CABINET
3 APRIL 2018

ITEM NO. ....7..............

DELIVERY OF NEW HOMES AT STAG HOUSE FARM
JOINT VENTURE PROPOSAL AND LAND DISPOSAL

Responsible Cabinet Member -
Councillor Stephen Harker, Efficiency and Resources Portfolio
Councillor Chris McEwan, Economy and Regeneration Portfolio

Responsible Director -
Paul Wildsmith, Director of Neighbourhood Services and Resources
Ian Williams, Director of Economic Growth

SUMMARY REPORT

Purpose of the Report

1. To seek approval to dispose of the Council's land at Stag House Farm for residential development, part to a Joint Venture Company and part to a national housebuilder.

2. To approve the establishment of a Joint Venture Company which will provide the infrastructure to open up the site and then build and sell homes on parts of the site.

3. To approve the sale of the remaining parts of the site to a national housebuilder.

Summary

4. The Council issued an OJEU procurement exercise in summer 2017 to seek a joint venture partner for residential development. Esh Homes Limited were appointed following that exercise.

5. The report recommends the establishment of a new Joint Venture Company between the Council and Esh Homes Limited to bring forward residential development on the Stag House Farm site as shown on the Location Plan attached at **Appendix 1a.**

6. It is proposed that the Joint Venture Company will purchase part of the site and procure infrastructure, including roads, sewers, drainage and services to open up the site and prepare it for development.

7. The site will be split into phases as shown on the attached Phasing plan attached at **Appendix 1b**.

8. Phases 1, 2 & 4 are to be built out by the Joint Venture Company and Phases 3 & 5 will be retained by the Council and sold to a national housebuilder. Subject to planning permission under reserved matters it is expected that upwards of 440 houses will be delivered over the 5 phases.

9. The Joint Venture Company will be based on a 50:50 split between the Council and Esh Homes Limited and the Company will return developer profits to the Council.

10. The Joint Venture Company will be fully funded by the Council and this will be via prudential borrowing of up to £12m. The loan will be repaid via the Joint Venture Company and the interest payable will deliver a net surplus to the Council over the life of the build project. The estimated pre-tax profit share for the Council is £2.1m. The loan interest will produce a further surplus of £0.5m.

11. The risks involved in the Joint Venture have been identified and mitigated via the agreement.

12. The land at Stag House Farm has been declared surplus to requirements by Cabinet.

13. Negotiations with the Joint Venture partner and the national housebuilder are ongoing and the principal heads of terms reported in the Appendices (Part III) may be subject to further discussion and variation.

14. The estimated capital receipt for the disposal of the site is circa £5.6m.

15. Further documentation referred to by appendices to this report are as follows:

    (a) Appendix 1a – Location Plan
    (b) Appendix 1b – Phasing Plan
    (c) Appendix 2 (Part III) – Heads of Terms Joint Venture Land disposal and Development Appraisal
    (d) Appendix 3 (Part III) – Heads of Terms Housebuilder Land Disposal
    (e) Appendix 4a (Part III) – Joint Venture Sale Terms Development Appraisal
    (f) Appendix 4b (Part III) – Joint Venture Appraisal
    (g) Appendix 5 (Part III) – Matters reserved for Shareholder approval

Recommendation

16. It is recommended that :-

    (a) Cabinet approve the establishment of the Joint Venture Company to deliver, build and sell new homes at Stag House Farm.

    (b) Cabinet agree to the disposal of land at Stag House Farm, part to a Joint Venture Company and part to a national housebuilder.

    (c) Cabinet approve £12m from the Investment Fund to fund the Joint Venture Company financed by prudential borrowing subject to a Legal Charge in favour of the Council over the Land acquired by the Joint Venture Company together with a Guarantee from the Joint Venture Partner in respect of 50% of the Loan sum.

(d) Conditional upon completion of the Joint Venture Agreement, that the sale of the land to the Joint Venture Company be approved and delegated authority to the Director of Neighbourhood Services and Resources be granted to finalise the negotiations for the establishment of the Joint Venture Company and the disposal of the land to the Joint Venture Company in line with the terms and supporting Development Appraisal annexed at **Appendix 2.**

(e) Conditional upon completion of the Joint Venture Agreement, that the sale of the land to the national housebuilder by private treaty be approved and delegated authority to the Director of Economic Growth be granted to finalise the negotiations in line with the terms annexed at **Appendix 3**.

(f) The Assistant Director Law and Governance be authorised to execute the sale of the property the entering into the joint venture and associated documents accordingly.

(g) Conditional upon completion of the Joint Venture agreement that a secured loan facility be entered into with the Joint Venture Company as a secured loan simultaneous with the land transaction.

(h) The Director of Neighbourhood Services and Resources, the Assistant Director Housing and Building Services and the Assistant Director Law and Governance are appointed to act as directors in the Joint Venture Company as part of its Executive Board.

