

This note contains the Government's note to the Select Committee of 15 January 2015 (in black) and HS2AA's response (in red).

Note to Select Committee on Property bond (as amended by DfT)

1. On 20 November the Committee heard extensively from the HS2 Action Alliance on issues of compensation and in particular their advocacy of a property bond. Rather than prolonging debate at that stage you asked for a note on the Government's view on the Property Bond. The Committee appeared to be particularly interested in the cost aspects of the Property Bond and the extent to which this influenced the Secretary of State's decision.

The promoter undertook to provide a note on the costs of a property bond. Mr Mould (272) on behalf of the Department for Transport (DfT) offered to provide a note explaining the Government's position on costs to a question raised by Sir Peter Bottomley (271-272) at the hearing on the afternoon of 20 November 2014.

The issue was a gross disparity between what the Government were claiming to be the costs of the property bond (£3bn) and the estimates quoted by HS2AA (£30m - £158m) from the Price Waterhouse Coopers (PwC) report that was commissioned by Government to understand the costs and practicality of a Bond solution. This Government note fails to address this matter.

Instead this note continues only to give the unblighted value of all properties covered by a property bond (the £3bn), not the cost of the scheme. This unblighted value of all the properties covered by the scheme is actually a measure of *benefit* rather than *cost*, as it is a measure of how much property is protected. The cost must take proper account of a range of factors, as the PwC report and detailed model do:

- Purchase and resale values
- Management costs
- Rental income
- % of properties enrolling in the scheme
- % of properties needing to be acquired by HS2 Ltd (the "uptake")
- The phasing of expenditures and incomes.

The standard method of assessing costs and benefits (and used for taking the decision on the HS2 project itself) is to estimate the net present values (NPV) in constant money. The PwC report provided such estimates, eg a 500m bounded rural property bond scheme was costed at £30m-£158m, depending on its effectiveness (see page 31 of PwC's cost report (obtained under FOI):

The table below shows the illustrative cost of implementing a property bond scheme with a 500m boundary eligibility criteria based on the assumptions that have been outlined:

Scenario	Total unblighted value of eligible properties (July 2013)	Net Present Value/(Cost) discounted at 3.5% real
Optimistic	£2,905.3m	(£30.5m)
Pessimistic	£2,905.3m	(£158.1m)

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A more detailed summary from PwC's main report is at Appendix 1 of this response.

So despite Government employing experts to inform them on the costs (PwC, and CBRE previously), their note entirely ignores these findings.

Hilary Wharf (for HS2 AA) explained (on 20 November) the Government's misleading use of the value of properties covered by a property bond as if they were the cost of the scheme. The Government note does not contradict her explanation (at 275), nor does it bring into question PwC's estimate of the costs of a bond approach for nearly 5,000 properties at between £30m and £158m.

2. As set out in the *Decision document – Property Compensation Consultation 2013 for the London – West Midlands HS2 route* the approach to property compensation has been assessed against five criteria:

- a. Fairness;
- b. Value for money;
- c. Community cohesion;
- d. Feasibility, efficiency and comprehensibility; and
- e. Functioning of the housing market.

3. Judged against these criteria the property bond represents an unacceptable risk to value for money, community cohesion and the functioning of the housing market. The high level of risk is because it is an untested and unproven scheme in practice. Therefore, while the proponents of the property bond focus on the eventuality where it all works as foreseen, we must consider that it is equally as likely not to work as intended.

Given the evidence in the PwC reports and from property professionals, we are surprised at this statement:

- No evidence is provided in this Government note that there is any risk of unacceptable **value for money**. It does not present any costing at all or even discuss the costs in the reports. PwC's £158m estimate of the cost of the bond is if it is unsuccessful (ie a pessimistic outcome¹, where Government are required to buy most properties that are marketed for sale). So contrary to

¹ Definition in PwC Cost report (page 5) is

- **'Pessimistic' scenario** – this assumes that a property bond does not achieve all of its objectives and the property market does not function as intended. In this scenario, we are assuming that a higher number of property owners would look to sell their properties, blight levels would be higher and there is limited demand in the private market to acquire properties at an un-blighted value, hence HS2 Ltd purchase more properties,

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the Government note, HS2AA do focus on the scheme costs where the property market does not work as intended. The cost is only £30m if the bond is successful.

