

APPENDIX 2

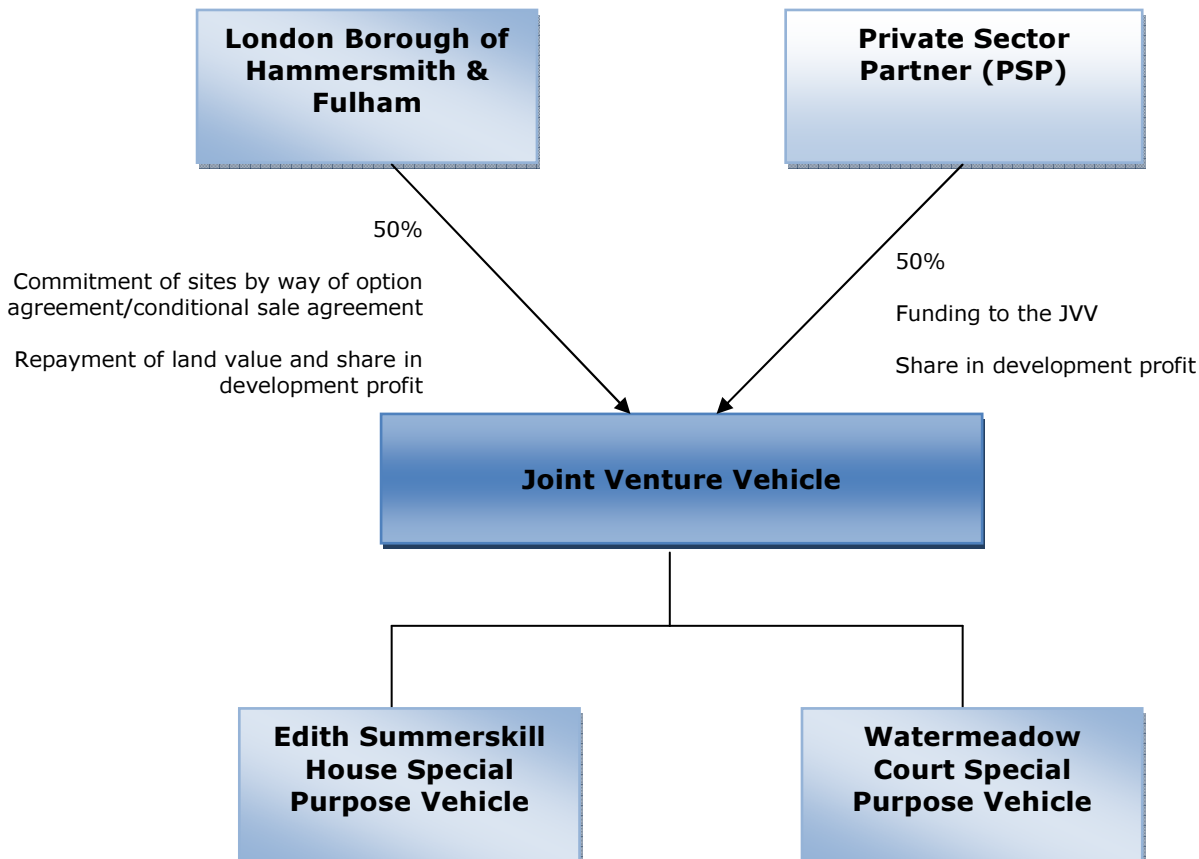
LONDON BOROUGH OF HAMMERSMITH AND FULHAM SELECTION OF A HOUSING AND REGENERATION JOINT VENTURE PARTNER

