

## London Borough of Hammersmith & Fulham

**Report to:** Cabinet

**Date:** 02/11/2020

**Subject:** Education City Update

**Report of:** Councillor Andrew Jones, Cabinet Member for the Economy

**Report author:** David Burns, Assistant Director - Growth

**Responsible Director:** Tony Clements, Strategic Director for the Economy

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### Summary

The Council's cabinet on April 29<sup>th</sup> 2019 and Full Council on 15<sup>th</sup> May 2019 approved entering into a master development agreement (MDA) and associated documents with ARK and its subsidiary companies for the delivery of the Ed City project. The Cabinet and Council also approved the capital budgets required to deliver the scheme.

ARK's elements of the scheme rely on the development and letting of a substantial office block in order to provide the funding necessary for their financial contributions. In response to Covid-19, the ARK Board decided to pause on the project and review the long-term viability of the office block. ARK have committed to the project long term and the development of the office block, however due to changes to the risk profile and funding environment, changes are required to the balance of funding and terms of the development agreements. In addition, ARK are seeking a commercial loan from the Council to fund the development of the office block.

This report is seeking approval for the Council to fund up to an additional £1.75m of the capital costs of the Youth Zone element of the Ed City development, an additional £5.1m of capital funding for the Council owned element of the scheme (to change the units from private rented accommodation to shared ownership and increase the council's funding contribution towards the Adult Learning Centre and Nursery) and to submit an application to amend the previously approved tenure mix and to recommend to Full Council the approval of the grant of a commercial loan for the construction of the office block.

This is a shovel ready project that supports the Council's industrial strategy, will support economic recovery post Covid-19, delivers a 100% affordable housing project, and delivers on a manifesto commitment for a youth facility in White City.

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### Recommendations

That Cabinet

1. Notes that Appendix 1 is not for publication on the basis that it contains information relating to the financial or business affairs of any particular person (including the authority holding that information) as set out in paragraph 3 of Schedule 12A of the Local Government Act 1972 (as amended).
2. Approves an additional £5,114,000 to the council's capital budget giving a total capital budget of £72,622,000 for the construction of 132 residential units, Adult Learning Centre, Nursery and associated professional fees and development management costs.
3. Approves a further capital budget of £1,750,000 to be funded by section 106 contributions for the Council's additional contribution to the Youth Facility giving a total contribution of £5,250,000 subject to receipt by the Council of the section 106 contributions.
4. Agrees that the Council enters into a funding agreement and agreement for lease with OnSide Youth Zones and any subsidiary company, which are required to facilitate the development of the Youth Zone and Education City subject to receipt of satisfactory state aid advice.
5. Delegates authority to the Strategic Director for the Economy, in consultation with the Cabinet Member for the Economy and the Arts and the Head of Law, to finalise and complete negotiations with OnSide Youth Zone and any subsidiary company in order to give effect to the decision in 3 above.
6. Notes the proposed changes to the master development agreement required in order to facilitate the development moving forward.
7. Notes the proposed the change of residential tenure of 61 private rented units to 61 Shared Ownership units, subject to any necessary planning approval.

That Cabinet recommends to Full Council

1. That the Council approves a loan of up to £35 million to Ark for the construction of the office block at Education City, based on the heads of terms attached at confidential Appendix 1, subject to receipt of satisfactory legal and financial advice, and state aid advice
2. To approve a capital budget of £35m be added to the capital programme to fund the loan to Ark.

**Wards Affected:** Wormholt & White City

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### **Reasons for Decision**

The changes to the tenure and the funding of the youth zone require additional capital budget of £6.9m, for which cabinet approval is required.

The awarding of a commercial loan requires full Council approval.

<b>Our Values</b>	<b>Summary of how this report aligns to the H&amp;F Values</b>
Building shared prosperity	The development includes facilities that will benefit a wide range of the local population, as well as much needed affordable housing.
Creating a compassionate council	The Youth Zone will create a safe space for young people to gather, learn and play. The project will also further the Council's ability to provide compassionate, high-quality services that residents can rely on.
Being ruthlessly financially efficient	The investment in the project will generate a significant social return for the Council and the local community.
Taking pride in H&F	The scheme will deliver quality additions to the borough in terms of housing provisions and are to be delivered to the highest safety standards reflecting the Council's priority to keep its residents safe.