(i) The Joint Venture to be funded from prudential borrowing from the Capital Investment Fund established by the report to Council dated July 2017.

(j) The Council will not dispose of any parts of Stag House Farm, until the new owners have entered into a Deed of Covenant ensuring that the Section 106 obligations are adhered to.

Reasons

17. The recommendations are supported by the following reasons :-

(a) To deliver a Capital Receipt and income for the Council.

(b) To assist in the delivery of the Economic Strategy by speeding up the building of new homes.

Paul Wildsmith
Director of Neighbourhood Services & Resources

Ian Williams
Director of Economic Growth

Background Papers

Appendices as listed in paragraph 15.

Guy Metcalfe : extension 6725
Jenny Dixon : extension 6320
Sarah Hutchinson : 5489

S17 Crime and Disorder	This report has no implications for crime and disorder
Health and Well Being	There are no Health and Well Being Issues
Carbon Impact	There are no sustainability issues
Diversity	There are no diversity issues
Wards Affected	Brinkburn and Faverdale
Groups Affected	Not Applicable
Budget and Policy Framework	This report does not represent a change to the budget and policy framework
Key Decision	This is not a key decision
Urgent Decision	This is not an urgent decision
One Darlington: Perfectly Placed	There are no issues adversely affecting the Community Strategy
Efficiency	An investment return will help the Council's budget
Impact on Looked After Children and Care Leavers	This report has no impact on Looked After Children or Care Leavers

MAIN REPORT

Information and Analysis

18. The Council has already established a Joint Venture Company to build and sell homes at Eastbourne with Esh Homes Ltd. The venture is progressing well and is on target to exceed profit expectations and is delivering ongoing net income from the loan repayment.

19. Stag House Farm is a Council owned site which in conjunction with Bussey and Armstrong's land at Mount Pleasant Farm enjoys an Outline Planning permission for 1200 new homes. This is a large site that requires significant upfront investment and co-ordination. A considerable amount of work has been undertaken to get the site ready to develop.

20. There is a Section 106 Agreement and Collaboration Agreement being finalised between the Council and Bussey and Armstrong to support the sharing of costs in relation to neighbouring development land and the land the subject of this report. The Council will ensure that upon any disposal of the land that purchaser(s) would enter into a Deed of Covenant, to ensure compliance of the terms.

Land Disposals

21. The Cabinet Report dated 16 June 2015 recommended that the Borough Solicitor is authorised to complete the section106 Agreement and Collaboration Agreement and for Stag House to be marketed.

22. The Joint Venture Company is proposing to purchase part of the site and procure enabling infrastructure to open up the site and then develop Phases 1, 2 and 4 as shown on the plan at **Appendix 1b.** The heads of terms of the proposed disposal

to the Joint venture Company are set out at **Appendix 2** to be reported in Part III of this report

23. Phases 3 and 5 shown at **Appendix 1b** will be retained by the Council and sold directly to the national housebuilder under the terms of the disposal set out at **Appendix 3** to be reported in Part III of this report.

24. Due diligence is currently ongoing and the principal heads of terms reported in the Appendices may be subject to variation.

25. It is proposed that the Joint Venture Company will put in the strategic infrastructure and the Sustainable Drainage Systems (SUDS) for Stag House Farm. This means that the national housebuilder will be purchasing a fully serviced site and the price being paid for the land will reflect the fact that infrastructure, SUDS and services are in place.

26. The land shown at **Appendices 1a and 1b** was declared surplus by Cabinet and it is proposed that Cabinet agree the disposals by private treaty on terms to be finalised and subject to a satisfactory independent valuation.

The Joint Venture Proposal

27. The proposal is to develop the site under the Joint Venture arrangement; the benefits of this over a straight forward land sale to a single or multiple developments are :-

    (a) Speed of delivery of the capital receipt

    (b) A share for the Council in developers profits

    (c) The Council retains more control over the overall site.

    (d) All infrastructure works are undertaken by the Joint Venture Company therefore ensuring quality and delivery on time.

    (e) The arrangement gives greater flexibility.

    (f) The land value is negotiated to deliver value for money for the Council.

    (g) The proposal will deliver a considerable investment surplus for the Council.

28. The principles of the Joint Venture are as follows:

29. The Council enter into disposals of the land (see **Appendices 1a to 1b**) to produce an estimated gross capital receipt in the region of £5.6m which is dependent on a number of variables including Stamp Duty Land Tax set out in the Development Appraisal.

30. The Council enter into a loan facility agreement of up to £12m simultaneously with security over the land and formal completion of the Joint Venture documents and a deed of guarantee from the Joint Venture Partner. The projected interest payable

to the Council under the Loan Agreement is projected to be £1.02m (Appendix 4b).