1. INTRODUCTION AND BACKGROUND

- 1.1 The London Borough of Hammersmith and Fulham (the "**Council**") wishes to establish a joint venture vehicle ("**JVV**") with a private sector partner ("**PSP**") to bring forward certain of its residential regeneration and development priorities within the borough.
- 1.2 The Council will be offering two sites to be developed by the JVJ, Edith Summerskill House and Watermeadow Court. The JVJ will be capable of developing other sites for the Council once established, provided that the parameters around the introduction of those sites is defined through the procurement process and in the legal documentation.
- 1.3 The Council is proposing to launch the procurement process to select a PSP using the negotiated procedure.
- 1.4 Eversheds have been advising the Council in relation to potential structures for the JVJ. This report consolidates advice given to the Council in relation to the JVJ structuring and governance considerations. Appended to this report we also set out high level State aid, best consideration and Council vires considerations. These will need to be kept under review as and when bidders come forward with proposals during the procurement process. Eversheds will provide relevant opinions and further detailed advice in these areas as required.

2. PROPOSED STRUCTURE OF THE JVJ

- 2.1 The proposed structure for the JVJ currently under discussion with the Council is as follows:



- 2.2 The JVV is to be established as a separate legal entity. The Council does not wish to be prescriptive to the market on the form of the joint venture and will consider the form proposed by bidders. In Eversheds' experience the form of the JVV is likely to be either a partnership (i.e. a limited liability partnership, limited partnership) or limited company. The main drivers for the selection of the ultimate structure will be:
- 2.2.1 taxation efficiency;
 - 2.2.2 bidder requirements – e.g. if an institutional investor will only invest via a limited partnership; and
 - 2.2.3 ensuring the Council has identified the power(s) pursuant to which it wishes to participate in the JVV and exercised that power(s) reasonably (see the Appendix to this report in relation to Council vires).
3. The primary difference between the two structures from a taxation perspective is that a company will be subject to corporation tax on its profits and gains, leaving only its net profits available for distribution to shareholders. By contrast, a partnership is a tax transparent vehicle and the profits and gains of the partnership accrue directly to the partners. A partnership structure, therefore, avoids this additional layer of taxation and should be more efficient for the Council. Stamp Duty Land Tax (SDLT) also needs to be considered in detail. A charge to SDLT will typically arise on the transfer of Council-owned assets to the JVV, regardless of whether a company or partnership joint venture structure is used. In the case of a company this SDLT charge will be based on the consideration payable (or on the market value of the land, in certain circumstances). In the case of a partnership this SDLT charge will be based on the other partners' interest following the transfer and the market value of the land at the date of transfer – i.e. it is possible to reduce the SDLT charge where a partnership structure is utilised in respect of the transfer of Council-owned assets into the JVV.
- 3.1 Regardless of the form of the JVV we consider that it is possible to include robust governance and decision making provisions in all such structures.
- 3.2 Whatever form of JVV is chosen the Council and the PSP (for the purposes of this report referred to as "**Partners**") will enter into an agreement (the "**JVV Agreement**") which will set out, amongst other things, the following:
- 3.2.1 the objectives and proposed activities of the JVV;
 - 3.2.2 how the JVV will take forward its activities in order to pursue the objectives;
 - 3.2.3 how decisions within the JVV will be taken, including dispute resolution procedures;
 - 3.2.4 how the activities of the JVV will be financed;
 - 3.2.5 how receipts into the JVV are to be allocated; and
 - 3.2.6 the process for winding up the JVV at the end of its life.
- 3.3 All decisions within the JVV will be made jointly by the Council and the PSP, providing the Council with the control it requires in relation to JVV activity and in

relation to the treatment of the land assets to be developed by the JVV. See paragraphs 4 and 5 for more detail in relation to the governance arrangements.