## Financial Impact

### Budget Impact

The recommendations in this report will increase the council's capital programme budget for the scheme by £6.9m with a total budget of £77.9m split between the Councils Development Scheme and the grant funding of the youth facility. This budget increase can be accommodated without increased borrowing due to increased scheme subsidy through right to buy receipts and s106 funding and the sales receipts generated from Shared Ownership tenure that have replaced the private rented tenure. The table below shows the proposed change in capital budgets and funding.

Table 1: Education City Financial Summary (all figures in £000s)

All figures in £,000s

<b>Council Scheme Funding</b>	<b>May Budget 2019</b>	<b>November Budget 2020</b>	<b>Change</b>
Residential	65,202	65,723	520
Adult Learning Centre and Nursery	2,306	6,900	4,594

<b>Total Council Scheme Costs</b>	<b>67,508</b>	<b>72,622</b>	<b>5,114</b>
GLA Affordable Housing Grant	4,168	2,492	-1,676
RTB Receipts	1,178	6,356	5,177
S106 Receipts			
Sales receipts		9,568	9,568
Borrowing	62,162	54,207 <sup>1</sup>	-7,955
<b>Total Council Scheme Capital Funding</b>	<b>67,508</b>	<b>72,622</b>	<b>5,114</b>

<b>Onside Grant for Youth Facility</b>	<b>3,500</b>	<b>5,250</b>	<b>1,750</b>
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Funded by

S106 Receipts	-	1,750	1,750
General Fund Borrowing	3,500	3,500	-
<b>Total Funding of Residential</b>	<b>3,500</b>	<b>5,250</b>	<b>1,750</b>

All of the budget increases bar that of the residential are due to the Council taking on funding that was previously expected to come from Ark. Further details on the background of this are provided in the detailed analysis section.

The previously approved budget is in the council's general fund capital programme. However, as the residential part of the scheme is now all affordable it is expected that the cost of the residential development will be reported in the HRA capital programme. This includes the Adult Education and Nursery which are to be built underneath the residential buildings. The timing of this is to be confirmed but is expected to be prior to build completion and will be reported through the council's quarterly capital budget monitoring process. Such an appropriation would trigger a transfer of debt from the general fund to the HRA equal to an appropriate valuation of the site. The legal and financial details of this will be set out in a future decision.

### **Scheme performance**

The original approval of this scheme in May 2019 precedes the financial performance hurdles agreed by the council's Development Board. The overall scheme financial performance has not materially changed since the last appraisal in April 2020 and remains negative. Appendix 2 shows a breakdown of the scheme performance as measured by Net Present Value (NPV)<sup>2</sup>. The following paragraphs set out the long-term implications to the general fund and HRA.

### **Long-term General Fund implications**

The £3.5m approved in May 2019 will be funded from general fund borrowing and result in financing costs to the general fund unless other funding can be identified in place of borrowing. The proposed £1.75m increase in the councils grant funding to

<sup>1</sup> Reflects net borrowing position. Borrowing will peak at £63.8m until the forecasted £9.6m shared ownership sales receipts are realised.

<sup>2</sup> **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.

Onside will be fully funded by s106 receipts and therefore not lead to additional financing costs.

Whilst not financially measured in the appraisal the additional affordable housing this scheme provides for Hammersmith & Fulham could provide financial benefits by helping to ease temporary accommodation budget pressures on the general fund. The Councils 2020/21 temporary accommodation budget is circa £1,800 per household on average. As an example, and in 2020/21 prices if the 33 London Affordable rented homes delivered by the project resulted in 33 less temporary tenancies with private landlords it would save council up to £59,000 per annum. However, there are more expensive properties at the margins which could result in an even greater cost avoidance than the example given.

### **Long- term HRA implications**

Due to the change in tenure of the private rented homes to shared ownership the residential part of the scheme is made up 100% affordable housing. Whilst the residential scheme performance still doesn't provide a positive return it has improved following a net increase in scheme subsidy through increased right to buy receipts and shared ownership sales receipts as set out in table 1. The latest appraisal indicates that the scheme's marginal impact on the HRA operating account is negative until up to year 13 on an annual basis and year 20 on a cumulative basis. The operating account performance could be improved if future affordable housing s.106 could be applied to the scheme in place of borrowing or if the Adult Learning Centre can generate an operating surplus and depending on the level of rent the Nursery occupants pay.

The scheme has been overlaid on the latest HRA financial plan and can be absorbed but this is in part dependent on other schemes in the Building Homes and Communities Programme with superior financial performance as result of a mixed tenure split between affordable and private rent/sale homes.

