London Borough of Hammersmith & Fulham **Council** **15 May 2019**	
EDUCATION CITY DEVELOPMENT	
Report of the Cabinet Member for the Economy - Councillor Andrew Jones and the Cabinet Member for Children and Education - Councillor Larry Culhane	
Open Report This report contains an appendix that is exempt from disclosure on the grounds that they contain information relating to the financial or business affairs of a particular person (including the authority holding that information) and information subject to legal professional privilege under paragraph 3 and 5 of Schedule 12A of the Local Government Act 1972 respectively, and in all the circumstances of the case, the public interest in maintaining the exemptions outweighs the public interest in disclosing the information.	
Classification: For decision **Key Decision:** Yes	
Consultation: Housing, IT, Property, Legal, Finance, Equality, Commercial, Risk Management	
Wards Affected: White City and Wormholt	
Accountable Directors: Jo Rowlands, Strategic Director for The Economy and Steve Miley, Director of Children's Services	
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1. EXECUTIVE SUMMARY

1.1. This report seeks approval for, funding and capital budgets for the Education City Development in White City. The development will create a new mixed used education hub on the site of the ARK Swift Primary School at Australia Road, W12, including:

- A high quality primary school
- New and expanded nursery for 75 children
- New adult education facilities
- New youth facilities

- An office for educational charities
- 132 new homes, 50% of which will be affordable housing

1.2. Since the end of the Building Schools for the Future programme capital investment in existing schools has been minimal, with no significant central government investment to rebuild or refresh schools. This means that children at ARK Swift are being taught in buildings that are beyond their anticipated life span. This lowers the overall educational experience for pupils, and risks ARK being forced to divert funding to maintenance over education.

1.3. In the absence of a national programme, the Council and Absolute Return for Kids (ARK) have been working together to plan and co-fund the new Education City, to enable a phased development with a new school being completed by Summer 2021, and the whole development completed by Summer 2023.

1.4. The funding for the school and the office will be provided by ARK. The Council will fund the residential elements of the development. Both parties will share the costs of the construction of the youth facility, the nursery, the adult education facilities and the shared amenities.

1.5. The Council now needs to make a series of decisions for the scheme to progress. Cabinet has agreed to enter to enter into a master development agreement, and associated leases and agreements. The implementation of the cabinet decisions and the development agreement are conditional on several factors (as described in appendix 1). This includes the Council publishing the relevant procurement notices described in section 12. The development agreement conditions include an approved development budget, funding from both parties, section 77 consent from the Department for and Education, and the surrender of ARK's existing lease. The Council will also complete due diligence on the funding from ARK before the cabinet decisions are implemented, and funding from the Council is released.

1.6. This report asks Council to agree to the necessary funding to move the project forward. The Council proposes to use a wholly owned local housing company for the development and ownership of the private rented homes. The report sets out the legal powers of the Council and actions required in this regard.

1.7. The total budget requirement to deliver the development is £64,831,000. This is made up of:
- £59,026,00 for the construction of the residential units
- £3,694,000 for the construction of the youth facility
- £2,111,000 for the construction of the nursery and adult education facilities

2. RECOMMENDATIONS

2.1. That Full Council approve long term loan/equity funding and budget of up to £28.58 million for the private rented housing in accordance with state aid compliant market terms, subject to receipt of satisfactory legal and financial advice.

2.2. That Full Council approves a capital budget of up to £59,026,000 for the construction of 132 residential units and associated professional fees and development management costs funded by capital receipts, developer contributions or borrowing by the HRA and General Fund with final confirmation of the source of funding delegated to the Strategic Director, Finance and Governance, in consultation with the Cabinet Member for Finance and Commercial Services.

2.3. That Full Council approves the use of up to £8,938,000 of retained right to buy receipts to support the development of affordable housing within this project.

2.4. That Full Council approves a capital budget of up to £3,694,000 to fund the construction of or provide a capital grant for the construction of the Youth Facility, funded by capital receipts, developer contributions or borrowing with final confirmation of the source of the funding delegated to the Strategic Director, Finance and Governance, in consultation with the Cabinet Member for Finance and Commercial Services.

2.5. To approve a capital budget of up to £2,111,000 for the construction of the Adult Education and Nursery Facilities, funded by capital receipts, developer contributions or borrowing with final confirmation of the source of the funding delegated to the Strategic Director, Finance and Governance, in consultation with the Cabinet Member for Finance and Commercial Services.

3. REASONS FOR RECOMMENDATIONS

3.1. The recommendations enable the funding of the development which will create a new mixed used education hub, meeting the Council's education, housing and planning objectives.

3.2. The Education City Development delivers on several key Council strategies and priorities. The current facilities at the ARK Swift Primary School, the Adult Education teaching spaces, and the Harmony Nursery, have reached the end of their life and need either renewal or replacement.

3.3. The decisions by Full Council are required as any additions to the capital programme above £5m must be approved by Council, as must any equity or loan funding agreements.

4. PROPOSALS AND ISSUES

Background

4.1. The Cabinet of the 29th April 2019 agreed that the Council should enter into a Master Development Agreement and other legal documents with ARK or any of its subsidiaries, which are required to facilitate the delivery of Education City.