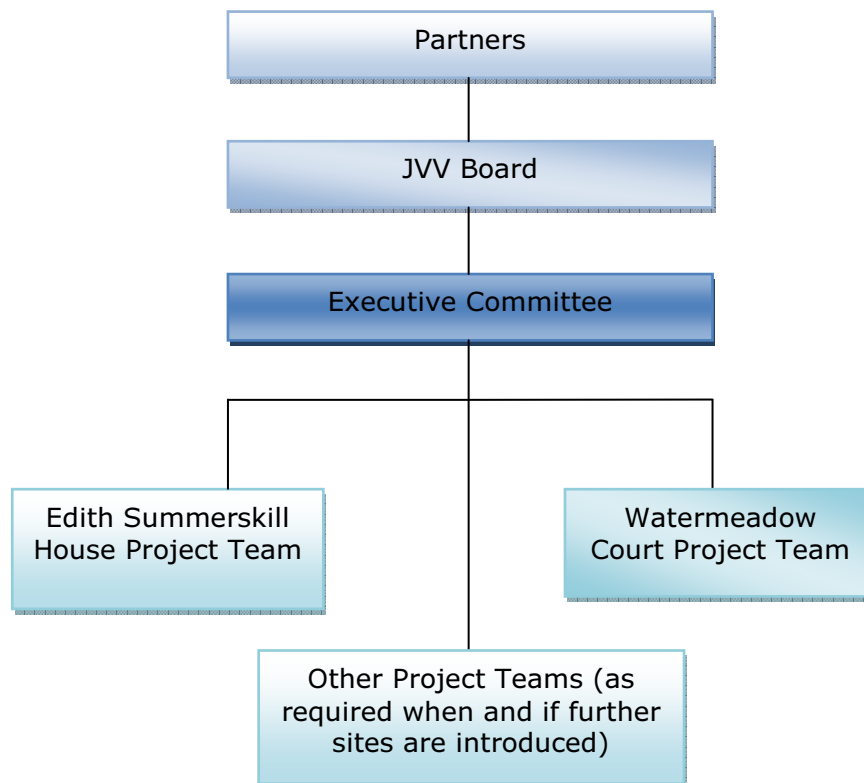
- 3.4 The Council will commit its identified development sites (Edith Summerskill House and Watermeadow Court) to the JVV by way of option agreement or conditional sale agreement. The sites will only transfer once certain conditions have been satisfied by the JVV (e.g. planning permission has been obtained). It will be the JVV's responsibility to satisfy these conditions.
- 3.5 Upon satisfaction of those conditions the Council will transfer either the freehold interest or a long leasehold interest to the JVV. Immediately prior to this the JVV can establish a special purpose vehicle for each development (which it owns wholly). This enables each development to be taken forward in a ringfenced special purpose vehicle (each a "Subsidiary SPV") and for each Subsidiary SPV to raise its own development finance.
- 3.6 The Council may wish to consider putting in place options to acquire its sites back (once transferred) in the event that development does not take place in accordance with identified milestones and long stop dates. Here, the acquisition price could be at a discount to market value to reflect the fact that the reason for non-delivery is due to a failure on the part of the JVV.
- 3.7 The funding structure is to be finalised but our understanding is that the expectation is that the PSP will fund the working capital requirements of the JVV and will be asked to put forward its proposals on funding which will ensure that the Council maximises its land receipt in the JVV by a long stop date envisaged to be in 2017 or 2018. It is likely, therefore, that bidders will be asked to present their proposals based on:
 - 3.7.1 the Council receiving its land receipt from the JVV at the point of transfer; or
 - 3.7.2 the Council deferring its land receipt until the long stop date envisaged to be in 2017 or 2018.
- 3.8 Any proposals will need to demonstrate compliance with State aid and best consideration requirements. See the Appendix to this report in relation to those areas.
- 3.9 Bidders proposals in this regard will also drive how development profits are to be shared. At this point in time, we understand that the Council envisages these to be shared on a 50/50 basis.
- 3.10 During the procurement process bidders will be required to present detailed proposals in relation to the delivery of the two identified developments at Edith Summerskill House and Watermeadow Court. We envisage that, ultimately, those proposals will form the business plan for the JVV, which will also encapsulate the overarching objectives of the Partners (as stipulated by the Council during the procurement process) and the methodology by which the JVV will conduct its business (including in relation to resourcing/dedicated personnel etc). We refer to this as the "JVV Business Plan".