### **Loan to Ark**

The loan to Ark will require approval from Full Council. Subject to satisfactory conclusion on the terms of the loan with Ark the full financial implications of it will be set out in the future Full Council decision.

### **Legal Implications**

The Council is being advised by Trowers and Hamlins LLP who have prepared legal advice for the Council on the terms of the Master Development Agreement (MDA) and ancillary documents, vires, procurement and state aid and other related matters.

The main legal implications have not changed significantly from previous reports with the exception of the loan.

Although for tax efficiency and other reasons, different aspects of the transaction are being implemented through different Ark legal entities, we refer below to Ark as a general term to include the various Ark entities.

Please note that certain legal implications in particular to public procurement and state aid may be subject to change following the date of providing these legal implications on 23 September 2020 due to the United Kingdom's exit from the European Union and/or legislative amendment or new case law.

### **Power to enter into the MDA**

The Council has the power to enter into contracts (e.g. the MDA) under s1(1) of the Local Government (Contracts) Act 1997 provided the contract is entered into pursuant to a substantive Council function and is for a proper purpose. In this case the relevant substantive Council functions include:

- in respect of the housing elements the Council's powers as local housing authority under the Housing Act 1985;
- in respect of the nursery the Council's powers as education authority under section 22 of the Childcare Act 2006;
- in respect of the new primary school under section 14 of the Education Act 1996;
- in respect of the adult education facility power to provide education facilities to adults pursuant to section 15ZA of the Education Act 1996;
- in respect of the youth zone under section 507B of the Education Act 1996 and the power to provide recreational facilities pursuant to section 19 of the Local Government (Miscellaneous Provisions) Act 1976.

### **Power to dispose of an interest in land**

The Council owns the freehold of the site which is already occupied by Ark under a long lease for the purposes of operating its academy primary school. This transaction will involve a surrender (of all parts other than the offices) with new leases being granted in relation to the same. Given this, the "housing" land will need to be appropriated into the HRA from the General Fund

The Council has the power to dispose of Government Act 1972 or where is held for planning purposes, s233 of the Town & Country Planning Act 1990.

Provided any disposal of a land interest is for the "best consideration reasonably obtainable" or there is Secretary of state consent. Leading Counsel has previously advised that the valuation from independent surveyors Bidwells indicated that the Council is satisfying this requirement, its common law fiduciary duty to obtain value for money and state aid law.

### **Power to borrow**

The Council has the power to borrow for the purposes of its functions pursuant to section 1 of the Local Government Act 2003, provided the borrowing complies with the Prudential Code and is within the Council's Prudential Indicators.

### **Power to provide loan and compliance with State aid**

The Council has the power to provide a loan to [Ark entity] pursuant to its investment power under s12 LGA 2003 provided the investment is in line with the Council's Investment Strategy, is prudent and represents value for money

The Council may wish to seek independent financial verification that the terms of any loan from the Council to Ark are on market to ensure that the Council can justify providing the loan on the basis of acting as a market economic operator.

## **Procurement**

Trowers & Hamlins LLP and ARK's lawyers, jointly sought a legal opinion from Leading Counsel on vires, procurement and State Aid in December 2018.

We understand that the substance of the transaction has not changed since Leading Counsel was instructed to advise on this matter which is reflected in our analysis below.

Leading Counsel advised that the transaction would fall within the "protection of exclusive rights" exemption from the requirement to advertise and competitively tender a public works contract pursuant to Regulation 32(2)(b)(ii) of the PCR 2015 because of Ark's unique position as long leaseholder on the site.

and advised that the Council should publish appropriate transparency and contract award notices in OJEU to mitigate risk of the transaction being declared ineffective by a court if it were challenged. The transparency notice was accordingly published in OJEU on 11 May 2020 and to date, there has been no indication of challenge or complaint. The deadline for challenging a valid transparency notice is 30 days from when the complainant knew or ought to have known about the alleged breach of procurement law.

On the information that we have been given (i.e. that the substance of the transaction has not changed materially) we have advised the Council that a fresh transparency notice is unlikely to be required.

## **Use of S106 monies**

The report proposes that funding of up to £1,750,000 for the youth facility will be provided from funds secured under a section 106 agreement. The proposed contribution to be used is the Youth Centre Contribution which is secured in the Fulham Gas Works section 106 agreement dated 8 February 2019. The agreement requires the Youth Centre contribution to be used towards community facilities within the borough. The proposed use of the funding towards a youth facility is permitted under the terms of the Section 106 agreement.

