

CABINET
3 JULY 2023

DELIVERY OF NEW HOMES AT NEASHAM ROAD
JOINT VENTURE PROPOSAL

Responsible Cabinet Member –
Councillor Mandy Porter, Resources Portfolio

Responsible Director –
Elizabeth Davison, Group Director of Operations

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 at Neasham Road, under the company name Hurworth Gardens JV Limited.
2. To seek approval for the sale of the land at Cell C, Neasham Road (the Land) to the newly incorporated JVC.
3. To seek approval for the payment of Nutrient Neutrality credits of circa £0.052m awarded, and agreement in principle to the purchase of further credits in accordance with Natural England requirements estimated at £0.122m.

Summary

4. 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. This was then extended following the meeting of Cabinet on 5 October 2021.
5. 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 Neasham Road Cell C, site as shown on the Location Plan attached at **Appendix 1**. The purchase price for the site has been negotiated at arms length and in line with the terms and supporting Development Appraisal and Cashflows annexed at **Appendix 2 (Part III)** and **Appendix 3 (Part III)**.
6. Subject to approval and on the terms of this report the Joint Venture Company will purchase the site and undertake associated works to deliver housing.
7. An application for planning permission has been submitted for the delivery of 144 houses on the site. In order to develop the site a payment for Nutrient Neutrality credits (payable to Natural England) of £51,690 is required. The calculations have now been revised in line with new advice from Natural England, meaning that an additional circa £0.122m could be

required. The Council will apply for these additional credits however if they are not forthcoming in the required timescales there is a Plan B, where mitigation land could be made available.

8. 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 and Esh Homes Limited.
9. The Joint Venture Company will be fully funded by the Council and this will be via prudential borrowing of up to a maximum of £6.7m (the initial payment from the Council will be £2,127,804), with further drawdowns subject to satisfactory progress on site.
10. The loan will be repaid via the Joint Venture Company to the Council and will generate a net income to the council after taking into account any cost of borrowing undertaken by the authority.
11. The estimated pre-tax profit share for the Council is £0.694m.
12. The risks involved in the Joint Venture have been identified and mitigated via the agreement. Due diligence on site condition have been done and the site investigation reports (SIs) do not indicate known issues with the land. The SI report, costs appraisal and a valuation report on the sale prices reviewed by the Councils estates section and are considered reasonably achievable. 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.
13. Further documentation referred to by appendices to this report are as follows:
 - (a) Appendix 1 – Location Plan, Site Layout and Site Plan
 - (b) Appendix 2 (Part III) –Joint Venture Development Appraisal
 - (c) Appendix 3 (Part III) – Joint Venture Cashflows
 - (d) Appendix 4 (Part III) – Land agent appraisal of disposal prices
 - (e) Appendix 5 (Part III) – Land SIs report.
 - (f) Appendix 6 (Part III) – Shareholders Reserved Matters

Recommendation

14. It is recommended that :-
 - (a) Cabinet approve the establishment of the Joint Venture Company to acquire the Site, deliver, build and sell new homes at Neasham Cell C.
 - (b) Cabinet approve £6.7m 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 Chief Executive be granted to negotiate the final terms of the Joint Venture Agreement and

finalise the establishment of the Joint Venture Company, in line with the terms and supporting Development Appraisal and Cashflows annexed at Appendix 2 (Part III) and Appendix 3 (Part III).

- (d) 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 acquisition.
- (e) The Chief Executive, Group Director of Operations and the Assistant Director Law and Governance are appointed to act as directors in the Joint Venture Company as part of its Executive Board.
- (f) The Joint Venture to be funded from prudential borrowing from the Capital Investment Fund.
- (g) Cabinet approve the purchase of initial Nutrient Neutrality credits of £0.052m and approve any future obtained credits circa £0.122m to enable the site to be built out.

Reasons

15. 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 deliver income for the Council.

Elizabeth Davison
Group Director of Operations

Background Papers

- (i) Appendices as listed in paragraph 12
- (ii) 200915 EG Neasham Road

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 and Climate Change	The new homes will comply with the governments energy efficiency requirements.
Diversity	There are no diversity issues
Wards Affected	Hurworth
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
Council Plan	Growing Darlington's Economy by delivering more homes
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

- The Council has already established a number of Joint Venture Companies to build and sell homes at various sites within and without Darlington with Esh Homes Ltd. These ventures are progressing well and have delivered impressive profits and ongoing net income from the loan repayments.

