

SURREY COUNTY COUNCIL

CABINET

DATE: 14 DECEMBER 2017

REPORT OF: MR TIM OLIVER, CABINET MEMBER FOR PROPERTY AND BUSINESS SERVICES

LEAD OFFICER: JOHN STEBBINGS – CHIEF PROPERTY OFFICER

SUBJECT: JOINT VENTURE DEVELOPMENT PARTNER – CONTRACT AWARD



PART 1

SUMMARY OF ISSUE:

This report provides an update on activities undertaken in response to Central Government's proposals to tackle the nationwide housing crisis, by unlocking sites for the construction of mixed use development schemes. Through utilising its own land and buildings, Surrey County Council (SCC) has the opportunity to unlock public land for redevelopment use, whilst also creating assets with income generating potential. In order to deliver this opportunity at scale and pace the Council has completed a procurement process for an external partner to deliver these benefits through a Joint Venture (JV).

This report highlights details of the procurement process and in conjunction with the Part 2 report, demonstrates why the JV contract award will deliver best value to our residents.

Due to the commercial sensitivity of the contract award, the financial and commercial details are covered in the Part 2 report.

RECOMMENDATIONS:

It is recommended that Cabinet approve:

- 1) delegation to the Cabinet Member for Property and Business Services; Acting Chief Executive and Chief Property Officer to finalise and enter into:
 - a. the JV contract documentation, as set out in the Part 2 report, with Places for People Group (PfP);
 - b. conclude contract requirements for the provision of an operating lease within the parameters set out within the Part 2 report;
- 2) the Investment Board:
 - a. commission the JV to undertake development opportunities and option analysis for the initial prioritised sites to be agreed by Shareholder Board when setting the business plan, with future development opportunities following the same process;
 - b. formulating and presenting recommendations back to Cabinet for final approval of any development proposal or alternative future uses for

the sites; and

- c. reviewing additional potential sites and commissioning feasibility proposals or options analysis for development proposals or alternative future uses of the sites;
- 3) Cabinet is asked to note that authority is delegated to the Shareholder Board (SB) to:
- a. appoint nominated representatives to the JV Strategy Board;
 - b. appoint two nominated Council officers to be representatives of the Council on the Joint Venture Board to oversee and deliver the day to day activities of the joint venture vehicle;
 - c. approve the Annual Business Plan, Annual Accounts and other applicable control and management member matters of the JV entity; and its terms of reference have been amended accordingly.

REASON FOR RECOMMENDATIONS:

These recommendations enable SCC to assist in enhancing economic prosperity within the County, through the delivery of mixed use development schemes, and potentially securing a long term revenue stream to the Council.

Entering into the proposed JV will provide SCC with an ability to secure the following objectives:

- 1) establish a delivery model, which can act as an agent for economic growth and social activity, delivering housing and mixed use developments;
- 2) create a focus for skills & training development and local employment opportunities;
- 3) utilise its assets, ensuring efficiencies, site optimisation and achieving best value and allowing a pipeline of sites to be made available to the JV partner to ensure economies of scale and scope to the programme of activities;
- 4) support delivery of key components of the Investment Strategy;
- 5) secure a significant, pre-committed and long term partner able to bring capital and expertise to the region;
- 6) support and benefit from wider collaborative opportunities through offering the vehicle to those public sector partners seeking a development delivery vehicle that satisfies their own corporate asset related objectives.

DETAILS:

Background

1. Housebuilding is falling significantly short of demand and needs to increase across the country. Through using its own land and buildings the Council has the ability to unlock sites for development, maximise the use of its land, to create economic prosperity and sustainable investment opportunities.
2. The Investment Strategy, agreed by Cabinet in 2013, determined that the Council would:

- create a diversified and balanced portfolio of property investments to manage risk and secure an ongoing annual income return to the Council;
 - use its Revolving Infrastructure Funds to invest in assets that have the potential to support economic growth and;
 - retain assets where it can be demonstrated that, subject to additional investment if necessary, it will enhance income;
 - seek to secure alternative sources of funding, thereby reducing reliance on government grants and Council tax increases in the future.
3. The Investment Advisory Board (IAB) evaluated a number of options to look at development opportunities for the Council's surplus assets which would align with the third aspect as listed above. The outcome of which supported Orbis Property Services in commencing a market engagement exercise to find a development partner.
 4. Orbis Property Services sought development consultancy and valuation advice from the Knight Frank Public Sector Team, a leading property consultancy, and Bevan Brittan LLP (BB) lawyers were appointed to advise on the JV proposal and contract documentation.
 5. Following these appointments additional soft market engagement sessions were held from May to September 2016 with a number of parties to test the parameters for a joint venture vehicle.
 6. The exercise invited a mix of land promoters, developers, contractors and investors to a briefing event, with further work and interviews confirming that the core interest was in a total service and a JV approach for a portfolio of assets – with acknowledgement that any partnering arrangement would require an OJEU procurement process.
 7. A Property Development Partnership Board was established as the core project sponsors. The recommended and preferred option remained the establishment of a longer term JV arrangement.
 8. At Sourcing Governance Meeting (SGM) consent was sought, on 5th January 2017, to conduct a formal procurement exercise to secure the appointment of a JV partner through a competitive dialogue process for both professional services and works.
 9. A JV agreement would add pace, capacity, private sector expertise and funding, where required, to bring identified sites forward through options appraisals and business case activities and then enable their onward delivery to provide revenue or capital receipt streams to be secured.
 10. After an initial selection exercise and bidding process, five parties were invited to enter into a competitive dialogue process to provide solutions based on the Authority's requirement.
 11. Technical, commercial and legal sessions were undertaken with all bidders through to summer 2017. An Invitation to Submit Final Tenders (ITSFT) was released with final bids requested and received on 31st July 2017.

12. Bidders were evaluated on their ability to select, manage, and grow the supply chain and on the risk profile for construction contracts and pricing, as well as demonstrating value for money.
13. The evaluation was undertaken during August and September 2017, and this has resulted in a recommendation to appoint Places for People Group. The procurement process is set out in paragraphs 8 to 13 and the commercial bid evaluation details are covered in the Part 2 paper.

What is to be created?

14. The creation of a joint venture between PfP and SCC is the preferred approach, as it offers direct participation and engagement with the private sector giving proportionate control and direction. SCC and PfP will appoint directors, but as partners there will be a list of Reserved Matters.
15. The JV will take the form of a Limited Liability Partnership ('LLP').
16. An LLP is a partnership in which some or all partners have limited liabilities. It therefore exhibits elements of partnerships and corporations. In an LLP, each partner is not responsible or liable for another partner's misconduct or negligence.
17. The LLP is liable for all its debts, and the default position of the contract will be that PfP will be obliged to seek or provide the development funding.
18. As equal partners; in a 50/50 joint venture, the risks, rewards and controls will be shared. The length of contract is for 15 years, plus the option of a 5 year extension, to reflect the development cycle from feasibility to delivery including sales and marketing.
19. Through the governance arrangements and Key Performance Indicators (KPI's) agreed by both parties, SCC and PfP will have termination options over the duration of the contact.

Outcomes of the JV

20. The JV is being formed to support economic growth, utilising the Council's assets to deliver mixed use developments, as well as helping to drive SCC's wider strategic objectives. Deliverability, sustainability and quality will be important factors in considering sites and schemes for development.
21. Both the JV and SCC will seek to promote developments that create opportunities within the first phase of schemes across all eleven districts and boroughs.
22. Additional objectives that the JV will be expected to achieve are:
 - to bring sites forward in a timely manner, responding to market demand and undertake site developments, where appropriate;
 - to bring forward the development of sites, which are considered more difficult to develop at a comparable rate to sites with minimal obstacles to develop;

- to support SCC in pursuit of its wider objectives by identifying and helping deliver favourable solutions that balance financial, economic and social returns;
- to develop the opportunities provided by Third Parties by increasing capacity, without having an impact on SCC or SCC's strategic objectives;
- to drive efficiencies and effectiveness of SCC's asset base;
- to secure and demonstrate value for money on all JV activities;

Other public sector partners

23. It is proposed that the JV contract structure is made available to additional participating authorities as noted on the OJEU concession notice. This includes Surrey's District and Borough Councils, Police and Health authorities along with organisations outside of SCC's geographical boundary.
24. Those participating authorities who may wish to use the JV may create their own JV as a "subsidiary" to the main JV owned by SCC and PfP. This would enable SCC to retain a nominal equity stake in any subsidiary with PfP's equity share and control remaining undiluted.
25. This also allows partners both within Surrey, and beyond, to utilise their own assets and purchase services from the JV.