4.2. Cabinet also agreed to delegate authority to enter into leases, and to enter into funding agreements for the delivery of the private rented housing with the Council's housing company.

4.3. Full Council authority is required for the associated budgets, as they are additions to the capital programme.

Land Ownership

4.4. The Council is currently the freeholder of the whole site. ARK is the leaseholder of most of the site, which includes the school, the playground, buildings currently occupied by the Adult Education service and some NHS functions. The current Nursery building is owned by the Council and occupied by the Harmony Nursery. The Council is responsible for maintenance of the Nursery and the Adult Education buildings.

4.5. ARK's lease has 123 years remaining and is simply a lease to own and operate the school buildings and ancillary spaces. The lease gives ARK no rights to develop the site without the Council's consent. The Council and ARK have to work together in order for any development to proceed on this site.

Strategic Context - Schools

4.6. The 2018-2022 Business Plan sets out clear priorities around improving and supporting schools in the face of ongoing funding reductions. This requires creative approaches to bridge the gap. The Industrial Strategy aims to promote a model of inclusive growth which recognises the key role of schools in equipping residents with the skills and capability to benefit from the dynamism of our local economy. Learning spaces that facilitate the borough's children acquiring the skills necessary to compete successfully in the future knowledge economy will be critical.

4.7. Hammersmith and Fulham has high performing and popular schools, with results at primary stage the fourth best in the country. To maintain and further accelerate standards for education in the borough, improvement in the school estate will be necessary – both at community schools and Academy schools like ARK Swift.

4.8. Much of the current site is not fit for purpose, with post-war prefabricated buildings that do not match the Council's ambition for excellence in teaching, learning and pupil wellbeing. As well as reducing future maintenance burdens, improving the physical environment benefits children's education by:

- Providing environments that contribute to improving children's self-esteem and self- worth
- Improving the flexibility of classroom space to meet new expectations around an agile curriculum, in line with the emerging OFSTED framework
- More creative use of play space to support healthy school outcomes

- Aiding teacher recruitment and retention, by providing modern fit for purpose working environments
- Improving inclusion, by designing sufficient space and facilities for learners requiring extra support

4.9. There are a range of factors which go into making a successful school, from strong leadership, to the quality of teaching and learning, but there is strong evidence on the link between capital investment, well-designed school estates, and educational outcomes.

Strategic Context – Housing

4.10. The 2018-2022 Business Plan sets out clear priorities around delivering 1,500 new affordable homes, including 500 for affordable home ownership and to review all sites including smaller areas to use every available piece of land for housing. The Council also has London Plan commitments to deliver new housing.

4.11. To support these policies the Council has been preparing an assets and growth strategy, with the objectives of:

- Increase the supply of affordable housing in line with the administration's priorities;
- Use capital resource to increase the Council's income in line with the long term financial strategy; and
- Utilise assets to help manage demand and avoid costs, for instance from specialist housing or temporary accommodation

Strategic Opportunity at ARK Swift Primary School

4.12. Planning permission has been granted for the following:

4.12.1. New office headquarters for ARK and others (let at sub market rent);

4.12.2. A rebuilt ARK Swift Academy School;

4.12.3. A Nursery;

4.12.4. An Adult Education Centre;

4.12.5. A Youth Facility;

4.12.6. New residential facilities consisting of:

	Private Rented Sector (PRS)	Social Rent	Intermediate Rent for Key Workers	Total
Studio			1	1
1	14	13	27	54

2	47	20	10	77
	61	**33**	**38**	**132**
	46%	25%	29%	

4.13. A plan showing the new different uses at ground floor and first floor is shown in appendix 2. The residential element is spread across four blocks – two are stand-alone buildings, while the remainder of the units are above the primary school and the nursery. The adult education is provided within the ground floor of one of the residential blocks. The youth facility and the office are stand-alone buildings.

4.14. The development will be constructed in two Phases. The first phase consists of the school, office, youth facility, 24 social rented homes and the site wide infrastructure (Combined Heat and Power (CHP)) and underground services, and central boulevard). The second phase consists of the nursery, adult education facility and the remaining 108 homes.

4.15. For the development to proceed ARK will surrender their current leasehold interest and new leases will be granted.

4.16. The result on completion will be the following property ownerships

Property	**Owner**
Freehold Land	LBHF
Residential PRS	LBHF Housing Company
Residential Intermediate	HRA
Residential Social Rent	HRA
Nursery	LBHF
Adult Education	LBHF
Youth Facility	LBHF
Office	ARK (Office Company)
Primary School	ARK (School)

4.17. The current buildings are at the end of their useful life and the approved development proposals allow the re-provision and enhancement of these facilities, while also providing affordable housing.