Land Disposals

- The new JVC will develop Cell C as shown in the plan at Appendix 1.
- It is intended the sale to the JVC will be completed once the planning permission has been obtained and the S106 terms have been agreed.
- There has recently been an obligation to pay for Nutrient Neutrality in order to bring sites forward for development. A payment of £51,690 was required to bring forward the 144 new homes. However, we are advised that the rules have changed and only 30% of the houses could now be built. Further credits of estimated at £0.122m would be needed for the remaining development. The situation is currently under review at the time of writing this report. The plan is to apply for additional credits, however if required and the credits are not forthcoming in the time period required the Council does have an alternative approach, in that there is DBC owned land within the classification which could be used in mitigation.

The Joint Venture Proposal

- 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.

21. The Council will enter into a loan facility agreement of up to £6.7m 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 projected interest payable to the Council under the Loan Agreement is projected to be £1,159,691 (Appendix 2- Part III).
22. 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 are required to be competitively tendered in compliance with the Councils own requirements must be reported to the Board of Directors at the next available board meeting together with a tender report providing evidence that the required processes have been followed.
23. Total cost of the Joint Venture development 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.
24. After the finance costs (payable to the Council £1,159,691) and the Joint Venture Company costs of sale and professional costs (as procured) the pre-tax profit to each partner is estimated at £0.694m.
25. The scheme return on capital employed is 63.17% over the four year scheme which is the expected build out period.
26. 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 and 3- Part III).
 - (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. 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 £6.7m. The drawdown of funding will be as required by the Development Cashflows (appendix 3 – 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.

27. 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 £6.7m (including a 10% tolerance level) to fund the Joint Venture development. The initial investment from the Council will be £2,127,804 with further drawdowns subject to satisfactory progress on site.
- (b) Interest on the loan to be calculated to be compliant with the Subsidy Control Regulations and will be subject to the Bank of England Base Rate.
- (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 3 – 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.

28. 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 2015.
- (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.

29. The proposal is set out in the Appendices see in particular the appraisal and cashflows at Appendices 2 and 3 (Part III).

Risk Analysis and Valuation Comment

30. 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

31. The expected total cost of the build works is £18,528,588. The Councils contribution to the build cost is restricted at any time to the amount of the loan advance.
32. 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 6 Part III**.
 - (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 is less than five units.
 - (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 make 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.

Achievement of Sales Value

- 33. The expected sale values have been subject to a formal valuation exercise and the sales report is contained at **Appendix 4 – Part III**. The anticipated values have been reviewed by the Council's estates department and are considered reasonably achievable at the present time.
- 34. 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

- 35. 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.
- 36. The sum of £6.7m 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. The loan will generate a surplus of circa. £0.260m to the Council.
- 37. 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 £0.694m.
- 38. The Land sale will generate a capital receipt for the council and is illustrated in the Cashflows annexed at Appendix 2 (Part III).
- 39. The cost of the Nutrient Neutrality credits anticipated at £0.174m will be offset against the capital receipt.

Mitigation of Risk

- 40. 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 Subsidy Control compliant interest rate required by the relevant Statutory Instrument. The scheme length and scheduled repayment dates are set out in the Development Cashflow at (Appendix 3 – Part III).
- 41. 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.

42. 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.
43. 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.
44. In such a case and where sales have slowed to impact cashflows to the extent that the funding limit is reached then 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.
45. Under the JV Agreement the JV partner is required to ensure that Building Contracts contain express provision that total 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 contractors 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 29(e).
46. 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

47. Internal consultations with Housing, Estates, Finance, Legal, Capital Projects and Corporate 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.
48. Statutory consultation is carried out through the required planning process.

Legal Advice

49. 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.

50. The Joint Venture is to be delivered with the Joint Venture partner appointed following an OJEU tender process conducted in Summer 2017. This appointment was extended in line with procurement advice at the meeting of Cabinet on 5 October 2021.
51. 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.
52. 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 investment risk.