31. The Joint Venture Company contracts with building contractors in respect of the substantive works. All contracts with a value over £25,000 require the approval of the Council and it is a requirement that any contracted works are competitively tendered in compliance with the Councils own requirements.

32. Total cost of the Joint Venture development works is anticipated to be £34m with an estimated resale value based on appraisal prices of just in excess of £41m. The cost of works is based on anticipated tender prices which will be obtained using the Councils tendering standards and subject to validation by an independent Quantity Surveyor.

33. After the finance costs (payable to the Council c £1.02m and the Joint Venture Company costs of sale and professional costs the profit to each partner is estimated at £2.1m.

34. Rate of return for the Council of circa 40% over the seven - eight year scheme which is the expected build out period.

35. The Joint Venture agreement has the following heads of terms :-

(a) The company will deliver the works and services as set out in the Appraisals (**Appendices 4a and 4b).**

(b) The costs and profits are split 50:50.

(c) The Council will fund the project and investment and capital will be repaid to the Council over the life of the project.

(d) The number of homes built at any one time is limited to reduce risks associated with sales.

(e) The maximum funding requested is £12m.

(f) Each joint venture partner will nominate three directors to the Executive Board.

(g) Decisions made by the Executive Board by simple majority will be binding on all partners save as to the shareholder reserved matters which must be agreed by both shareholders in writing.

(h) A process to resolve disputes is included.

(i) The Joint Venture will incur costs and execute sales in accordance with the appraisal. Sales may not be made at less than 95% of the appraisal value without the consent in writing of both shareholders.

(j) Profits will be shared equally (50:50) between the Joint Venture members.

(k) The Agreement can be terminated under defined circumstances.

(l) The Building contracts can be delayed or terminated under defined circumstances.

36. The principal elements of the Loan Agreement are:

(a) A cash advance by the Council to the Joint Venture Company in the sum of up to £12m to fund the Joint Venture development.

(b) Interest on the loan to be calculated at the State Aid compliant rate, currently 4.84% and variable over the term.

(c) Security on the land to the extent of the advanced sum.

(d) Legal Charge over the land to secure the lending.

(e) The whole of the advance will be repayable as a debt if any instalment is not paid or in the event of any insolvency action.

37. The principal elements of the Building contracts are:

(a) Contract between Joint Venture Company and building Contractor.

(b) Based on formal tenders for the works.

(c) Variations over £15,000 require consent in writing of the Council and Esh Homes Limited.

(d) Works can be delayed at the instance of the Joint Venture Company with agreed delay costs of £5,000 per week.

(e) Terminable by the Joint Venture Company on notice with agreed termination payment for demobilisation costs of £25,000.

38. The proposal is set out in the Appendices see in particular the appraisal at **Appendices 4b.**

Risk Analysis and Valuation Comment

39. There are two main areas of risk on the expected return; *the cost of the build* (which if it increases will diminish profit) and the *achievement of the sales value*. Safeguards are in place on both elements as below:

Cost of the build

40. The expected total cost of the build contract is £34m. The Councils contribution to the build cost is restricted at any time to the amount of the loan advance.

41. Over the course of a building project the building contracts allow for required variation instructions to be given in the form of Architects Instructions (AIs). Increases to the Building contract costs affect the profitability of the Council investment. Accordingly the AIs are managed in two ways;

(a) Mechanism in the Building contracts that no AI or variation with a value in excess of £15,000 can be made without the approval in writing of the contract administrator

(b) Mechanism on the Joint Venture Agreement that no variation with a value in excess of £15,000 can be made by the Joint Venture Company save with the consent in writing of both the Council and Esh Homes Limited. This is recorded in the Joint Venture and in the Articles of Association of the Joint Venture Company as a shareholders reserved matter. A full list of the shareholders reserved matters is appended at **Appendix 5.**

(c) Mechanism in the Joint Venture that the building contracts cannot be varied with cumulative variations with a total value in excess of £50,000 save with the consent in writing of both the Council and Esh Homes Limited. This will be recorded in the Joint Venture and in the Articles of Association of the Joint Venture Company as a shareholders reserved matter.

(d) A further mechanism in the building contracts provides that the works are released on a staged basis of five units at a time. These phased releases are to be approved by monthly governance meetings and the requirement for this is recorded in the Joint Venture. The approval for further releases shall not be given where the sales programme is behind targets to the extent that the Joint Venture Company does not have sufficient funds to meet the liability of the additional release.

(e) The Joint Venture Agreement governs the situation where consent is sought to sell properties for less than 5% below the appraisal value, or where the sales programme is behind the projections in the cash flows requiring a further advance on the loan agreement to maintain liquidity of the Joint Venture Company. In such a case (on a case by case basis) the parties will not continue with the building contracts unless there is agreement in writing by both parties to do so. The parties may alternatively agree to delay the progress of the building contracts until the sales programme less than five units.

