financial impact and risk on the Local Authority,
- To use the expertise already available from existing mortgage providers

The scheme is aimed at first time buyers who can afford mortgage payments but do not have the initial deposit to access affordable mortgage finance. Under the scheme, each Local Authority is able to specify the criteria for those who should qualify for a mortgage under the LAM scheme. If the applicant also meets the lenders strict criteria the Local Authority will underwrite up to 20% of the mortgage. The applicant will thereby obtain a 95% mortgage on similar terms to a 75% mortgage, but without the need to provide the substantial deposit usually required. The Local Authority will underwrite up to 20% of the mortgage through an indemnity for a fixed period of time, usually 5 years but extendable to 7.

The scheme offers two options for the Council, a funded option whereby the Council deposits with the lender an amount of money to cover the guarantee or an unfunded option whereby the lender accepts the strength of the Council’s guarantee without any deposit. It is recommended that the Council seek a lending partner willing to accept the latter option.

8.4 Early discussions with the Cooperative Bank and the Manchester Building Society suggest that they are very interested in developing this concept further as a ‘Manchester Mortgage’. This is a real opportunity to build upon the equity share products we have already pioneered in North and South Manchester so we have developed a proposition as described and that subject to executive approval will approach lenders with a formal proposal based on the unfunded mortgage indemnity guarantee.

8.5 The scheme could provide incentives to residents who may not otherwise have the option for home-ownership in the immediate future. It is intended that this scheme could be offered as an alternative to the equity share described above or it could be used to support development schemes on sites where the Council has no equity stake to offer but would seek to support private house sales and development.

8.6 One of the fundamental parts of the scheme would be the qualifying / eligibility criteria. We are in an excellent position through the work happening around both the Redrow and Bowes Street schemes to produce a robust operational process that would ensure the financial risk to the Council was kept to a minimum. We would also need to ensure a strategic approach to the availability of the guarantee and whether this is offered on a thematic basis i.e. first-Time Buyers, by location on specific areas or developments or both. The detail of this will be covered in a future report to the Executive.

9.0 Conclusion
This report has described the key requirement for the pace of housing delivery to be increased to ensure alignment with economic growth projections. It has outlined two approaches that will achieve these objectives:

- A development model that seeks to respond to current market conditions and link development of higher value land to the momentum on key sites in our priority regeneration areas.
- The potential for a mortgage guarantee scheme that will support First Time Buyers without a substantial deposit to access affordable home-ownership.

Through the use of both approaches we will:

- Allow an accelerated and sustainable recovery of Manchester’s Housing Market.
- Ensure that there is an adequate housing supply for those people who work in and contribute to the economic growth of the City.
- Align with our wider regeneration ambitions for the city that and protect the existing investment that has been made.
- Maintain supply and go some way to alleviating potential demand expected due to population growth.
- Replace the need for large amounts of public funding to go into house building in the future.
- Retain and create employment opportunities with the construction industry and associated supply chains.
- Ensure continued economic growth.
- Allow housing mobility through a range of tenures for existing and future residents.

10.0 Contributing to the Community Strategy

(a) Performance of the economy of the region and sub region

10.1 Delivery of the project will contribute to meeting the new build housing targets for the City and city region and thereby play a key role in the City’s economic development.

(b) Reaching full potential in education and employment

10.2 Working families are a key target market of the new homes to be provided and this initiative will therefore help to attract and retain economically active individuals.

(c) Individual and collective self esteem – mutual respect

10.3 The well-designed homes and estates to be provided will improve the quality of life for local people.
(d) **Neighbourhoods of Choice**

10.4 The provision of these homes will increase housing choice within the city and contribute to the availability of neighbourhoods of choice.

11.0 **Key Policies and Considerations**

(a) **Equal Opportunities**

11.1 The partnership between the City Council and the Greater Manchester Pension Fund will bring a substantial amount of construction activity and supply chain management across Manchester, which in turn will create and retain a number of employment, skills and training opportunities for the City’s residents. We will seek to maximise the accessibility and environmental sustainability through the design of the buildings and the surrounding environment.

The provision of the mortgage guarantee will allow first times buyers onto the housing ladder without the need for a substantial deposit. Without this support they would not have been able to access the home of their choice for a number of years.

(b) **Risk Management**

11.2 The pilot project will comply with the standards set out in the Manchester Method and thereby have robust risk management processes in place.

(c) **Legal Considerations**

11.3 The City Council and the Greater Manchester Pension Fund are considering the most flexible, tax efficient options for a joint venture to deliver a new housing model. Some options are not available because of the restraints / requirements of the Pension Fund, for example, limited liability partnership due to specific pension taxation rules.

11.4 Options to consider include contractor arrangements, a joint venture (for example a partnership), and a company. Options being considered include a limited partnership. A limited partnership is governed by the Limited Partnerships Act 1907. Investors hold limited partnership interest i.e. economic interest and shares are held by the general partner. The general partner controls the assets.

11.5 Using powers under Section 2 of the Local Government Act 2000, the Council has well being powers to support the social, environmental and economic well being of the area. The joint venture between MCC and the Pension Fund operating, as an authorised body of Tameside MBC will support the social, environmental and economic benefits outlined detailed in paragraph 10 of this report.

11.6 The City Council will obtain best consideration for the sites as described in
paragraph 5 and fulfil its duty under Section 123 of the Local Government Act 2000.

11.7 Legal Service have received full details of the Sector LAMS pilot scheme, including the legal analysis of the scheme and the Council has power to enter into such a scheme under Section 442 of The Housing Act 1985. The scheme is aimed at first time buyers to address the “deposit gap” they have in entering into the property market. It is worth noting that the first time buyers must meet the initial criteria to be able to afford the mortgage payments. In this respect there has been a recent announcement to ensure stringent checks are made in relation to first time buyers finances and debts before a mortgage is offered and this further adds weight to the fact that this scheme is to those buyers who can afford the mortgage payments.

The scheme is aimed at individual borrowers, who are not commercial undertakings, state aid does not apply to individuals.

The indemnity to be given by the Council to the lenders will require a number of legal documents to implement the scheme dependent upon the chosen option. The MCC scheme would look to include lenders other than the existing lender, Lloyds, for example the Cooperative and the Manchester building Society, which will not only assist Manchester residents but also support the national scheme plus the national housing market.
Appendix 1

Proposed Investment Sites

Land Adj to Gorton Monastery - 76 Units
West Gorton - 35 Units
Oakwood (Darley Avenue) - 86 Units
Ossington - 30 Units
Woodwise - 17 Units

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Ossington Court Site - 30 Units

MILLERS CLOSE
HAWKSWICK DRIVE
KELFIELD AVENUE
ALFISTON DRIVE
MELSOMBY

Ossington Walk

Gantry

Playground

Ward Boundaries

Ossington Court Site

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Woodwise Site - 17 Units

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