- The note also does not discuss **community cohesion**. PwC concluded there would be a positive effect on community cohesion ² as a bond encourages people to stay. Their conclusion also relied on HS1 experience. HS2AA believe there are also strong reasons to think that failure to provide a means to enable people to move normally, particularly for the elderly, will lead to unbalanced communities with an increasing proportion of 'trapped' elderly.
- Expert evidence is entirely against the suggestion that a property bond would adversely affect the **functioning of the property market** – as evidenced by support from the Council of Mortgage Lenders (CML), the National Association of Estate Agents, as well as Government's own expert advisors. We are aware that Mr Mould had thought that the CML had changed their view of the Bond (para 257 of 20 Nov hearing) and no longer supported it – we attach at Appendix 2 the CML's letter of 17 November 2014 to the Select Committee which says otherwise.

4. The main risk around a property bond is that it is impossible to know how property owners, property buyers and property professionals will react to its operation. A property bond might reassure property purchasers that there is no financial risk in purchasing a property at its unblighted value and so allow the housing market to function normally. However, it is equally likely that property purchasers would view a property with a bond as evidence that the property is blighted and so "unliveable" as a result of HS2. In addition, there is a clear risk that such "blight" spreads to its neighbours as purchasers could interpret the fact that one property possesses a bond as evidence that all nearby are also "blighted". This risk is particularly high with a bond scheme with a wide boundary – as the wider the boundary the more severe the level of blight "must be to require such a wide boundary" and so the greater the risk that purchasers view it as a disincentive.

Decisions rarely rely on perfect knowledge, but rest upon evidence and expert advice. The assertion that it is "*equally likely*" that a property bond would spread blight is contrary to the evidence and expert opinion (that underpinned the PwC report). Property professionals have given their view, as have property owners in six successive consultations.

The Government fails to put their speculation in the context of how generalised blight arises. They simply ignore the detailed account of this provided by HS2AA and

² PwC Report, page 82

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therefore fail to offer a justification for not accepting the implication that a property bond should be effective.

5. It is also worth noting that these concerns are shared by others. The DETR Interdepartmental Working Group on Blight, commended by a number of petitioners, notes that all interventions to address generalised blight run:

"...some risk of causing blight to snowball (when one house is deemed to be sufficiently devalued to warrant intervention by a buying agency its neighbours will be tainted by proximity)."

This quote is misleading as it fails to include the rest of the paragraph that comments on the Central Railway property bond as follows:

" Nevertheless, the Group thought that a property purchase scheme devised by Central Railway Ltd (CRL) as part of the construction of a freight railway system linking the Channel Tunnel, London and the Midlands, using power in the Transport and Works Act 1992 came closer than any other to addressing these concerns."

It should be noted that an Exceptional Hardship Scheme (EHS) and a Voluntary Purchase Zone had been used for CTRL (HS1), and it was the issues with these arrangements for CTRL that provoked the formation of the Working Group. The Group clearly considered the Central Railway scheme superior to CTRL schemes.

The property bond is markedly superior in regard to extending blight than the Government's own schemes, because purchasing properties under the EHS (or 'Need to Sell') is proof that a property is blighted – while a home with a bond is one that has in effect an insurance policy. Indeed some years ago an insurance policy against blight from infrastructure works could be purchased on the insurance market.

The reason that a property bond works is that while blight endures for too many years for individuals to withstand before there is any recovery, the bond can give assurance to owners and potential owners that they will not suffer financial loss if they sell before the market recovers. This allows owners and potential owners to have confidence that they can obtain an unblighted price and hence to buy and sell normally through the blighted period until property values (in most cases) recover.

It is crucial that mortgage providers have similar confidence that unblighted values are supported, otherwise they will only lend against valuations at blighted values. The CML do support the property bond as a sufficient basis to value at unblighted levels, as the letter they wrote to the Select Committee confirms.

A successful bond involves few purchases by the purchaser of last resort. An unsuccessful one involved more purchases, but still has a modest net cost (as PwC demonstrate).

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6. The risk of a property bond not working represents a significant level of financial exposure for the taxpayer. A property bond with a 500m boundary would leave the taxpayer as a purchaser of last resort for almost £3bn-worth of property. While it is unrealistic to expect that the Government would be required to purchase all these properties it is clearly important that any property bond is properly evidenced and clearly demonstrates value for money.