4.18. The core drivers for the development compromise a mixture of financial and strategic drivers. These are summarised below:

Strategic drivers

- The potential to renew key community assets so that they are modern, fit-for-purpose and which can support key outcomes in the community
- Leveraging Council land to increase the supply of affordable homes, contributing to London Plan targets and the administration's commitment to delivery 1,500 new genuinely affordable homes

Financial drivers

- Lower life-cycle maintenance costs of re-provided community assets, including the nursery and the adult education facility
- Avoidance of major planned maintenance
- The potential for future income to help support the provision of Council housing and other services, generated from the PRS units
- The avoidance of costs from temporary accommodation

Adult Education and Nursery Re-provision

4.19. The current site includes a nursery, operated by Harmony Nursery a local charity. As part of the development, a new nursery will be created for Harmony. The nursery will be temporarily decanted during the construction, to allow the development to proceed. On completion, the Nursery will occupy the new property, with space for 70 children. Harmony will be granted a lease by the Council for this building to manage the nursery.

4.20. The adult education service currently operates a satellite service from temporary buildings on the primary school site. The service is in the process of being decanted to a property on the Uxbridge Road to allow the service to continue uninterrupted. On completion of phase 2, it will be able to return to a new fit for purpose facility.

4.21. Both of these facilities are needed moving forward, and so have been included in the masterplan and budget.

Youth Facility Provision

4.22. The masterplan for the scheme includes a youth facility. The 2018-2022 Business Plan includes a commitment to deliver a new youth facility in the north of the borough. The facility is proposed as a universal service, providing open access facilities for young people to. The design of the facility includes homework and learning spaces, meeting spaces, media and music rooms, and sports pitches.

4.23. The Council and ARK are contributing a maximum of £3.5m (excluding interest costs) each for the construction of this facility, and the Youth Charity Onside are contributing £3.25m.

4.24. The funding for the operational aspects of the youth facility will be the subject of a further Cabinet report, if required.

5. OPTIONS AND ANALYSIS OF OPTIONS

5.1. There are options regarding the decision to enter into the development in principle, and through what mechanism the Council owns and delivers the housing units.

Option 1 – Do Nothing

5.2. This option is not preferred. Without approval of a budget for funding the development, the Council will not benefit from the proposed development, in terms of provision of new housing and community facilities. The school pupils will miss the opportunity to be educated in modern, fit for purpose schools.

5.3. It would also mean that the Council would not benefit from the long term income stream generated from the private rented units, and an opportunity to provide badly needed additional affordable homes in the borough would not be taken.

5.4. The Council would also become liable for £1.93m in costs, due under the terms of the contingent cost sharing agreement, agreed in January 2019**.**

Option 2 – Approve the funding for the development

5.5. This is the preferred option. There is a clear need for re-provision of the school, adult education and nursery, and the educational benefits are clear. The additional housing will provide much needed affordable housing as well as the potential for a long-term income stream from the private rented units.

5.6. Management of financial and development risks is through the development agreement, which sets out clear conditions precedent before the development can proceed. In particular, the Council will not proceed if the funding condition cannot be satisfied (that is the Council has satisfied itself that the scheme is viable for it to be funded); and that the contract price is within an agreed budget.

5.7. The development agreement sets out the roles and responsibilities of each party and sets out how the development will be funded and how construction will be delivered. It also sets out the Council's and ARK's rights to step in and complete the development, should either party fail to deliver once the development is under way.

Delivery Options for the Council

5.8. The Council proposes to deliver the London Affordable Rented Homes and Intermediate homes through the HRA, as this is the most efficient and appropriate use of capital. On completion, the homes will be owned and managed within the HRA, and all income streams will be to the benefit of the HRA.

5.9. The private rented housing is proposed to be held within a wholly owned housing company, subject to the receipt and consideration of financial advice on the proposed loan terms – while the Council can develop the new homes, it cannot hold commercial residential property in anything other than a housing company. In order for the company to develop or acquire the private rented units from the Council, it will require equity and loan funding. The recommendations above enable the Council to provide this funding. The terms of the funding are subject to State Aid advice, which will determine the most appropriate loan to value, interest rate and key funding terms. State Aid advice on the terms of the loan and balance of equity/ loan funding is being sought and will be obtained prior to any loan agreement being signed.

5.10. The Council has also engaged PWC to provide the Council with tax advice, to ensure that the contractual structure with ARK provides the Council does not create any unnecessary tax liabilities or impact on the Council's partial VAT exemption. The Council will not sign the development agreement until it is satisfied on these issues.

5.11. This advice will also cover issues around timing of when leases should be granted to the housing company and to ARK (or its subsidiaries), again to mitigate against any unnecessary tax liability.

5.12. The development agreement with ARK covers the procurement of a contractor for the construction of the whole development. The initial stages of this process have begun and will conclude in summer 2019 to enable a start on site before the start of the new school year, subject to all necessary planning and contractual arrangements being in place.

5.13. The legal and financial sections of this report cover the detail of the Council's options with regards to delivery and contractual arrangements, and the implications of these.

6. CONSULTATION

6.1. Extensive public consultation has been undertaken on the planning application, with both public exhibitions and statutory consultation taking place prior to submission.

6.2. Specific consultation with the school, teachers, parents and pupils has also been undertaken.

6.3. ARK and the Council are applying under section 77 to the Secretary of State for the consent required for the changes to school land. This involves a public consultation process, including newspaper notices which will last for six weeks, and which started on 7th February. The application to the Secretary of State will then be considered by Department for Education and the Minister.