Decision making and governance

26. SCC will have two distinct roles in the contractual arrangements;
- a) as a Member (defined as SCC organisation) – SCC will make decisions pursuant to the JV Agreement by way of its nominated management board members.
 - b) as a Client – SCC will also be the client for the development of those schemes it offers to the JV. The relationship and the process for development is set out in the Site Commissioning Agreement (SCA) referred to in the Part 2 paper. Under this process SCC, as the client authority will be confirming and approving the development of each site, or basket of sites, based on business cases approved by Cabinet.

27. An overview of SCC's decision making process is listed below:

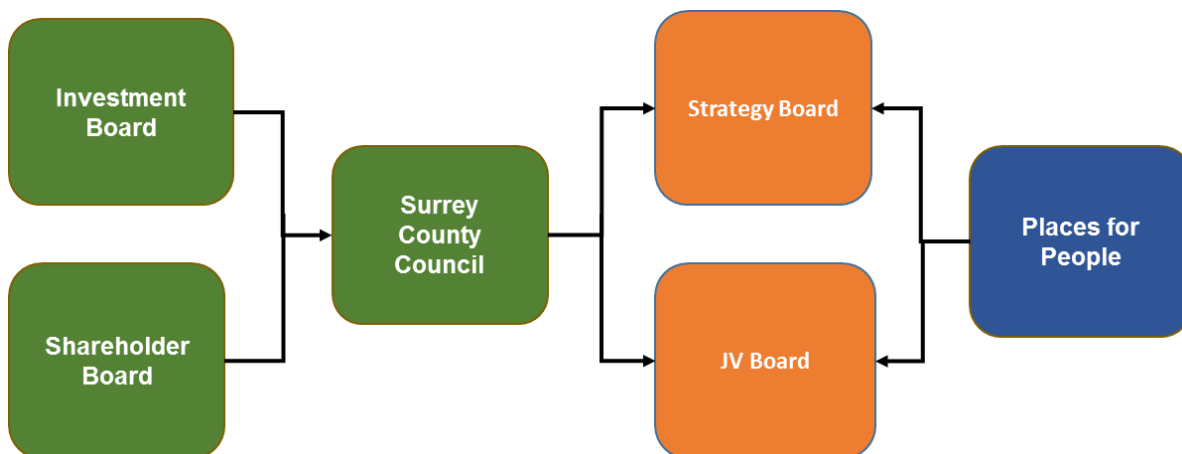
Investment Board	Shareholder Board
<ul style="list-style-type: none"> • Receive the recommended options appraisal for each site or basket of sites from the JV. • Agree the option for each site and approve its associated actions – this may include the disposal of the site, its development and following development, the sale or retention of completed units and recommendation to Cabinet on proposed solutions. • Recommend to Cabinet any associated finance requirements and the provision of loans to the JV by SCC, where it is beneficial to do so. • Monitor the performance of the JV and achievement of agreed milestones. • Review and consider the performance of the JV in terms of its impact on the Investment Strategy and the Revolving Fund and report back to Cabinet as part of the investment strategy annual report. 	<ul style="list-style-type: none"> • Receive and consider year-end financial accounts and approve proposed distribution of surplus. • Approve annual business plan. • Appoint / remove management board members (similar to Directors). • Approve changes to the Members Agreement (similar to Articles of Association) and any other reserved matter.

28. The JV governance structure is formed by two boards;

- a) a Strategy Board made up of officers and elected members of the Council alongside senior personnel from PfP will form part of the governance structure of the JV. This will ensure SCC's elected members are kept up to date with progress and performance of the JV whilst providing feedback and direction to the JV Board.
- b) a Joint Venture Board will be made up of an equal number of representatives from PfP and SCC. This board will be responsible for overseeing the delivery of the day to day activities, delivery of Business Plan and JV objectives.

Governance Structure:

29.



