

**DELIVERY OF NEW HOMES AT MIDDLETON ST GEORGE
JOINT VENTURE PROPOSAL**

**Responsible Cabinet Member -
Councillor Stephen Harker, Leader and Efficiency and Resources Portfolio**

**Responsible Director -
Paul Wildsmith, Managing Director**

SUMMARY REPORT

Purpose of the Report

1. To approve the establishment of a Joint Venture Company which will provide the infrastructure build and sale of homes in Middleton St George, under the company name Middleton St George JV Limited.
2. To seek approval to acquire of the land at Middleton St George for residential development, through the Council's Joint Venture arrangements

Summary

3. The Council issued an OJEU procurement exercise in July 2017 to seek a joint venture partner for residential development and Esh Homes Limited were appointed following that exercise.
4. The report recommends the establishment of a new Joint Venture Company between the Council and Esh Homes Limited to acquire the site and bring forward residential development on the Middleton St George site as shown on the Location Plan attached at **Appendix 1**. The purchase price for the site has been negotiated at arms' length at £1,350,000.
5. Subject to approval and on the terms of this report the Joint Venture Company will purchase the site and procure infrastructure, including roads, sewers, drainage and services and associated s.278 works to open up the site and to deliver private and affordable housing.
6. The site has the benefit of detailed planning permission dated 14 December 2018 (18/00971/CON) for the delivery of 55 houses, in accordance with the planning application. Five of the houses will be affordable to be disposed of to an RSL - North Star Housing, on the terms further set out in the appendices to this report. The site will not be purchased until after the appeal period to the planning permission has duly expired.

7. 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 equally to the Council and Esh Homes Limited.
8. The Joint Venture Company will be funded by the Council and this will be via prudential borrowing of up to £4.7m. The initial payment from the Council will be £1.447m which includes the purchase price stamp duty and fees) with further drawdowns subject to satisfactory progress on site and security.
9. The loan will be repaid by the Joint Venture Company to the Council and is expected to generate a net income after taking into account any cost of borrowing undertaken by the authority.
10. The estimated pre-tax profit share for the Council is projected to be £0.594m in addition to interest on the commercial loan repaid over 30 months in the sum of £0.321m charged at state aid compliant rate.
11. The risks involved in the Joint Venture have been identified and mitigated via the agreement. Due diligence on title and site condition have been carried out to establish there are no title matters adversely affecting development and the site investigation reports (SIs) do not indicate known issues with the land. The Joint Venture is set up to deal with changes in the sale market with the ability to slow or stop development on agreed costs should there be changes in the market and the council lending is supported by a legal charge over the land and works.
12. Further documentation referred to by appendices to this report are as follows:
 - (a) Appendix 1 (Part III) – Location Plan, Site Layout and Site Plan
 - (b) Appendix 2 (Part III) – Joint Venture Development Appraisal
 - (c) Appendix 3 (Part III) – Land agent appraisal of disposal prices
 - (d) Appendix 4 (Part III) – Land SIs report.
 - (e) Appendix 5 (Part III) – Shareholders Reserved Matters

Recommendation

13. It is recommended that :-
 - (a) Cabinet approve the establishment of the Joint Venture Company to acquire land, deliver, build and sell up to 55 new private sale and affordable homes at Middleton St George.
 - (b) Cabinet approve £4.7m from the Investment Fund to fund the Joint Venture Company financed by prudential borrowing subject to a first 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.
 - (c) That the Joint Venture Agreement be approved and delegated authority to the Managing Director be granted to finalise the establishment of the Joint Venture Company in line with the terms in this report and supporting Development Appraisal and Cashflows annexed at **Appendix 2 (Part III)**.

- (d) The Assistant Director – Resources (CFO), 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.
- (e) The Joint Venture to be funded from prudential borrowing from the Capital Investment Fund established by the report to Council dated July 2017.

Reasons

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

- (a) To assist in the delivery of the Economic Strategy by speeding up the building of new homes.
- (b) To assist in the delivery of the Housing Strategy by enabling the building of fifty houses for private sale and five affordable housing properties.
- (c) To deliver income for the Council.

Paul Wildsmith
Managing Director

Background Papers

None

Paul Wildsmith:
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	Middleton St George
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

15. 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 initial profit expectations and is delivering ongoing net income from the loan repayment.
16. The site at Middleton St George is owned by a third party and the JV partner has negotiated terms to acquire the site on an arm's length basis and progressed and obtained detailed planning permission for the development of 55 homes, including five affordable housing units with agreement in principle for these to be acquired by North Star Housing a Registered Social Landlord.