7. EQUALITY IMPLICATIONS

7.1. It is not anticipated that there will be any negative impact on any groups with protected characteristics, under the terms of the Equality Act 2010, from this proposed development

Implications verified by: Peter Smith, Head of Policy and Strategy, 0208 753 *2206*

8. LEGAL IMPLICATIONS

8.1. The legal implications are contained in exempt appendix 1.

9. FINANCIAL IMPLICATIONS

9.1. As set out in the report, the most appropriate delivery mechanism for this scheme, plans for appropriations and funding terms are still subject to legal, tax and treasury advice. Changes to the current assumptions which have been made in the report will also change the financial implications, particularly in relation to tax and the funding and return on the PRS. The financial implications will be updated as necessary within any future Cabinet or delegated decision reports.

Financial stability and financial strength of the contracting party

9.2. A Creditsafe check has been completed for Absolute Return for Kids (ARK) and ARK Schools which as at 30th August 2018 have Creditsafe ratings of 73 and 87 respectively and pass the Council's Financial standing tests. If permitted by the MDA, the Council should be satisfied by the financial checks carried out by Education City Developments Ltd. on the chosen works contractor ahead of formal appointment. As mentioned in the report approved by the Leader in January 2019 financial checks will be completed on third-party occupiers within the completed development.

Taxation

9.3. The Council has engaged PWC to provide taxation and corporate finance advice to determine the most appropriate lease and company structure, and timings of grant of leases to ARK and related companies. This work is not yet complete and discussions are taking place with ARK and their tax advisers. The completion of this work and consideration of their advice may amend some of the structures, and timing of transfers/ leases and cashflows set out in this report.

9.4. The Council will need to ensure that the structure does not lead to adverse Stamp Duty and Land Tax (SDLT) implications; and that any transaction does not create unmanageable risks around the Council's VAT partial exemption. A breach of this threshold could cost the Council £3-4 million per year of breach.

9.5. The recommendations are subject to the Council receiving satisfactory tax advice that satisfies the above. The Conditions Precedent to the contract should include the ability for the Council to not proceed if adverse tax implications are identified which cannot be mitigated or afforded.

9.6. H&F Housing Ltd. is a company limited by shares, with the Council the sole corporate shareholder. This means that the Council will receive any profits from the company via dividends, although, the company is subject to corporation tax on profits. As the Council owns more than 75% of the shares, the company would be considered a group company for SDLT purposes and so eligible for Group relief.

9.7. While the company is eligible to be part of a VAT group it is subject to "normal" VAT rules, so can only recover VAT incurred on VAT taxable activities. Rental of residential property is exempt from VAT, so the company will not be able to recover VAT incurred on its on-going property management costs nor on property maintenance and refurbishment costs. The construction of the property will be through a design and build contract, meaning there will be limited direct purchase of supplies and services in construction by the company, and so the bulk of fees will be zero rated for VAT purposes.

9.8. In relation to any loans to the company from the Council, HMRC would require these to be given on arm's length terms.

Capital budget

9.9. This scheme requires significant capital investment from both the HRA and General Fund. Further legal advice is required on the sequencing of appropriations of land between the General Fund and the HRA which may affect the split of the capital budget requirement between the HRA and General Fund. The below table summarises the required budget and funding positions for the Council and the Council's housing subsidiary company assuming that the HRA and GF will be responsible for the capital funding of their affordable housing and other elements of the scheme respectively.

9.10. Based on the social rented and intermediate homes being delivered in the HRA and the housing company receiving on-lending from the Council, the figures below assume the following:

- Long term PWLB loan for HRA & non-residential.
- Council on-lending to housing company at 5% with nil equity funding.
- Capitalised interest during the development period (in accordance with International Accounting Standard 23).
- Right to buy receipts applied towards 30% of works and development on costs for development of HRA units.

9.11. The capital budget addition and funding requirements are presented below:

		No. of Homes	2019/20 £,000	2020/21 £,000	2021/22 £,000	2022/23 £,000	Total £,000
Social Rent Phase 1	HRA	24	3,968	6,868			10,836
Social Rent Phase 2	HRA	9	134	498	2,869	514	4,015
Intermediate Rent Phase 2	HRA	15	224	806	4,638	831	6,498
Intermediate Rent Phase 3	HRA	23	339	1,383	4,311	2,412	8,444
Capitalised interest	HRA		40	186	174	257	657
Total Affordable Units		**71**	**4,705**	**9,740**	**11,992**	**4,014**	**30,450**
Private sector Rent Phase 3	Housing Company	61	905	4,380	14,064	8,154	27,503
Capitalised interest	Housing Company		19	41	263	750	1,073
Total Private Units		**61**	**924**	**4,421**	**14,327**	**8,904**	**28,576**
Total Residential		132	**5,629**	**14,161**	**26,319**	**12,918**	**59,026**
Non-Residential							
Youth Facility	General Fund		972	2,333	194		3,500
Adulth Education & Nursery	General Fund		556	1,333	111		2,000
Capitalised Interest	General Fund		38	130	138		306
Total			**1,566**	**3,797**	**443**		**5,806**
Total Council Project Costs			**7,195**	**17,958**	**26,762**		**64,832**

Funded by

	2019/20 £,000	2020/21 £,000	2021/22 £,000	2022/23 £,000	Total £,000
RTB Receipts - HRA	1,400	2,866	3,545	1,127	8,938
Borrowing - Social Rent	3,306	6,874	8,446	2,887	21,512
Borrowing - PRS	924	4,421	14,327	8,904	28,576
Borrowing, capital receipts, developers contributions - General Fund TBC	1,566	3,797	443		5,806
Total	**7,195**	**17,958**	**26,762**	**12,918**	**64,832**

The final funding of the Youth Facility, Adult Education Centre and Nursery by the General Fund will depend on the availability of other capital resources but the above table assumes that it will be fully funded by borrowing.