Business Plan

30. The Members' Agreement will contain and set out the principles of the Business Plan, which will be adopted and agreed between both parties. The Business Plan will set out and demonstrate the development strategy for how the JV will deliver SCC's requirements. The Business Plan will be submitted to the Shareholder Board for approval.

Scope of works provided by the JV

31. The range of services and activities will include, but not be limited to:

- option appraisals and business case presentation;
- land promotion services, including planning;
- development management services;
- arranging development finance
- design and construction activities;
- marketing, sales and letting services for developed property, including maintenance;
- asset management services.

32. The focus is on developing surplus assets primarily for housing as a means of enhancing economic growth within the County, generating more jobs and improving living standards.

Benefits of a JV

33. SCC has identified a requirement for a partner to deliver at scale and pace a number of possible developments. PFP provides the JV with the people, support services and functions required for successful delivery and operation over the lifecycle of the JV. A core objective of the JV is to accelerate development and economic objectives and therefore SCC requires PFP to assist with the appropriate resources, management and skills to do so.

34. There will be contracts for supply chain entities to deliver costed services with the measurement of funding and performance activities.

How will the services of the JV be paid?

35. The JV will require general working capital to meet its everyday running costs that are not scheme specific. A working capital loan will be provided by PfP and an assessment of the necessary general working capital will be in the JV's Business Plan for the years 1 to 5. There is the potential for SCC to provide funding assistance through a debt/funding agreement, at a commercial rate of return, at SCC's discretion.
36. On a scheme by scheme basis, the JV will have working capital to initially undertake the land promotion activities and secure planning. Thereafter, there will be additional working capital requirements, as well as funding for the development programme as it progresses. The JV will be expected to conduct business activities at its risk.
37. If it wishes, SCC can purchase additional services from the JV, such as standalone planning promotion activities, disposals etc. for sites that are not to be developed by the JV. SCC will pay a fee to do so calculated as a percentage or a range of percentages dependant on size, scale and complexity of the scheme and, which specific service SCC requests.

How will the JV be paid for its services to third parties?

38. Third Parties wishing to purchase services and use the JV will be free to do so, subject to satisfying themselves of their procurement position.
39. Third Parties may seek two types of engagement with the JV: the first may be a simple request to provide land promotion services, including planning. The second may be more substantial where the Third Party wants the JV to develop sites on their behalf.

Initial JV Programme

40. The Shareholder Board as part its role in approving the annual business plan will approve the first 12-15 priority developments based on recommendations that will set out timeframes, resource requirements, cost and income considerations, and the proposed next steps.
41. SCC is continually reviewing and identifying strategic operational opportunities as part of their Strategic Asset Management Plan (SAMP) of the estate portfolio. Ongoing service review work focusses on demographics plotted against local need and key growth areas. In turn, this work will bring additional value through the partnership to SCC.
42. PfP will look to assist SCC to identify opportunities within the operational estate with a view to improving the financial and operational outcomes that would provide a fit for purpose estate that is resilient, and able to improve the Council's service offer to residents.

CONSULTATION:

43. A joint letter from the Leader of the Council and Chief Executive in October 2016 outlining the JV, programme of work and benefits went to third party organisations, including Surrey's District & Borough Councils, along with other public sector organisations across the South-East.

RISK MANAGEMENT AND IMPLICATIONS:

Corporate risk

44. In progressing these arrangements SCC will be participating in additional risks through development activity. By entering into a JV with an established national partner who has significant experience in developing, constructing and managing completed assets across the country the Council will mitigate and manage these risks.
45. IB will evaluate the options for each scheme on the basis of a robust business case that will consider a range of scenarios. The scenarios will take into account current and future market trends.
46. To manage the performance of the JV there will be an open book approach and provision of monthly management accounts and annual audited statutory financial reports. The performance of the JV will be measured through an agreed set of KPI's which will be reviewed by the Strategy Board.
47. SCC is committed to facilitating regeneration initiatives and the JV will look at wider programmes to work with public sector partners to assist in delivering comprehensive initiatives to the benefit of Surrey residents. An ability by the JV and Orbis Property Team to create a joined up approach to drive the programme is key.