4. GOVERNANCE WITHIN THE JVV

- 4.1 Given that the Council would like to ensure that the JVV structure encapsulates joint decision making and joint working as between the Council and the PSP, we have put forward the proposed governance structure set out in this paragraph 4

on the assumption that the commitment of resources from both the Council and the PSP will be contained within the governance structure of the JVV (and not delivered through separate service level agreements with the JVV). This, however, may be subject to negotiation with bidders during the procurement process if they have alternative arrangements they would like to put forward but which meet with the Council's overarching objectives and aspirations.

- 4.2 Another area for the Council to consider is its commitment to resources. If it requires representation at all levels of the proposed governance structure then it will need to ensure it can dedicate the personnel and their time to that activity. It may be that the Council determines that it only requires equal representation at certain levels and this will come down to where the Council has most concerns over decisions and at what level it wants to build internal skills and capabilities.
- 4.3 With the above comments in mind, the current structure under consideration comprises four tiers of governance within the JVV.



4.4 The Partners (i.e the Council and the PSP)

Decisions to be taken at this level will require the unanimous consent of both the Council and the PSP and will be restricted to key strategic decisions, such as any change to the objectives or business of the JVV and the approval of any material changes to the JVV Business Plan.

4.5 The JVV Board (comprising representatives of the Council and the PSP)

Decisions at this level will require the unanimous consent of both the Council and the PSP representatives and will be restricted to key decisions (as opposed to day to day decisions), such as the approval of development appraisals, planning, annual budgets, any non-material changes to the JVV Business Plan and of any disposal of the assets of the JVV.

At this level the Council and the PSP will be entitled to appoint an equal number of representatives to sit on the JVV Board. The Council will need to consider whether it wishes to appoint a combination of officers and members to the JVV Board and how many JVV Board seats it requires. See paragraph 6 below in relation to Council appointees to the JVV and conflicts of interest.

4.6 The Executive Committee (comprising representatives of the Council and the PSP)

We envisage that the Executive Committee will comprise one representative from each of the Council and the PSP. Decisions at this level will be unanimous and the Executive Committee will be the interface between the project teams and the JVV Board and will report regularly to the JVV Board in relation to activities being carried out as against the JVV Business Plan.

It will have delegated to it certain activities which will be more clearly defined through the procurement process but are likely to include delegated authority to:

- 4.6.1 authorise expenditure in accordance with the JVV Business Plan budgets; and
- 4.6.2 engage consultants/external advisors as required to deliver the JVV activities.

4.7 The Project Teams for each development

Each development being taken forward by the JVV will have a dedicated project team. We envisage that this will include representatives from both the Council and the PSP. It is likely that consultants to the JVV will also sit on these project teams and advise the Council and PSP representatives.

Each team will be an implementation team which will engage, liaise with and monitor services providers/consultants to the JVV and whose remit is to implement the JVV Business Plan for each project.

The project teams will report regularly to the Executive Committee.

5. DECISION MAKING AND DEADLOCK

- 5.1 The JVV Agreement will contain a delegation matrix setting out which of the four decision making bodies (the Project Team, Executive Committee, the JVV Board and the Partners) has the approval rights (i.e. authority) for decisions to be taken by or in respect of the JVV.
- 5.2 Subject to certain exceptions set out at paragraph 5.10 below, we expect that decisions at all four levels will be made by unanimous consent (unless the Council determines otherwise).
- 5.3 At Partner level, each Partner would have one vote and at Board level, the appointed representatives of the Council will have one collective vote and the appointed representatives of PSP will have one collective vote. We anticipate that each of the Council and the PSP will appoint three or four representatives to the Board. The number of representatives on the Executive Committee and Project Teams will be determined in dialogue with the PSP.
- 5.4 We set out below a suggested dispute resolution procedure.