HRA Business Plan impact

9.12. The revenue budget implications for the HRA will depend on whether the Council elects to internally or externally borrow which will be informed by the Treasury Management Strategy and availability of cash balances.

9.13. An appraisal has been completed by Altair which demonstrates that all of the HRA units produce a surplus before interest from year 1. However, after interest is applied there are several years of deficit before a surplus is achieved. To demonstrate that the long term HRA Business Plan can accommodate this, the position approved at 4 February 2019 Cabinet in the report “Financial Plan for Council Homes” has been overlaid with the inputs from the Altair appraisal. This sensitivity analysis confirmed that the long-term HRA Business Plan position maintained adequate reserves and Capital Financing Requirement levels within prudential borrowing limits.

9.14. Statutory accounting regulations require a notional debt adjustment to be made to reflect the appropriation of land and assets between the Council’s General Fund and HRA and vice versa, based on valuation in the financial year the transaction occurs.

9.15. If an appropriation of land between the General Fund and HRA is required then there will need to be a transfer of CFR attributable to that asset. There may also need to be a re-allocation of attributable debt between the General Fund and HRA. This will lead to increased revenue costs of borrowing (MRP and interest costs) based on the valuation at the time of appropriation. Any benefit to the General Fund in reduced capital financing costs, and costs to HRA arising from the appropriation will be based on a professional independent valuation of the land to be appropriated.

9.16. Further legal advice is required on the timing/ sequencing of the appropriations required and formal valuations will be required to establish the financial implications. These will be included in full in any future appropriation decision report.

Youth Facility, Nursery and Adult Education Centre

9.17. The investment in the nursery and youth facility will result an ongoing MRP charge and potential interest charges (if external borrowing is taken out) or loss of investment income if cash balances are used, to the General Fund of c£250,000 per annum. Based on a 2.5% PWLB interest rate and MRP charge over the life of the assets (assumed to be the maximum 50 years) this would result in the following charges to the Council's revenue budgets if the capital investment was fully funded by borrowing:

	Capital Budget	2019/20 £,000	2020/21 £,000	2021/22 £,000	2022/23 Onwards £,000
Youth Facility 2.5% interest and 2% MRP	**3,500**	24	83	88	158
Adult Education 2.5% interest and 2% MRP	**760**	5	18	19	34
Nursery 2.5% interest and 2% MRP	**1,240**	9	29	31	56
Capitalised interest 2% MRP	**306**	-	-	-	6
Total	**5,806**	38	130	138	254

9.18. The Council's Adult Education Service may have the ability to generate additional revenues from the new premises however, detailed work will need to be completed on a revised business plan.

9.19. It is possible that some of the increased costs in relation to the Nursery could be met through the lease to Harmony of the new premises. In relation to the revenue implications of the capital expenditure on the Youth Facility, these are likely to be borne by the Council.

9.20. If the Council identified funding alternative to borrowing such as capital receipts or developer contributions this would reduce the interest and MRP charges. However, availability of such funding would need to factor in other potential calls on it such as the Town Hall refurbishment.

Altair Appraisal of Education City Development

9.21. The Altair appraisal has been worked on in consultation with Finance officers so that the long term economic and financial assumptions are consistent with the HRA Business Plan. As expected the affordable housing and intermediate housing have a negative net present value[1] which is in effect the cost of delivering additional affordable housing for the Council. The PRS has positive net present value if a conservative future capital receipt from a potential disposal is factored in but this is not enough for an overall positive NPV when taking all tenures into account. The NPVs are below:

Tenure Type	NPV £,000	
PRS		4,667
Social rented	-	5,483
Intermediate rented	-	701
Total	**-**	**1,517**

9.22. If the Council wanted a break even present value the scheme would require further subsidy of £2.19m, the cost of providing the affordable housing. As RtB receipts are being applied to the maximum this would need to come from borrowing, developer contributions or other non-housing capital receipts that may become available in the future.

Provision of Development Funding to the Housing Company

9.23. The report requests approval to provide funding (via equity/ loan funding) to the Housing Company of up to £28.58m for the private rented sector housing. The timing of when the Housing Company will need investment, and/or need to borrow from the Council, will depend on the final structure and whether the Housing Company or the Council develop the properties. This is subject to the receipt of advice on tax and state aid from legal and financial advisers.

9.24. To on-lend to the Housing Company, the Council will need to consider its overall borrowing requirements and may borrow from the Public Works Loan Board (PWLB) or may use internal borrowing in line with the overall Treasury Management Strategy. It is expected that this will be long term borrowing but the length and repayment method, e.g annuity or repayment at maturity, will be determined once the Housing Company's requirements are clearer.