Procurement

48. There is a potential risk from unsuccessful bidders that may wish to challenge against the contract award however by following an EU compliant procurement process these risks have been mitigated.
49. Throughout the procurement process all clarification questions were answered, logged and distributed to all bidding contractors via the Surrey portal with the exception of specific commercial information requests from bidders.
50. All communication with the bidders and exchange of documentation was carried out within the Surrey's SE Shared services e-Sourcing Portal, to meet the EU treaty principles of transparency creating a clear audit trail compliance.
51. The protocol of the process was set out in the Selection Questionnaire and was followed, meeting EU treaty principles of running an open, fair and transparent process.
52. Bidders were tested on their methodology, approach and ability to provide services in line with SCC's anticipated requirements. Bidders were evaluated on:

- Quality - carrying an overall weighting of 60%; split in to four sections;
 - i. Business Plan (19%)
 - ii. Options exercise (21%);
 - iii. Delivering the Value Chain (12%);
 - iv. Asset Management & Interim Income (8%);
- Financial submissions - 30% weighting;
- Legal - 10% weighting.

53. This comprised a blend of questions which required Bidders to demonstrate elements such as; how relevant decisions will be taken; how options will be identified and assessed; how outcomes will be justified; how risks will be identified, managed and mitigated; and how the JV will be accountable for the relevant activities. SCC wanted to test these areas to ensure the appointed partner has the relevant skills and experience capable of delivering the scope of works required by the Council.

54. Through the qualitative process bidders were given briefs on three test sites and asked to demonstrate their methodology; including site logistics and design, performance measures, technical and resourcing abilities. Whilst also clearly setting out their optimisation of return in line with SCC's core objectives.

55. Prospective partners were asked to demonstrate their experience, expertise and ability to flex capacity without incurring disproportionate costs, through leveraging their integrated supply chains.

Financial and Value for Money Implications

56. An objective of the JV is to utilise the Council's identified assets to deliver an ongoing income stream or an enhanced capital receipt. The aim is to offset the impact of the reduction in government grants by growing income streams from a residential portfolio and mixed use schemes over the longer term and to protect service provision, while minimising the burden on the local council tax payer.

57. SCC reserves the right to provide working capital to the JV alongside PfP. This is dependent on SCC's appetite to risk, evaluated on a site by site basis. The default position is that working capital required for development activities will be loaned to the JV 100% by PfP which will be repaid from the JV revenues before distribution of profit.

58. If the Council opts to fund investments it will do so through its reserves, capital receipts and prudential borrowing; under the Council's powers. Any borrowing required would need to be made in accordance with the conditions of the Prudential Code, which includes the Council approving any changes required to the prudential indicators. The Code requires borrowing to be affordable, sustainable and provide value for money. The return on any investment would therefore need to be in excess of the capital financing costs of the borrowing, which consist of the interest payable and the statutory Minimum Revenue Provision (MRP) that sets aside funds for the repayment of the borrowing.

59. All sites to be developed under the JV will require a robust business case to guarantee that sites are providing value for money. Each site or basket of sites will undergo options appraisal in order to evaluate development of the site(s) and ensure the return on investment and/or uplift in value is secured.
60. The Part 2 paper explains the commercial methodology.

Section 151 Officer Commentary

61. The Investment Strategy and the creation of a joint venture development company will have a positive financial impact and alter the risk profile of the Council. The proposal will enable the council's surplus sites to be developed, increasing the number of development projects that are underway at any one time. Development risks will however be mitigated by the engagement of an experienced partner. The proposal will contribute to the achievement of the income target of £10m expressed in the Investment Strategy Review approved by Cabinet in March 2017. Consideration will be given on how to reflect the progress being made toward this target as part of the Medium Term Financial Planning refresh.
62. The proposal recommended in this paper sets out the framework and methodology for the engagement of Places for People as a joint venture partner and as a supplier to the joint venture. The governance arrangements require that each development proposal is made on the basis of a robust business case, supported by the Investment Board and approved by Cabinet. A range of options will be tested for each of the council's assets and full and due proper consideration will be given to the balance between risk and reward.
63. The Department for Communities and Local Government (DCLG) has recently published a consultation on its proposed changes to Investment & Minimum Revenue Provisions guidance. If fully implemented these proposals could have an impact upon the financial appraisals for each development scheme. Councils are currently seeking clarity on the guidance as there are inconsistencies in the proposals however this clarity should be forthcoming well in advance of any individual development business cases being presented to Cabinet for approval.
64. The representatives of the Council on the joint venture board will have authorisation to undertake the day-to-day decision-making of the company in accordance with the approved business plan and approved site development plans.
65. The joint venture will be arranged as a Limited Liability Partnership (LLP). This is beneficial since a LLP is "transparent for tax" meaning that tax is paid in accordance with each member's tax status and therefore no corporation tax will be payable on development profits since SCC is a non-tax paying entity. A LLP is also transparent for reporting purposes meaning that a 50% share of all profits and losses will be reported in the council's group accounts. It is expected that, due to the nature of the activities being undertaken, that a loss will be reported for at least the first 3 years of operation since there will be significant development spend in advance of delivering any profits. This loss will however not impact upon the council's own financial position since it will be held at arm's length in the LLP.