- 5.5 If a resolution at either the JVV Board Level or Partner level is not approved by both the Council and the PSP, the relevant meeting will be adjourned and reconvened at a later date. If the resolution is not passed at this meeting and is considered by either Partner as sufficiently material to the JVV that it cannot carry on the business of the JVV then that matter will become a deadlock matter. Any disagreement at Executive Committee level or project team level will be referred to the JVV Board for determination and will not immediately become a deadlock matter (unless there is lack of agreement at JVV Board level).
- 5.6 The JVV Agreement would contain an escalation procedure for a deadlock matter as follows:
- 5.6.1 first, both parties must use all reasonable endeavours to agree the matter between themselves within a specified period of time;
- 5.6.2 secondly, the matter is escalated to the respective Chief Executives of the Partners (or other senior officer if the Chief Executive is not available).
- 5.7 In the absence of agreement by the Chief Executives, the matter will be referred to a suitable expert (either a joint appointment or appointed by a suitable independent body) for a final and binding determination.
- 5.8 If either Partner believes that the matter is not suitable of being determined by an expert then the matter becomes a deadlock event and either Partner shall be entitled to require the JVV to appoint an independent valuer to value both the assets held by the JVV and each member's interest in the JVV. The Council (or its nominee) will then have the right to acquire the land at the value set out in the report of the valuer. If the Council chooses not to exercise its right to then the JVV shall instruct the valuer to sell the assets of the JVV or the interests in the JVV to a third party (excluding the PSP or any connected body of it). If such third party sale is not agreed within a set period then the JVV shall be wound up.
- 5.9 In order to prevent a party engineering a deadlock matter, the JVV agreement will state that the failure to agree certain matters will not lead to a deadlock with the status quo at that time being maintained. Such matters include:
- 5.9.1 any proposed alteration to the objectives and/or business of the JVV;
- 5.9.2 the variation of JVV Business Plan; and
- 5.9.3 the proposed adoption of an annual budget for the JVV (which in the absence of agreement will be referred to an independent expert for a binding decision).
- 5.10 In addition, each Partner will be deemed to have a conflict with the JVV in certain circumstances. Examples are where there is a decision to be made in respect of an alleged breach by that Partner of the JVV Agreement or another material agreement between the JVV and that Partner. For the Council this is likely to be the agreements relating to the transfer of its land to the JVV and for the PSP this will be the agreements relating to the providing of finance to the JVV. For a decision on such a matter, at both JVV Board level and Partner level, the other member (e.g. the Council in respect of a PSP conflict matter) will be entitled to make the decision without the approval of the other Partner.

6. Council Appointees to the JVV – Conflicts of Interest

Council members and officers need to ensure that they take account of general principles such as the need to ensure that they do not cause the Council to act outside its powers; the need to act reasonably and to take decisions fairly and on the merits; and their fiduciary duty towards Council Tax payers and other funders of the Council. There is also a need to have regard to the client/commissioning requirements, as distinct from the delivery or JVV arrangements and to separate decision making, as applicable.

Code of Conduct

- 6.1 The local members' Code of Conduct applies to members when they conduct the business of their office as a member and also when they represent their local authority on another body. They must comply with the Code except when it conflicts with any other lawful obligations which apply to the other body.
- 6.2 Any member who takes a seat on the JVV Board will need to comply with the requirements of the Code of Conduct and will also need to comply with any legal requirements applicable to the JVV. If there were to be any conflict, the member should not act in breach of the legal requirements of the JVV in order to comply with the Code of Conduct. Depending on what form the JVV takes, the legal requirements will differ. Broadly speaking if the JVV is a limited company the member would be a director of that company and the directors' duties provisions of the Companies Act and common law fiduciary duties would apply. If the JVV is a limited liability partnership or limited partnership then such fiduciary and statutory duties would not apply.
- 6.3 A member with a personal interest through an appointment to an outside body (i.e. the JVV) would need to disclose that interest at any meeting of the Council at which they address the meeting on a matter relating to the body. A member who makes an executive decision in relation to a matter affecting a body on which they are a Council representative would need to ensure that the written statement of that decision records his or her interest.
- 6.4 If a member has an interest in a matter being discussed, unless that member has obtained a dispensation from the Council's standards committee, he or she must withdraw from the meeting; not exercise executive functions in relation to that matter; and not seek improperly to influence a decision about the matter.
- 6.5 Any member appointed to the JVV as a Council representative will need to consider each matter to be discussed and decide whether on each occasion they do have a personal interest. There could be a genuine conflict on important matters of principle and in those circumstances a member of the public may think that the member's close involvement in the body would be likely to prejudice their judgement of the public interest.
- 6.6 We, therefore, suggest that if the Council is proposing to appoint a Councillor to take a position as a JVV representative, then he/she must not only register and declare such interest but also withdraw from the executive meeting and take no part in the executive decision on such matter.