9.25. In on-lending to the Housing Company, the Council will need to ensure that it does so on state-aid compliant terms, considering the terms of the agreement including the interest rate. This is likely to consider the split between debt and equity in the company, therefore the Council funding will need to be a mix of equity and debt funding. Given that the Council can borrow relatively cheaply from the PWLB, it is likely that the Council will obtain a margin from on-lending to the Housing Company. The Council's margin will be determined by both the interest rate obtained from the PWLB and the state-aid compliant rate as advised by financial and legal advisers. In addition, the debt interest costs will be an allowable expense by the Housing Company against corporation tax.

[1] **Net present value** (**NPV**) is the difference between the **present value** of cash inflows and the **present value** of cash outflows over a period of time. **NPV** is used in capital budgeting and investment planning to analyse the profitability of a projected investment or project.

9.26. Under accounting rules, loans to third parties must be treated as capital expenditure (and the repayment considered a capital receipt) by the Council and considered under MRP regulations. Regulations require that MRP is charged based on the life of the underlying assets being created by the party to whom the loan is granted. This spreads the impact of any impairment of the loan that may be required to the Housing Company.

9.27. As the split between equity and debt funding of the private rented sector housing is not known, the PWLB loan rate and the on-lending rate cannot yet be determined, the detailed financial implications are not yet available and the implications in the report are based on high level assumptions including the use of debt rather than equity funding and an example interest rate of 5% in modelling the effect on the Housing Company cashflows.

9.28. The key risk where the Council provides equity or loan funding to the Housing Company is a risk of default should the Company be unable to afford the interest payments or repay the Council. The funding will be provided on state-aid compliant terms which will include mitigations such as a charge on the assets the Housing Company.

Financial Benefits to Council

9.29. The regeneration could attract additional investment in services to serve the new homes and occupied offices to the local area thus creating additional jobs and generating business rates/council tax for the Council.

9.30. Potential reduction in temporary accommodation cost reductions from the development of 33 social rent homes. Based on the 2019/20 temporary accommodation budget this represents a cost reduction of £76,000 per annum based on 33 fewer households being in Temporary Accommodation.

9.31. The end Gross Development Value as estimated by Bidwells results in an increase in asset base for the Council from the current £1m to £50.7m, although this could only be realised if the Council were to dispose of the property.

9.32. The margin the Housing Company is paying on the loan from the Council and future dividends will provide an ongoing income stream for the Council. There is also potential for a future large dividend payment in the longer term if individual units of the PRS or the entire portfolio is sold.

Other financial risks to Council

9.33. Net contribution of affordable housing to long term HRA business plan is negative and for the first few years there is a revenue deficit if external borrowing is taken out, however this can be accommodated in the long term HRA Business Plan.

9.34. Gleeds have been advising the Council on the construction costs and have included an 8% contingency. To mitigate further for cost rises the appraisal model and capital budget include an additional 5% contingency. The Council will also reconsider the budget and funding on consideration of the tender prices and could consider value engineering to reduce the contract price to manage within the agreed budget.

9.35. The right to buy receipts being allocated to this scheme are time limited to up to three years depending on when they were generated, after which they have to be repaid to the Government. There is no guarantee that the Council will continue generating these receipts as they are dependent on a certain level of disposals. Therefore, any delay to the scheme could result in a shortfall that would result in further borrowing or alternative funding being required.

9.36. If the Council does not enter into the development by the long stop date, then it could be liable for its share of the pre-development costs of 43% up to £1.93m which would be a direct hit to the Council's reserves. If the Council enters into the development agreement but does not satisfy the conditions precedent by an agreed long strop date, and the agreement subsequently terminates, the maximum share of the pre-development costs would be £3,648,804.

9.37. There is a chance that that the cost of borrowing could increase between the date of this report and the time at which capital funding is obtained. Borrowing for this scheme will be undertaken within the wider Treasury Management Strategy to mitigate borrowing costs risks.

9.38. Running costs may be greater than estimated. The appraisal assumes that running costs will increase in line with inflation. It makes conservative assumptions about maintenance assuming that these costs will be incurred from year one whereas in reality most reactive repairs would covered by the builders guarantee.

9.39. If increased rates and running costs result in the housing company defaulting the Council will have the power to take possession of the PRS units which it could retain as an income stream or dispose of to repay the associated debt. As it is the sole owner of the housing company the Council would ultimately end up absorbing any deficits or losses that the company incurs.

Scheme Appraisal

9.40. The Council commissioned Altair Consultancy and Advisory Services Ltd (Altair) to undertake scenario analysis and stress testing of the residential element of the Education City scheme, as agreed with Council officers:

- Education City base position
- Comparison of interest only and repayment mortgage scenarios
- Interest rate (development period and long-term rate) stresses on 4, 5 and 6%
- Cost and value stresses
- Rents and long-term costs inflated over development period scenario
- Disposal of private rent unit scenarios.

9.41. The appraisal model has been agreed with subject to the state aid compliant interest rate being confirmed. The details are contained in the reports and are attached for reference at appendix 1.

Implications completed by: Firas Al-Sheikh, Head of Financial Investment and Strategy (Growth and Place) 020 8753 4790.