(f) The building contracts contains express provision that delay payments of £5,000 per week are incurred for delay at the request of the Joint Venture Company. The contract further makes provision to be terminated subject to a liability to the contractor of £25,000 being the contractually agreed termination costs for the building agreement which would be the contractual liability of the Joint Venture Company to the Contractor in the event that further releases of the programme are not agreed under the mechanism outlined in para 28(e).

(g) In such an event the Joint Venture agreement would be subject to the dispute resolution procedure and terminable.

Financial Implications

42. The Joint Venture Company will be registered for VAT and the house sales will be zero rated any input tax on purchases paid by the Joint Venture will be able to be claimed back from HMRC this is because new house sales are Zero rated rather than Exempt or Outside scope, the cash flow is net of VAT.

43. The sum of £12m allocated for the Joint Venture to be funded from the Capital Investment fund via prudential borrowing. The loan will generate a surplus of £0.5m for the Council.

44. After the finance costs (payable to the Council circa £1.02m) and the Joint Venture Company costs of sale and professional costs, the pre-tax profit to each partner is estimated at £2.1m.

Mitigation of Risk

45. The Council's contributions are made to the Joint Venture Company by shareholder lending supported by shareholder guarantee. The advance from the Council will be on the basis of the required state aid compliant interest rate required by the relevant EU legal communication notice. This is currently calculated at 4.84% per annum. The scheme length and scheduled repayment dates are set out in the Cashflows.

46. The Council's lending is proposed to be secured by a legal charge on the land and build and a restriction on title as well as the guarantee for 50% of the lending from the Joint Venture partner.

47. In addition to the safeguard above the funds at the bank will be protected as follows:

    (a) Both of the Joint Venture members directors will be named on the company bank mandate have immediate direct access to account information.

    (b) Each of the Joint Venture members i.e. Esh Homes Limited and the Council will cross guarantee to the other over the conduct of the bank account by their employee directors in the Joint Venture Agreement.

48. The Joint Venture Agreement governs the situation where consent is sought to sell properties for less than 5% below the appraisal value, or where the sales programme is more than five units behind the projections in the cash flows.

49. In such a case (on a case by case basis) the parties will not continue with the Building contracts unless there is agreement in writing by both parties to do so. The parties may alternatively agree to delay the progress of the Building contracts. A further mechanism in the building contracts provides that the works are released on a staged basis of five units at a time. These phased releases are to be approved by monthly governance meetings and the requirement for this is recorded

in the JV. The approval for further releases shall not be given where the sales programme is more than five units behind the target shown in the cash flows.

50. The Building Contracts contain express provision that delay payments of £5,000 per week are incurred for delay at the request of the Joint Venture Company. The contract further makes provision to be terminated subject to a liability to the contractor of £25,000 being the contractually agreed termination costs for the Building contracts which would be the contractual liability of the Joint Venture Company to the Contractor in the event that further releases of the programme are not agreed under the mechanism outlined in para 26(e).

51. In such an event the Joint Venture Agreement would be subject to the dispute resolution procedure and terminable with the interests and liabilities of each member calculated at that point.

Outcome of Consultations

52. Internal consultations with Housing, Estates, Finance, Legal and Corporate Procurement have not raised any objections to the proposal.

Legal Advice

53. The Localism Act 2011 includes a ‘general power of competence’ which gives local authorities the legal capacity to do anything that an individual can do that is not specifically prohibited.

54. The Joint Venture is to be delivered with the Joint Venture partner appointed following an OJEU tender process conducted in Summer 2017.

55. Under the provisions of the Local Government Act 1999 the Council is subject to a general duty to obtain ‘best value’ in the exercise of its functions. Cabinet should consider in making the recommendations of this report that the deal represents value for money which is supported by obtaining independent valuation comment on the terms of the land disposal the Council’s professional appraisal of the sales values and by requiring that the engagement of the building contract be conducted in accordance with tendering processes on an arm’s length basis in accordance with the Council’s own tendering thresholds.

56. Specific legal advice has been obtained on the envisaged agreements and the Assistant Director, Law and Governance, will be required to document the Joint Venture on the basis set out in this report, specifically in the Joint Venture Agreement, the Loan Agreement, the Legal Charge, the Deed of Guarantee and register the necessary restrictions at the Land Registry to protect the Council’s interest in the scheme and mitigate any investment risk.

Risks and Risk Mitigation

57. The Joint Venture will operate on a risk reward basis, and each parties risk share will be limited to half of the required lending to fund the scheme.

58. The risk of non-payment of lending will be secured firstly against the land and assets of the Joint Venture Company, as well as by a guarantee from the Joint Venture Partner for their share of the project.

59. Additionally the building contracts will be let on flexible terms to ensure that they can be terminated early if needed and offering the Joint Venture Partners the opportunity to slow or phase development as needed to reflect changes in the market.