Officers

The controls on the conduct of Council officers will result from their contracts of employment and in some cases specific statutory obligations. There is a statutory requirement under section 117 of the Local Government Act 1972 for officers to disclose the fact that they have a personal pecuniary interest (whether direct or indirect) in a contract which the Council has entered into or

proposes to enter into. If that is the case then such officers should not be involved in making decisions about the JVV nor in supporting the Council's representatives on the JV.

APPENDIX

1. STATE AID

1.1 Land Transfer

1.1.1 Any transfer of land by the Council to the JVV must be transacted in accordance with the Commission Communication on State aid elements in the sale of land and building by public authorities (OJ C209 10.7.1999, p3-5) ("the Sale of Land Guidelines") in order to avoid the transaction being deemed not to include the grant of State aid to the acquiring entity (which would need to be approved in advance of its grant by the EC).

1.1.2 The Sale of Land Guidelines state that in order for State aid not to be present in respect of the sale of land by a public body the land must be transferred/sold at or above its open market value as established pursuant to either an unconditional bidding process akin to an auction (in which the highest or only price bid must win) or by way of an independent valuation. If the latter route is chosen, there must have been at least one independent valuation of the land undertaken (in advance) in compliance with the requirements of section 2 of the Sale of Land Guidelines and we would recommend a copy of the Sale of Land Guidelines be given as part of the instructions to any appointed valuer(s)

1.2 Council Investment

1.2.1 The basic parameter for the Council to consider is that it cannot use its investment (i.e. land) to provide a direct or indirect selective benefit to an economic operator – i.e. the JVV or the PSP.

1.2.2 In relation to joint ventures similar to that proposed, the argument which is usually run to address State aid is that the authority is investing into the structure on terms that are strictly in accordance with the Market Economy Investor Principle – i.e. that it is investing on terms that would be acceptable to a prudent private sector investor in the same circumstances (motivated by profit and looking purely at the economic situation of the transaction rather than any socio economic factors). Therefore, if the Council injects its land (the value of which will need to have been established in accordance with the Sale of Land Guidelines) which is matched (at the same point in time) with cash invested into the JVV by the PSP and both investments operate on a strict *pari passu* basis, then the Council would have robust arguments that the Market Economy Investor Principle applies.

1.2.3 Care would need to be taken if the PSP were able to obtain returns relating to the various projects outside of its investment in the JVV, as the EC may regard such extra returns as impacting on the validity of arguments that the basis of their investment into the JVV is in line with what a prudent private sector investor in the same circumstances (as those applicable to the Council who only gets returns from its investment in the JVV).

1.2.4 Where the Council seeks to contribute its land in return for a back ended payment, rather than as some form of equity investment in the JVV – i.e. deferred consideration – then, typically, that deferred

consideration should be treated as being akin to a loan from the Council and must carry a coupon rate at or above what the EC would regard as the market rate for such a loan. The EC has set out, within its Communication on the revision of the method of setting the reference and discount rate (OJ C 14, 19.1.2008, p.6), a methodology (taking into account the credit worthiness of the entity paying the deferred consideration) for calculating the "proxy" market rate for a public sector loan. Loans at such rates will be deemed not to involve elements of State aid (subject to all other terms being fully commercial in nature).

2. VIRES AND BEST CONSIDERATION

2.1 The Council needs to ensure that it has identified the right power pursuant to which it will enter into this transaction and that it has exercised that power correctly, having regard to all relevant consideration, at the date upon which the transaction is entered into.