The Joint Venture Proposal

17. The principles of the Joint Venture are that the Council and its procured delivery partner enter into a Joint Venture Agreement on the basis of a 50%:50% risk reward share.
18. The Council will enter into a loan facility agreement of up to £4.7m 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 interest payable to the Council under the Loan Agreement is projected to be £0.321m (**Appendix 2-Part III**)
19. The Joint Venture Company contracts with building contractors in respect of the substantive works in accordance with the Joint Venture Development Appraisal. 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 Council's own requirements.
20. Total cost of the Joint Venture development works, land acquisition and fees is anticipated to be £9.546m with an estimated resale value based on appraisal prices of £10.733m. The cost of works is based on anticipated tender prices which will be obtained using the Council's tendering standards and subject to validation by an independent Quantity Surveyor.
21. After the finance costs (payable to the Council £0.321m) and the Joint Venture Company costs of sale and professional costs (as procured) the pre-tax profit to each partner is projected at £0.594m.
22. 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 2 Part III**).
 - (b) The costs and profits are split 50:50.
 - (c) The Council will fund the project with capital will be repaid to the Council over the life of the project. Interest will be paid throughout.

- (d) The number of homes built at any one time is limited to reduce risks associated with sales.
- (e) The maximum funding requested is £4.7m. The drawdown of funding will be as required by the Development Cashflows (**Appendix 2 – Part III**) and subject to satisfactory progress of works on site.
- (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) The Agreement can be terminated under defined circumstances.
- (k) The Building contracts can be delayed or terminated under defined circumstances.

23. The principal elements of the Loan Agreement are:

- (a) A loan facility from the Council to the Joint Venture Company in the sum of up to £4.7m to fund the Joint Venture development. The initial investment from the Council will be £1.447m with further drawdowns subject to satisfactory progress on site.
- (b) Interest on the loan to be calculated at no less than 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 to be released as required for sales of housing units subject to satisfactory repayment of the loan in accordance with the Development Cashflows (**Appendix 2 – Part III**)
- (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. The Council in such a case will rely on its first legal charge over the land and development.

24. The principal elements of the Building contracts will be:

- (a) Contract between Joint Venture Company and building Contractor.
- (b) Based on formal tenders for the works in accordance with Public Contracts Regulations 2016.
- (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.
25. The proposal is set out in the Appendices see in particular the appraisal and cashflows at **Appendix 2 (Part III)**.

Risk Analysis and Valuation Comment

26. 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

27. The expected total cost of the development, including infrastructure, preliminary works, fees, contingency and a section 106 contribution of £0.364m is £6.768m. The Council's financial commitment is limited to the amount of the loan advance.
28. Over the course of a building project the building contracts allow for required variation instructions to be given. As increases to the Building contract costs affect the profitability of the Council investment and financial risk these are managed in the joint venture agreement as follows;
- (a) Mechanism in the Building contracts that no variation with a value in excess of £15,000 can be made without the approval in writing of the contract administrator
 - (b) Mechanism in 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.
- (f) The building contracts will contain express provision that delay payments of £5,000 per week are incurred for delay at the request of the Joint Venture Company. The building contracts must 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 29(e).
- (g) In such an event the Joint Venture agreement would be subject to the dispute resolution procedure and terminable. In the event the terms of the loan agreement require the full amount of lending to be repaid immediately and the council would in such a case rely on its first legal charge as required together with the guarantee from the Joint Venture partner.

Achievement of Sales Value

- 29. The expected sale values have been subject to a formal valuation exercise and the sales report is contained at **Appendix 3 – Part III**.
- 30. The sales values are further controlled through the risk mitigation processes below to ensure no disposal can be effected at less than 95% of the amount stated in the Development Appraisal (see paras 38 and 39 below).

Financial Implications

- 31. 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.
- 32. The sum of £4.7m allocated for the Joint Venture to be funded from the Capital Investment fund via prudential borrowing to be fully repaid by the Joint Venture Company.
- 33. After the finance costs and the Joint Venture Company costs of sale and professional costs, the pre-tax profit to each partner is estimated at £0.594m. The interest payable on the Council lending is projected at £0.321m.

Mitigation of Risk

- 34. 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.

35. Due diligence on title and site condition have been carried out to establish there are no title matters adversely affecting development and the site investigation reports (SIs) do not indicate known issues with the land. The SI report, costs appraisal, and an independent valuation report on the sale prices are attached to this report.
36. Assistant Director – Resources (CFO), 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 which meets regularly monitor progress on the development. Control and governance of the company will be equally shared and neither shareholder will have a casting vote. In the event the parties do not agree then the matter will be covered by deadlock provisions in the joint venture agreement.
37. 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.
38. 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.
39. 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 (variable upwards in accordance with changes to the Bank of England base rate).
40. 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.
41. 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.

Outcome of Consultations

42. Internal consultations with Housing, Estates, Finance, Legal, Capital Projects and Procurement have not raised any objections to the proposal and the expectations on build and sales costs are considered reasonably achievable at the present time.
43. The development of the site has been subject to full consultation with residents as part of the planning process.

Legal Advice

44. 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. This gives the powers to enter into prudential investment and in this context the investment provides a financial return along with ancillary benefits in terms of delivery of housing, new homes bonus.

45. The Joint Venture is to be delivered with the Joint Venture partner appointed following an OJEU tender process conducted in Summer 2017.
46. 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.
47. 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 and at Companies House to protect the Council's interest in the scheme and mitigate investment risk.