The value of the properties covered by the scheme (estimated at £2.903bn by PwC) is no indication of the cost of the scheme, as discussed above. The Government's note does not estimate or comment on the actual expected cost. As stated above, the PwC report does, with a comprehensive and detailed model based on optimistic and pessimistic estimates of £30m and £158m respectively³. HS2 Ltd, DfT, and property and mortgage experts were all involved in the PwC costings (including the estimated levels of 'uptake' expected).

If Government ignore the estimates from the experts they hire then it is hard to see how progress can ever be made without actually implementing a pilot scheme to test the market. Yet this approach is rejected.

7. Proponents of a property bond argued before Committee that the reassurance of a bond would effectively mean that people would act rationally in relation to properties in the bond area and so reduce generalised blight. However, again drawing on the DETR report this notes that:

"[Generalised blight's] effects depend generally on the attitude of possible purchasers of the property. These attitudes are susceptible to misperception, misrepresentation and uncertainty. Indeed,..., in many instances, generalised blight is the product of all three."

8. Therefore, the efficacy of the property bond relies on property purchasers responding to the bond in a rational manner when generalised blight is, to a considerable degree, the product of the irrational response of property purchasers to a major project. There is, therefore, a considerable risk that purchasers would not respond rationally to a property bond scheme and it would actually worsen blight at considerable cost to the tax payer.

Property blight is not an irrational response to potential damage to the environment and amenity of a property. It is typically much greater than the final settled-down

³ In HS2AA's view the PwC scheme is actually un-necessarily costly (as the initial property valuation does no real work as new valuations are required if the bond is actually called upon), so the scheme could cost about £3.5m less.

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change in property values because it reflects uncertainty and risk aversion. It is true that blight may be amplified by a mistrust of the promoter's assurances as to an absence of environmental detriment. But this is not irrational, given the promoter's interest in playing down adverse effects. Risk aversion is the basis for insurance. A property bond is a form of transferable insurance for property owners who are or might otherwise be affected by blight.

Even were property owners to act as the Government speculate, it would not result in a major cost to the taxpayer. This is because properties can be resold when the scheme is complete and property blight has abated. The cost is the difference between purchase and sale price after taking into account other costs. This is what PwC estimate to be in the range of £30m-£158m.

The key to the Bond reducing the generalised blight is in the approach of mortgage providers. As we note above the CML have said the Bond allows them to lend against unblighted valuations – so maintaining prices. Their support is vital and they have given it.

9. A number of petitioners have argued that, contrary to the Government's view, the Central Railways Property Protection Scheme does provide the necessary evidentiary base on which to be confident that a property bond would be effective.
10. There are, however, a range of reasons why the Central Railways scheme does not provide the necessary evidence to support the introduction of the property bond over a wide geographic area supported by the HS2 Action Alliance and others. The most important is that the Central Railways Property Protection Scheme was not a bond with a wide geographic scope. As the guidance says "*The scheme covers property which could be needed for construction of sections of new railway.*"
11. Therefore, primarily the Central Railways bond was an alternative to safeguarding. The guidance does go on to say that "*It can [our emphasis] also cover neighbouring properties where common sense suggests that people will be affected regardless of legal definitions*" but it is clear that this is very much a limited geographic scheme with properties neighbouring those properties required by the railway receiving a bond being very much the exception. This view was supported by those local authorities affected by the scheme. The Local Authorities Central Railway Consortium (whose members included, amongst others, Buckinghamshire County Council, Chiltern District Council, the London Borough of Hillingdon, South Buckinghamshire District Council and South Northamptonshire Council) in its submission to the Strategic Rail Authority in June 2001 noted that "*The CR Property Protection Scheme is only offered to very close / adjacent properties*". This, therefore, means the scope of the Central

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Railways bond appears much narrower than even the Rural Support Zone for HS2.

The Government and the Select Committee have heard evidence from Mr Robert Raffety (the originator of the Central Railways Scheme, who was also responsible for its implementation). The scheme was far more extensive than ‘an alternative to safeguarding’. Its purpose was to address generalised blight that goes much wider. As Mr Raffety’s slide for the Select Committee said

“(Scheme) Objective: to restore market confidence and prevent opposition.