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## **Background Papers Used in Preparing This Report (*all published*)**

Cabinet Report April 29<sup>th</sup>, 2019

Full Council Report May 15<sup>th</sup>, 2019

Leaders Decision Report April 20<sup>th</sup>, 2020

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## **DETAILED ANALYSIS**

### **Proposals and Analysis of Options**

3. The April 29<sup>th</sup>, 2019 cabinet report set out the approvals required and the strategic rationale for the Council entering into a MDA with Ark schools and its associated subsidiary companies for the delivery of the Ed City project. And the 20<sup>th</sup> April 2020 Leaders Decision report sought further approval to increase the project budget to cover an increase to the construction costs due to enhanced building regulations and health & safety measures.

### **Proposed Contractual and Funding Changes**

4. Ark were originally relying on a combination of charitable loans and commercial borrowing to fund their elements of the development and contribution to the wider scheme.
5. In addition, to funding the office, school and their share of site wide costs, the Council negotiated a contribution of £2.3 for the replacement of the nursery and adult education facilities (currently on site), and a £3.5m contribution to the construction of a Youth Zone.
6. In light of the changed risk position post-Covid ARK has stated that it is unable to fund the additional cost – it is taking a speculative risk on developing an office and being able to let it, and it does not have pre-lets secured at this stage. The additional funding for the nursery, adult education

and the Youth Zone would stretch its financial commitment beyond that which its board would approve. It has at this stage already agreed to write off up to £12m of funding that would originally have been capitalised to its revenue budget as unrecoverable.

7. In response to this it is proposed that for the residential, nursery and adult education funding required:
  - The Council funds the £5.1m additional capital required
  - The PRS units are converted to Shared Ownership, the £5.1m is absorbed within the costs of the development
  - Modelling demonstrates this produces a better NPV than the original PRS (largely due to the capital receipts that come from Shared Ownership)
  - Additional grant is obtained from the GLA (which has been confirmed by the GLA as part of existing funding agreements)
8. For the funding for the Youth Zone
  - ARK have applied to the DFE for the funding necessary to bridge this gap
  - In the absence of this, they have requested that the Council provide s.106 funding to fill the gap in funding – funding has been identified from the Fulham Gas Works s.106 for this purpose, which has already been received
  - However, as the school relies on the play facilities located on top of the youth zone, then it is fair that ARK contributes to its construction – it is recommended that the council's contribution is limited to 50% of any residual gap after DFE funding, up to £1.75m
9. The original contractual structure included a revenue overage on the office building, which restricted rents to 80% of the market – with the intention that the building would be let to education charities.
10. While ARK are still committed to this principle, they are not prepared to be contractually bound to it given that it restricts the value of the building and borrowing that can be secured against it, and the ability to generate revenue to service debt in the future.
11. It was previously proposed to Cabinet that the Council would enter into legal agreements with ARK and/or any other company for the future management of the Estate including but not limited to granting a lease to a management company for the central boulevard and service tunnel.
12. This is no longer necessary and the Council will take on direct management responsibility for this aspect of the development. This will provide a cost-efficient management and maintenance service for both the Councils' residents and the other stakeholders on the development, The Council are experienced in providing this service on the wider White City Estate and would be well placed to carry out this service on the new Education City hub development.

13. The energy centre which is to serve the Education City Hub development is to be located in the basement of the ARK Office building, in order that this can be accessed by a third party or the Council, separate lease arrangements will need to be entered into.
14. The MDA will also require some amendments, (principally to the Schedules and Annexures to that document), in order to record consequential alterations to the construction programme and to the parties' financial contributions; while the Council's contribution to the funding of the Youth Zone will give rise to the need for (i) a new funding agreement between H&F Onside and the Council; and (ii) inclusion in the proposed Agreement for Lease between EdCity Development Limited and H&F Onside of additional powers of intervention for the Council as funder, in the event of ECDL default.