Implications verified by: Emily Hill, Assistant Director, Corporate Finance, 020 8753 3145.

10. PROPERTY IMPLICATIONS

10.1. The Property team have been involved in providing advice on the lease terms to third parties as well as the long lease to ARK Swift for the office accommodation. Property have worked with Trowers on lease terms

10.2. In addition, property advice has been provided where requested by the Project Manager on other property matters including proposed Estate management company.

10.3. "Section 128 (1) of Local Government Act 1972 confers to Secretary of State power to give general consent to local authorities for the purpose of land disposals by local authorities. The terms of the Consent mean that specific consent is not needed for disposal of any interest in land which the local authority considers will help it secure the promotion or improvement of the economic, social or environmental wellbeing of its area. Local authorities are granted powers under Local Government Act 1972 (s123) to dispose of land. The specific general consent is subject to a best consideration guidelines where any under-value must not exceed £2,000,000. For valuations, where the under-value is above £2,000,000 then specific formal SOS consent is needed

10.4. The Council secured external valuation advice to provide best consideration advice in accordance to RICS guidelines by Bidwells and its advice has concluded the best consideration valuation has been met as any under-value is less than the threshold outlined below so general consent can be granted by the local authority. The external valuation advice was provided in February 2019 by Bidwells and was prepared in accordance with Circulate 6/03 – Local Government Act 1972 General Consent 2003."

Implications verified by Nigel Brown, Head of Asset Strategy and Property Portfolio, 020 8753 2835

11. IMPLICATIONS FOR BUSINESS

11.1. The scheme has the *potential* to create tender opportunities for local small and medium size enterprises during the construction and operational phases of the development. The Local Supply Chain Initiative will be utilised to identify, engage and prepare suitable local businesses.

11.2. There is also scope to create employment opportunities ranging from work experience and *apprenticeships* to sustainable jobs for local people. The Work Matters Team will assist in engaging and supporting local residents (including local schools) to access any opportunities created.

Implications completed/verified by: Albena Karameros, Economic Development Team, 07739 316 957

12. COMMERCIAL IMPLICATIONS

12.1. External legal advice has been sought with regards to the procurement implications of this report and the usage a negotiated procedure without advertisement under Regulation 32(2)(b)(ii) of the PCR 2015.

12.2. While as the Leading Counsel advises, PCR 2015 allows for the direct award under the negotiated procedure without advertisement, a waiver from the CSOs for seeking competitive tenders or calling-off from a framework agreement must be approved. A waiver can be approved under the Council's CSOs by the Relevant Person (in this case by the appropriate Cabinet Member(s) and the Leader of the Council) if they are satisfied that a waiver is justified.

12.3. A Voluntary Ex Ante Transparency (VEAT) Notice shall be published in Tenders Electronics D (TED) following the award stage. A contract shall be created in the Council's Contracts Register to meet Council's policies and statutory transparency regulations.

Implications provided by Andra Ulianov, Procurement Consultant, x2284

13. IT IMPLICATIONS

13.1. There are IT implications arising from Option 1 for the intermediate housing component which "introduces an additional product into the HRA management, bringing complexity to tenancy management and requiring new processes to manage" (see 4.46.3) and IT services should be consulted should this be the preferred option going forward. IT services should also be consulted should any IT implications arise as a result of implementing any other aspects of the scheme.

13.2. IM implications: (A) Privacy Impact Assessment(s) (PIA) will need to be conducted to ensure all potential data protection risks around implementing this scheme are properly assessed with mitigating actions agreed and implemented.

13.3. Any contracts affected by this will need to include H&F's data protection and processing schedule if this is not yet the case. This is compliant with the General Data Protection Regulation (GDPR) enacted from 25 May 2018.

Implications verified/completed by: Tina Akpogheneta, Interim Head of Strategy and Strategic Relationship Manager, IT Services, tel 0208 753 5748

14. RISK MANAGEMENT

14.1. As set out in the report, the most appropriate delivery mechanism for this scheme and funding terms are still subject to legal, tax and treasury advice. Changes to the current assumptions which have been made in the report and any potential changes in risks arising from the final advice will need to be considered and updated as necessary within any future Cabinet or delegated decision reports. Officers will ensure that the risk implications of any changes are fully understood. There are a number of risks associated with a project of this size and complexity. Regular project team and programme boards are used to manage risks.

14.2. Some of the key risks and associated mitigations, as identified by officers, are identified below.

Risk	Impact	Mitigation
Pre-Contract Risks		
Transaction structure leads to unintended or unforeseen tax liabilities, including risk to VAT partial exemption	Additional cost liability renders scheme unviable VAT partial exemption breached	Clear PWC advice being secured on appropriate mitigations. Conditions precedent include a viability condition, which means Council can't proceed without being satisfied as to tax advice
Procurement and State Aid Challenges	Contract is rendered ineffective by High Court judgement, and Council is liable for state aid fines	Clear Counsel's advice on correct way to proceed and publication of VEAT notice and State Aid compliance
VEAT Notice is drafted incorrectly	VEAT notice is challenged in light of Faraday ruling and contract is rendered ineffective	Advice in drafting of VEAT and contract award notice
s.77 Consent is not obtained	Development cannot proceed	S.77 Consent is a condition to surrender of lease by ARK, limiting the financial exposure of both parties, and is before build contract is signed
Funding Condition is not Satisfied	Development cannot proceed	MDA contains clear provisions for termination and cost exposure in event funding cannot be obtained by either party. Council will complete due diligence on ARK funding before signing MDA
Construction Budget cannot be met through procurement	Development cannot be funded and so cannot proceed	Opportunity to value engineer, and amend planning application so that budget can be met
Delivery/Post Contract Risks		
Delays to satisfying planning conditions	Construction costs increase and programme slips	Strong resourcing and quality of work in the pre-contract period

