

SURREY COUNTY COUNCIL**STRATEGIC INVESTMENT BOARD****DATE: 29 OCTOBER 2019****REPORT OF: MR MEL FEW, CABINET MEMBER FOR FINANCE****LEAD OFFICER: LEIGH WHITEHOUSE, EXECUTIVE DIRECTOR – RESOURCES****SUBJECT: SOUTH RIDGE DEVELOPMENT (SRD) LLP – DEVELOPMENT FUNDING****SUMMARY OF ISSUE:**

Surrey County Council (SCC) has entered into a Limited Liability Partnership (LLP) with Places for People (PfP). The purpose of the LLP is to undertake developments within the County of Surrey and the surrounding area over an initial term of 15 years, with an option to extend for a further five years.

This report considers funding arrangements for the initial developments and in conjunction with the Part 2 report, demonstrates why SCC part financing the first phase of developments will deliver best value to our residents.

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

RECOMMENDATIONS:

It is recommended that:

1. The Council should in principle seek to provide development funding to South Ridge Development LLP at up to 50% of the total requirement, subject to approved Site Development Plans (SDPs).
2. Actions are put in place to draw up a development funding agreement, including seeking external legal advice at an estimated cost of up to £10,000.

REASON FOR RECOMMENDATIONS:

The funding will enable the LLP to carry out development activity in line with the objectives agreed with the Council which include:

- To accelerate growth in terms of housing completion and jobs on Council owned assets
- To ensure that the LLP works to the benefit of all Surrey residents in terms of outcomes;
- To create profitable and transparent relationships with commercial enterprises which deliver financial and regeneration benefits;

- To capture financial benefits and the opportunities available to a dedicated delivery vehicle that can benefit from agile operating arrangements
- To maximise development and minimise risk to the Council by providing dedicated delivery arrangements and property and commercial expertise, bring scale and pace to the programme.

DETAILS:

Background

1. Cabinet agreed in December 2017 that Surrey County Council (SCC) would set up a joint venture (JV) company with PfP to undertake developments within Surrey utilising surplus assets, accelerating growth and minimising risk.
2. SCC has the right to provide up to 100% of SRD LLP's funding requirements provided that this is loaned on terms available on the open market or in relation to a sum equal to the amounts that the LLP agrees to loan from PfP.

Latest Status

3. Indicative Site Development Plans (ISDPs) have been issued by the LLP for the first nine sites under consideration. As part of preparing the SDPs for these sites, which will seek the final approval from SCC to go ahead, PfP have asked the Council to clarify their intentions regarding the provision of development loan financing. A decision is required so that this can be factored into the supporting financial models and furthermore it determines the extent and timing of when any third party funders need to be engaged by the LLP.

Key Considerations

4. In making the decision to provide development funding the Council will need to take into account the risks involved, our legal powers to enter into these arrangements and the latest CIPFA guidance relating to prudential property investment.
5. The risks and legal implications are set out below in specific sections of this report. The latest guidance for local authorities sets out three main considerations for local authorities in determining whether they can borrow to invest in property:
 - Does the local authority have the legal power to borrow for the purchase (or development) of a property?
 - Is the use of that legal power reasonable?
 - Is the local authority acting within its own policies and strategies?
6. Our initial interpretation of the guidance leads us to conclude that the Council is in principle able to provide development funding to the LLP. Further due diligence will be completed as part of the preparation of the formal report to approve the facility in order to evidence our compliance and confirm we are acting lawfully, reasonably and in accordance with the prudential code.

CONSULTATION:

7. 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:

8. In progressing these arrangements SCC will be participating in additional risks through financing development activity. By entering into the LLP with an established national partner who has significant experience in developing, constructing and managing completed assets across the country SCC will mitigate and manage these risks.
9. All sites to be developed by the LLP require SCC approval of a 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.
10. To manage the performance of SRD LLP there is an open book approach with the provision of monthly management accounts and annual audited statutory financial reports. The performance of the LLP will be measured through the production and review of progress against an Annual Business and agreed set of KPI's. These will be considered periodically by both the LLP Board and Shareholder & Investment Panel.
11. The ability of the LLP to repay the development loan and to cover interest payments needs to be considered in the context of risks relating to the planned development activity, the housing market and also PfP's financial standing. PfP have over 50 years' experience in the placemaking business, building sustainable communities for everyone. Due diligence was completed on the PfP covenant as part of the procurement process for the joint venture development partner and will be reviewed in detail again in the lead up to approval of the first SDPs and preparation of a development funding agreement.
12. Further, a funding agreement will be signed between SCC and the JV (and PfP as required) to ensure that the terms of the funding are fair and provide appropriate security.
13. Weighing up the overall risks involved in comparison to the potential financial returns leads us to conclude that at this stage we should limit our funding offer to a maximum of 50% of the total development funding required. This will be subject to review as the developments progress and complete, with a view to SCC increasing its funding commitment to up to 100% where the LLP has a proven track record. A separate decision would be taken on the funding profile for each phase of developments.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

14. If the Council opts to fund the development it will do so through its reserves, capital receipts and prudential borrowing under the Council's powers. Any borrowing will

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 proportionate. The return on any investment will therefore need to be in excess of the capital financing costs of the borrowing.

15. The Part 2 paper provides further detail on the financial implications.

SECTION 151 OFFICER COMMENTARY

16. The creation of SRD LLP Joint Venture company and provision of development funding is expected to have a positive financial impact and alter the risk profile of the Council. The LLP will enable the council's surplus sites to be developed (subject to SDP approvals), increasing the number of development projects that are underway at any one time. Development and financing risks have been mitigated by the engagement of an experienced partner. Further, the inherent financial risks would be mitigated by ensuring appropriate legal agreements are in place.

LEGAL IMPLICATIONS – MONITORING OFFICER

17. Section 3(1) of the Local Authorities (Land) Act 1963 states that “where a local authority are satisfied that it would be for the benefit or improvement of their area, they may, subject to the provisions of this section, advance money to any person for the purpose of enabling him —

(a) to acquire land; or

(b) to erect any building or carry out any work on land.”

18. Additional conditions apply to this power, including that the advance must be secured by a mortgage on the land and that it cannot exceed nine-tenths of the total land value. There is some uncertainty over whether these conditions can be satisfied in this particular circumstance and further investigation will be necessary.

19. If the above Section cannot apply, 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. This power enables the Council to provide loan finance to the LLP joint venture of which it is a part and has negotiated certain rights to do so. Use of the general power may impact upon whether the loan can be financed by the Council through direct borrowing under the CIPFA guidance and the prudential code.

20. In either event, state aid restrictions will not apply so long as the interest charged and general terms upon which the loan is given are either fully ‘arms-length’ (i.e. market standard) or no more favourable than any private sector parent company would provide in similar circumstances.

21. Specialist legal representation will be sought to prepare the loan documentation to ensure the Council is adequately protected.

EQUALITIES AND DIVERSITY

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

ENVIRONMENTAL SUSTAINABILITY:

23. 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:

24. In accordance with the timetable for approval of the first Site Developments, the Executive Director – Resources will put in place arrangements to:

- a) procure external legal advisors to provide necessary legal due diligence and prepare funding agreement; and
- b) advise Corporate Finance Team of the decision and the expected profile of the loan requirement.

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Sources/background papers:

- Joint Venture Development Partner – Contract Award (Cabinet, December 2017)
 - Asset and Place Strategy (Cabinet, April 2019)
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