2.2 Here the Council is:

2.2.1 entering into a JVV with the PSP; and

2.2.2 disposing of its land to the JVV.

2.3 Entering into the JVV

2.3.1 For structures akin to the proposed joint venture, the powers available to local authorities for the formation of companies or other vehicles, such as Limited Partnerships (LPs) or Limited Liability Partnerships (LLPs) are:

2.3.1.1 the power of general competence contained in section 1 the Localism Act 2012; and/or

2.3.1.2 the power to do "anything which is calculated to facilitate or conducive or incidental" to the exercise of functions under Section 111 of the Local Government Act 1972.

2.3.2 Some lawyers take the view that local authorities do not have the power to enter into such partnerships due to the absence of an explicit power. This is not Eversheds view (and our view has been backed by Leading Counsel). This is further bolstered by the fact that recent legislation has recognised the ability of local authorities to participate in such vehicles (e.g. audit of connected entities under the Local Democracy Economic Development and Construction Act 2009). We, therefore, are of the view that the Council has the power to enter into the JVV by relying on the power of general competence and/or section 111 of the Local Government Act 1972.

2.3.3 Additionally, or in the alternative, the Council may consider that the primary purpose for the creation of an investment partnership is investment for housing purposes pursuant to its investment functions under s.12 Local Government Act 2003. This power enables an authority to invest for any purpose relevant to its functions and/or for the prudent management of its financial affairs.

- 2.3.4 In addition to identifying relevant powers the Council must also exercise them properly - the so-called "twin pillars" of the ultra vires doctrine. The failure to take into account relevant considerations, failing to follow proper procedures, or acting irrationally could result in the Council being challenged by way of judicial review. In making decisions therefore, the Council must identify the power; ensure that it is appropriate for the circumstances; and then ensure that the power is exercised properly.
- 2.3.5 Any reliance on the power of general competence will require an evaluation of the benefits likely to be achieved as well as regard to the Council's sustainable community strategy and a proper audit trail of how the well being benefits have been calculated. We, therefore, recommend that the Council's Cabinet report clearly identifies the economic, social and environmental benefits likely to accrue to its community by entering into the JVV - mentioning regeneration benefits including jobs, housing and other outcomes (e.g. training contracts, apprenticeships and/or other community benefits such as infrastructure provision).
- 2.3.6 If a court decides that the Council's actions are ultra vires then the arrangements are void from the start.

2.4 Disposal of Land – Best Consideration

- 2.4.1 There are numerous powers for holding and disposing of land available to the Council.
- 2.4.2 Powers enabling local authorities to dispose of land require the Council to secure "the best consideration that can reasonably be obtained". Relevant powers include:
 - 2.4.2.1 s.123 Local Government Act 1972, unless the land is disposed of on a short tenancy of less than seven years or the Secretary of State's consent is obtained; and
 - 2.4.2.2 s.233 Town & Country Planning Act 1990, in order to secure the best use of that or other land and other buildings or works which have been or are to be erected, constructed or carried out or to secure works for the proper planning of the area.
- 2.4.3 Best consideration is usually taken to mean the best price for any purpose, without any artificial value reducing limitations but case law has established that the value must be assessed in money or money's worth. The valuation criteria could reflect other matters that have a financial value, but social considerations and job creation benefits are not to be taken into consideration when determining whether the Council receives best consideration.
- 2.4.4 The valuation needs to be on the basis of open market value as between a willing purchaser and willing vendor.
- 2.4.5 Where land is not disposed of by way of open tender (as is the case here) then we would expect the valuation to comply with the Sale of Land Guidelines for State Aid in relation to open market valuation in order for the best consideration requirement to be satisfied.

- 2.4.6 Where an authority wishes to dispose of land at an undervalue then the Secretary of State's consent will be required, unless it falls within a relevant general consent - i.e. the wellbeing consent in circular 06/03. We understand that there is no proposal to transfer the land at an undervalue in the current transaction.