66. The arrangements mean that the development costs will not be borne by the Council since they will be recouped from the sale of residential units once developed. The LLP's cash flow requirements will be provided by the initial working capital loan provided by PfP. The council is able to provide development finance to the company and will do so if it is financially beneficial. Any loan provided will be required to be on an arm's length transparent basis commensurate with prevailing market conditions. The detailed financial structuring of each development will be considered as part of the options appraisal and be based upon specialist advice.

Legal Implications – Monitoring Officer

67. Under Section 2(1) of the Local Authorities (Land) Act 1963 a local authority has extensive development powers and may, for the benefit or improvement of their area, erect, extend, alter or re-elect any building and construct or carry out works on land, The General Power of Competence in Section 1 of the Localism Act 2011 allows the Council to do anything which an individual may do, anywhere in the United Kingdom or elsewhere, subject to some limitations and restrictions. Taken together, these powers enable the Council to enter into a Limited Liability Partnership joint venture to undertake residential development so long as the primary aim in doing so is in fulfilment of a public function and not for a commercial purpose.
68. The Council appointed Bevan Brittan LLP as external legal advisors to facilitate the procurement and creation of the joint venture. To ensure its selection of a partner was open, transparent and reflected the best value for money the Council could achieve, it followed an EU procurement compliant process under the Concession Contracts Regulations 2016.
69. Once a development has been completed the Council may dispose of land or individual units to any purchaser under Section 123 of the Local Government Act 1972. In doing so, the Council must ensure that it obtains the best value reasonably obtainable.
70. The Council will exercise any member decisions of the LLP through its existing governance arrangements for the Shareholder Board. The reserved matters over which the Council and PfP must reach agreement on are set out in Schedule 4 of the Members' Agreement. In the event of agreement not being reached there are significant deadlock provisions built into the Members' Agreement to facilitate resolution.
71. The Council will be acting as the equivalent of shareholder, director, client, funder and public authority in its interactions with the joint venture. The relevant members and officers will need to be cognisant of the different roles and responsibilities they will be assuming as part of the governance arrangements. The separation of decision making between the management of the joint venture and the Council as shareholder/client will be of particular importance. Legal Services will provide advice and guidance to ensure robust decision making at every stage.
72. In entering into the joint venture Cabinet Members will want to satisfy themselves that it represents an appropriate use of the Council's assets. Members should note that no obligation exists within the contractual framework to provide sites for development by the joint venture and so future changes in the Council's requirements will not be prejudiced.

Equalities and Diversity

73. There are no equalities and diversity issues for the Council in undertaking this proposal.

Climate change/carbon emissions implications

74. The intention will be for all developments to be designed and built to the latest Building Regulations and take into account the Home Quality Mark developed by the Building Research Establishment Environmental Assessment Method.

WHAT HAPPENS NEXT:

75. Cabinet Member for Property and Business Services; Acting Chief Executive; Chief Property Officer are to:

- i. authorise legal services to enter into a contract with Places for People;
- ii. approve the detailed arrangements in order to set up a Limited Liability Partnership (LLP) and the Joint Venture Board with PfP.

76. Shareholder Board to appoint nominated representatives to the LLP Strategy and Joint Venture Board and approve its Annual Business Plan.

Contact Officer:

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Sources/background papers:

1. Strengthening the Council's Approach to Innovation: Models of Delivery (Cabinet March 2013)
2. Investment Strategy (Cabinet July 2013)

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