Build risk - timing and quality	Delay in delivery of the development	MDA includes LADs for the developer, which also flow through into the build contract
Cost inflation for construction	Reduces scheme viability or increases risk of contractor default	Robust sensitivity analysis to consider headroom, regular forecasting as part of business plan process, more control and expertise provides choices for value engineering
Risk in market values changes	Private rented units do not perform, risking viability of housing company	Risk is limited by them being private rent rather than sale, but there could be a sale of units to HRA or change affordability, robust sensitivity analysis has also been completed
Increase in finance rates	Reduces viability of schemes and financial or affordable housing outcomes	Flexibility of sources for finance to ensure best rates can be accessed, robust sensitivity modelling, fixed rate borrowing
Failure by developer	Scheme cannot be delivered	Council and ARK have mutual step in rights to the build contract to ensure completion
Failure by contractor	Scheme cannot be delivered	Council and ARK have robust rights to appoint a new contractor
Maintenance costs of assets higher than planned for	Long term risk of underperformance if investment asset	Benchmarking against resource requirements and other examples, robust sensitivity analysis of business model, robust business planning processes
External Risks that cannot be directly controlled by the Council		
Failure of ARK schools or main charity	No organisation to fund school and office element of scheme	Council has step in rights. Close liaison with central government
Wider legislative Tax Changes	Unforeseen increased costs, and long-term impact on performance of assets	Housing vehicle is flexible enough to respond to changes
Legislative changes increase build costs	Higher build costs reduce scheme viability and financial / housing outputs or delays scheme progress, future maintenance or upgrade costs unexpected and higher than planned impact financial viability of vehicle business plan	Monitoring of changes, identification of approach and budget for refurbishing stock held, consideration as part of tenure / service charge arrangements, quality of management resource
Economic Recession and impact on development sector	Skills shortage and impact on supply chain driven by national picture stalls housing delivery	Flexibility in delivery model to adapt to new circumstances e.g. Greater role for Council in development and flexible approach to tenure

14.3. Officers have considered the risks associated with the various stages of this project, as set out above, and sought to put in place appropriate mitigations. It is recommended that they continue to review, monitor, and escalate project risks as appropriate until the project objectives have been delivered and ensure that new risks identified are assigned to risk owners.

14.4. The financial implications section in this report identifies a number of key financial risks, including: the viability of the project if there are any changes to the affordable housing element; the need to ensure that funding required for the scheme can be accommodated within the HRA Business Plan while maintaining adequate reserves and CFR levels within financial borrowing limits; that the proposed structure of the scheme does not lead to adverse SDLT or VAT partial exemption implications; that any loan to the proposed wholly owned local housing company is state aid compliant and enables the company to set a balanced budget and business plan. The financial risks which will need to be closely monitored and managed and subject to regular reporting to Members.

14.5. On receipt of the final tax advice from PwC, officers will need to consider the impact on the advice on the feasibility and affordability of the project and make appropriate recommendations to Members in terms of progressing the project.

14.6. Officers have obtained appropriate external legal advice to assure those approving this report that the proposed approach would enable the Council to achieve its objectives for this project, subject to the final tax advice being received, and in following the legal advice received should not be subject to procurement challenge by following the recommended course of action.

14.7. Officers will need to ensure that final legal and financial advice in respect of ensuring compliance with state aid regulations is followed in respect of on-lending to the Housing Company and that this advice is followed to ensure that the funding is provided in accordance with state aid compliant market terms. This will mitigate the risk of potential future challenge.

14.8. Officers will also need to ensure they act on all final advice/reports received when progressing the relevant transactions and provide appropriate assurances to the Chief Executive and Members that this has been done. This will mitigate the risk of challenge or potential qualification by the Council's external auditor as part of their audit procedures.

14.9. Officers will need to ensure there are appropriate governance and oversight arrangements in place to protect the Council's interests in respect of the use of a wholly-owned company (H&F Housing Ltd) and the proposed Community Benefit Investment (charity) vehicle.

14.10. Given the significance, value and complexity of the proposed programme, officers should set out the officer and member governance arrangements which will provide project oversight and assurance and ensure that costs are appropriately controlled, and key actions taken once approvals have been confirmed.

Implications verified *by: David Hughes*, Director of Audit, Fraud, Risk and Insurance, *02073612389*

15. BACKGROUND PAPERS USED IN PREPARING THIS REPORT

None.

List of Appendices

Appendix 1 – Confidential legal and financial comments
Appendix 2 – Scheme layout plan