Properties covered: a common sense approach –all properties likely to suffer general blight”

In fact very few properties (200) were needed to construct Central Railways⁴, while many properties were concerned about the blight, especially in rural areas. Mr Raffety has seen this Government note and confirms that bonds for homes over 100 yards from the line were put in place (particularly in rural areas), as the scheme rules itself permitted. By 2004 over 1,100 bonds had been drawn up.

Misrepresenting the geographic scope of the Central Railway Scheme is not a new matter. HS2AA contested and corrected⁵ similar statements made by Deloitte and DfT in the 5th compensation consultation documentation on the Bond (where it was said to be for properties “required for construction”, “adjacent to the railway”, “lineside”, and “designed purely for property directly affected”). This was simply not true. It was designed to give owners worried about the impact of blight on the value of their property reassurance, with a Bond (supported by the CML, who were crucial to its success) that enabled the property market to still function. And it did.

We are astonished that neither the DfT, nor Deloitte, nor PwC, nor anyone else acting for Government asked former officers of Central Railway about the basis of its scheme – particularly given the previous exchange of correspondence on this topic.

12. It is also notable that the DETR report when recommending further investigation into a property bond talks about “*a scheme which offers a guarantee of future value...for a property which is statutorily blighted [our emphasis].*” So the DETR report’s “support” for a property bond, referred to by Petitioners, is limited to properties required for a scheme and not a wide-ranging geographic bond.

⁴ The Local Authorities Consortium submission to SRA of 2001 that is quoted from at para 16 of this Government note states Central Railway needed 200 properties to construct their railway (para 4.3.2).

⁵ Letter from Leigh Day (on behalf of HS2AA) to Secretary of State (27 November 2013) on errors and misrepresentations in the 2013 Property Consultation Documentation.

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This is incorrect. The DETR report clearly recognises that the Central Railway scheme applied more extensively than to properties to which statutory blight would apply. It says:

"7.19.2The scheme, which was targeted mainly on properties that might be required for the development" (emphasis added)

The scheme is supported at paragraphs 7.19.1 to 7.19.5 of the report.

The Group were wrong to the extent that the focus of the Central Railway Scheme was not properties needed for the construction of their railway, but this is a separate matter (discussed above).

13. Great emphasis has been placed on the fact that according to Central Railways 35% of properties with bonds were sold or re-mortgaged as proof of the efficacy of the bond. However, as the DETR report notes in relation to property bond schemes:

"Obviously the guarantees have a market value only as long as the developer and / or his proposal are credible forces in the market, but the theory is that if either or both lose credibility and the proposal does not proceed, the market will return to its unaffected level anyway."

14. In this context it is useful to examine the history of the Central Railway scheme. An application for a Transport and Works Act Order for the scheme was submitted in May 1996. It was the subject of a vote in the House of Commons on 24 July 1996 where it was defeated by 172 votes to 7 and the Order was rejected. This was before the Property Protection Scheme was introduced. The Central Railway proposal was resurrected in July 2000 when a revised route was published and in January 2001 Central Railways asked the Government to support a hybrid Bill for the scheme. The Government asked the Strategic Rail Authority (SRA) to consider the case and the SRA recommended in March 2002 that the Government did not support the scheme.

15. Therefore, it is arguable that the scheme was only "credible" for less than two years between July 2000 and March 2002. Even then, given the comprehensive rejection of the scheme by Parliament in 1996 and the lack of certainty about funding for the scheme, it is arguable that its credibility was in doubt and so the blighting effects of it would have been less.

This is a poor argument. Crossrail was defeated in Parliament on the first attempt to get approval in 1991. It is however currently being built.

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Furthermore, some form of the Central Railway was a real possibility until 2006 as despite a proposal for a hybrid bill being turned down by the Ministry in 2004, further attempts were made to deliver the railway until 2006⁶. Government support was necessary, as a hybrid bill was the only potential source of planning consent.

Central Railway were offering bonds until 2006 to address concerns about blight.

There are estate agents, eg Trevor Kent, ex-President of the National Association of Estate Agents (who ran an agency in Gerrards Cross (Buckinghamshire), an area affected by the proposals), who recalled the difficulties the Central Railway project presented⁷, and other local agents who successfully sold homes with the bond. Amongst HS2 AA's members we have those who also still hold the Bonds and can confirm the reassurance they brought. We are aware that CLA members also had such bonds.