### **Changing tenure from PRS to Shared Ownership**

15. The introduction of shared ownership in substitution of the private market rented homes provides a low-cost home ownership product allowing local keyworker professionals the opportunity to invest in their own home and establish a firm commitment in their community. This change of tenure is dependent on achieving planning consent.
16. Based on research undertaken via the Future of London – Council Led Housing Forum just over 30% of the 32 London Councils leading a development programme have shared ownership homes included as part of their programme.
17. The sale of each shared ownership home will provide the Council with an initial equity capital receipt which collectively will allow the Council the opportunity to use these receipts from the housing element of the scheme to invest and support the additional funds required to for the nursery and the adult education.
18. The GLA are keen to support the 61 shared ownership homes within the Mayors Affordable housing programme and have approved £1.708m funding available as part of the programme.
19. Overall this scheme remains expensive for the Council on a per unit basis, reflecting the complex nature of the site and the mixed use buildings. However, financial modelling shows it is affordable within the HRA, and viability is likely to improve once the real cost of borrowing is factored in.
20. Financial modelling demonstrates that the introduction of Shared Ownership improves the NPV position of the scheme, as shown in the financial comments of this report.
21. The scheme is ready to move to site once contracts are approved, and this project can be a key part of the post Covid-19 economic recovery.

### **Loan to Ark**

22. ARK is seeking to agree the terms of a commercial loan from the Council of up to the value of £35m. The loan would be used to fund the construction of the commercial office block that is a key part of the development. This would be a facility offered on market terms, with interest only payable on the amount withdrawn, over a 10-year duration period and a split in the interest rate – during development and post completion. The terms of the loan are subject to legal and financial advice, and satisfying state aid requirements.
23. Draft heads of terms for the loan are set out in confidential appendix 1, and these are the basis on which officers are negotiating. The heads of terms set out the security that the Council will require from Ark in the form of land during development, and the building itself once completed, subject to maximum value of the loan and LTV rate – so the Council has the protection of the asset itself, and a substantial cushion against any drop in value during construction or occupation.
24. Risk for lettings and responsibility for servicing the debt is passed to Ark, who have a lettings strategy in place (and who will occupy part of the building themselves). The location itself is considered lower risk relative to other West London locations, given the success of the White City Innovation district, and the close public transport and road links.
25. The Council is being supported by Bidwells who will provide the Council with an appropriate valuation as part of the loan process.

### **Options Appraisal**

26. If the Council decides not to proceed with the additional capital funding requested the project will not be able to proceed, and the Council will have to write off up to £2.3m of expenditure that has already been committed to date (approved in previous cabinet reports). If the commercial loan is not approved, the project will be delayed or cancelled, as Ark may not be able to obtain similar funding in the market-place. The opportunity to create a new mixed-use Hub will be lost.
27. It is recommended that the Council proceeds with these decisions. This is a key shovel ready project, that will contribute to economic recovery in the borough, while providing vital affordable homes and educational services, and meeting an administration commitment to deliver a youth facility in White City.

### **Risk Management Implications**

28. A commercial loan facility to ARK, approval to the change in tenure allows the Council the opportunity to invest and support the additional funds required for the nursery and the adult education and to provide vital affordable homes in the borough.
29. A summary of the key risks are identified below. The project has a detailed risk register.

Risk	Mitigation
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The introduction of Shared Ownership as a tenure	During the last six months there has been a major rise in the interest of Shared Ownership. Sensitivity analysis has been undertaken as part of the business case and we will continue to monitor performance.
Approval of Commercial Loan Facility to ARK	The Council will ensure that the security to the value of the investment are set out in the Heads of Terms. This would be in event of default giving the Council the right to step in.
Ed City Developments Limited Failure	The Council has the right to step in and either take over the building contract or appoint another developer should ECDL fail for any reason.
Approval of DfE gap funding of the Youth Zone facilities	The school relies on the play facilities located on top of the youth zone; ARK to also contribution to the construction cost of the youth facilities.
Council responsible to provide Estate Management service including the servicing of an Energy Centre under the office block	The Council will enter into separate lease arrangements to access the Energy Centre. The terms of an agreement will form part of the MDA.
Delays as a result of Covid-19	The programme is continually reviewed with the contractor and project team to reflect the emergency situation. The building contracts and MDA allow for amendments and delay associated with Covid-19.

Risk implications verified by Michael Sloniowski, Risk Manager, tel 020 8753 2587

### **Equality Implications**

30. 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: Fawad Bhatti, Policy & Strategy Officer, tel. 07500 103617*

### **Consultation**

31. There has been substantial consultation on all aspects of the project over a number of years, and this consultation continues.

### **List of Appendices:**

Appendix 1 - Heads of Terms for Commercial Loan - Exempt  
Appendix 2 - Finance Appendix