The 35% of bonds that were used on the open market were for both securing private sales and for re-mortgaging. Clearly mortgage lenders felt them credible, or they could not have been used for re-mortgaging, as they were.

16. Therefore, it is not at all clear that the evidence that 35% of bonds were transferred up to 2004 is evidence that the bond worked effectively or that the scheme had lost credibility and the bonds were being transferred because there was no blight, for example after the scheme was rejected in 2002. It is worth noting that the Local Authorities Central Railways Consortium's conclusion was that *"the Central Railway's Property Protection Scheme offers little by way of protection to affected residents and in reality does nothing to reduce the very real problem of blight."* Therefore, their view appears to be that transfers were not a result of the scheme working effectively. It is not clear what has caused many of these same local authorities to change their view and now support a property bond that uses the Central Railway's scheme as its justification.

The statement that the compensation scheme offers little to protect residents from blight is not borne out by the House of Commons Library Note (SN/BT/688) of 13 April 2010, which correctly explains how the Central Railway Bond *"works to prevent the problem of 'blight' faced by property owners in advance of the project proceeding"*.

17. Therefore, the Government's view is that the risks associated with a property bond are unacceptable for the tax payer.

Conclusion

The Government undertook to provide a note on the costs of a property bond. Their note does not even mention the costing done on a bond for HS2, despite the PwC work.

⁶ As described in the House of Commons Library note SN/BT/688

⁷ He gave written evidence in the case of HS2AA v Secretary of State in the judicial review on compensation that included this issue

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The Government not only commissioned the PwC work but were involved in settling its assumptions. The Government have not repudiated PwC's cost estimates in their note, and so one can only infer that the Government accept them. While the Government rehearse the uncertainties with predicting the outcome of a bond, their note does not offer new estimates of cost, even for the most adverse credible outcome. In fact the costs are – whether the bond is effective or not – modest on the expert analysis conducted for HS2 on behalf of and with the involvement of the Government.

The Government note persists in misrepresenting the Central Railway property bond. Mr Rafferty is also writing separately to the Select Committee on this matter.

26 January 2015

Appendix 1

Extract from PwC Report, (Analysis and Advisory work on a Potential Property Bond scheme for Property owners affected by plans for HS2” March 2014

Pages 9 and 10

Model outputs

A summary of the results of the financial analysis across a number of boundary scenarios and assumptions is set out below. The table firstly highlights the total current value of un-blighted properties within a number of potential property bond boundaries. It then presents the results of our analysis as to the potential net present costs and peak annual and cumulative cash requirements to implement a scheme under a range of scenarios

and assumptions relating to uptake, properties acquired, blight levels and both rental income and receipts on ultimate disposal of properties.

Scenario	Value of un-blighted properties eligible for a property bond (nominal)	Projected peak annual cash requirement (nominal)	Projected year of peak annual cash requirement	Projected maximum cumulative cash requirement (nominal)	Projected net present value/(cost) of scheme in base case (3.5% real discount rate)
120m optimistic	£242.7m	£32.9m	2015/16	£104.1m	(£13.1m)
120m pessimistic		£54.5m	2015/16	£169.3m	(£38.5m)
300m optimistic	£1,066m	£61.0m	2015/16	£235.0m	(£17.7m)
300m pessimistic		£143.3m	2015/16	£509.4m	(£85.0m)
500m optimistic	£2,905m	£101.7m	2015/16	£468.0m	(£30.5m)
500m pessimistic		£255.3m	2015/16	£1,072.2m	(£158.1m)

Appendix 2

Letter from Council of Mortgage Lenders



Robert Syms, MP
Chair of High Speed Rail (London - West Midlands)
Bill Select Committee
House of Commons
London
SW1A 0AA

17 November 2014

Dear Mr Syms

HS2 Enquiry

The CML is the representative trade body for the residential mortgage lender industry that includes banks, building societies and specialist lenders. Our 125 members currently hold around 95% of the assets of the UK mortgage market. In addition to lending for home-ownership, the CML members also lend to support the social housing and private rental markets.

In our responses to the earlier consultations we have referred to the fact that lenders will prefer to see a method of compensation which will provide for valuations and purchase on an un-blighted basis. This will give greater certainty to owners and lenders. For these reasons both the Voluntary Purchase Scheme and the Property Bond Scheme would be preferred over the Hardship Scheme and the Compensation Bond.

Yours sincerely

Chris Smyth

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