	Housing and Growth Committee **14 June 2021**
Title	**Northway/Fairway Proposed Approach to Site Disposal**
Report of	Chairman of the Housing and Growth Committee
Wards	Hale
Status	Public with accompanying Exempt Report (not for publication by virtue of paragraph 3 of Schedule 12a of the Local Government Act 1972 as amended as this relates to information of a financial or business nature)
Urgent	No
Key	Yes
Enclosures	None
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Summary

This report sets out the proposal for the Council to enter into a commercial arrangement with a developer/funder that delivers the social and environmental regeneration to meet the future housing demand and support the economic prosperity of the borough. The creation of an income generating asset will also help reduce the Council's budget gap and generate both a Capital receipt and additional Council tax revenue. This asset will be a Build to Rent (BtR) product, consisting of a minimum of 150 residential units of which 50% are affordable.

The proposed transaction is a sale and leaseback arrangement whereby the Council grants the developer a major interest in the land i.e. a 125- year lease (Council retains the freehold) and out of that interest the developer grants a lease for 40-years back to the

Council. There are no upfront costs to the Council, as the preferred developer (Kuropatwa Group) takes all design, planning and development risk and obtains its own funding to enable it to develop out.

Upon financial close i.e. conditions being satisfied one of which is planning consent being granted, the developer will pay a lump sum (purchase price) to the Council for the value of the lease land, which will accord with the developer's bid to the Council, received during the competition process. The Council will also sign up to an agreement for lease with the developer. Once practical completion takes place, the Council is under an obligation to pay a guaranteed CPI indexed linked rent to the developer for the proposed 40-year term, subject to a collar (1%) and cap (4%) arrangement. This is a mechanism used to set the minimum and maximum that the Council's rent can increase, regardless of market conditions. The figures outlined in the exempt report are indicative only and will be finalised prior to financial close. i.e. satisfaction of the conditions of the agreement for lease.

The full operating, maintenance, insurance and occupancy risk for the term will be managed by the Council, in collaboration with the developer, with day-to-day management outsourced to a management company (ManCo) who specialise in the BtR sector with all services that they provide being branded in the name of the ManCo i.e. white labelled.

At the expiry of the lease term the Council acquires the asset back for £1.00 and at that point the Council either continue to rent, refinance, or sell the assets benefiting from capital growth over the 40-year lease term.

Recommendations

1. **That Committee notes progress to date in respect of the proposals for the development of the Northway/Fairway ("the Site") delineated at Figure 1 paragraph 1.4 below.**

2. **That Committee approves the proposed sale and leaseback approach to the development of the site.**

3. **That Committee approves the Kuropatwa Group as the preferred developer for the delivery and sale and leaseback approach on this Northway/Fairway site.**

4. **That Committee delegates authority to the Deputy Chief Executive acting in the best interests of the Council and in consultation with the Chairman of the Housing and Growth Committee to: -**
   - **agree the final terms for the proposed transaction.**
   - **negotiate finalise and complete the terms of the required documentation to be entered into with Kuropatwa Group (including companies within that group) to give effect to the agreed finterms as referred to above.**
   - **to negotiate, approve, finalise, and complete such other documents as may be required to effect implement fund deliver and/or manage the scheme.**

- **approve and conclude the exchange of an agreement for lease and Leaseback to be entered into with an appropriate company within Kuropatwa Group subject to such agreement being compliant with the Council's statutory obligation to obtain the best price reasonably obtainable as evidenced by an independent valuation;**

5. **That subject to approval from the Policy and Resources Committee this Committee approves the creation of a management company (ManCo) by the Council for the ongoing management of the completed units at the Site and to enter into the proposed sub-underlease with the Council as outlined at paragraph 3.8.**

6. **The Committee approves that, if planning permission is received for the development, the Deputy Chief Executive (acting in the best interests of the Council and in consultation with the Chairman of the Housing and Growth Committee) be authorised to approve the final red book valuation for the site.**

7. **That the committee (i) approves the advertising as required to appropriate to the required use or to appropriate to planning purposes any part of the Site deemed or designated as Public Open Space in accordance with S122(2A) of the Local Government Act 1972 and (ii) delegates to the Deputy Chief Executive the consideration of any objections received following the conclusion of the above advertising process.**

8. **That the Committee delegates to the Deputy Chief Executive if appropriate following the conclusion of the consideration of any objections to advertise pursuant to s 123(2A) of the LGA 1972 or s 233 of the Town and Country Planning Act 1990 the disposal of any land referred to at 7 above which is to be comprised as part of the Site.**

9. **That subject to paragraph 7 that the Committee delegates authority to the Deputy Chief Executive to authorise that the whole or any part of the Site as may be required be appropriated for planning purposes pursuant to s 122 of the LGA 1972 and to commence negotiations and settle any lawful claims asserted by third parties pursuant to ss 203 and ss 204 of the Housing and Planning Act 2016.**

10. **That the Committee authorises that the Deputy Chief Executive may instruct as required the appropriate Council officers to make any applications to the Secretary of State for consent to enable the lawful disposal of the Site.**

11. **That the Committee delegates authority to the Deputy Chief Executive in consultation with the Chairman of this Committee to make any alterations to the extent of the Site with the above recommendations to apply to the Site as altered.**

1. WHY THIS REPORT IS NEEDED

1.1 As reported to the Housing and Growth Committee on 9th July 2020, the Northway/Fairway site is part of a programme of Council owned sites under investigation for development and disposal. The site was identified as having potential to meet a number of the Council's housing delivery objectives and the potential of generating a return that is commensurate with the risk associated with any development.

1.2 This report sets out the case for the preferred approach to deliver these objectives on the Northway/Fairway site and seeks Committee approval for the project team's preferred approach to delivering these objectives on the Northway/Fairway site.

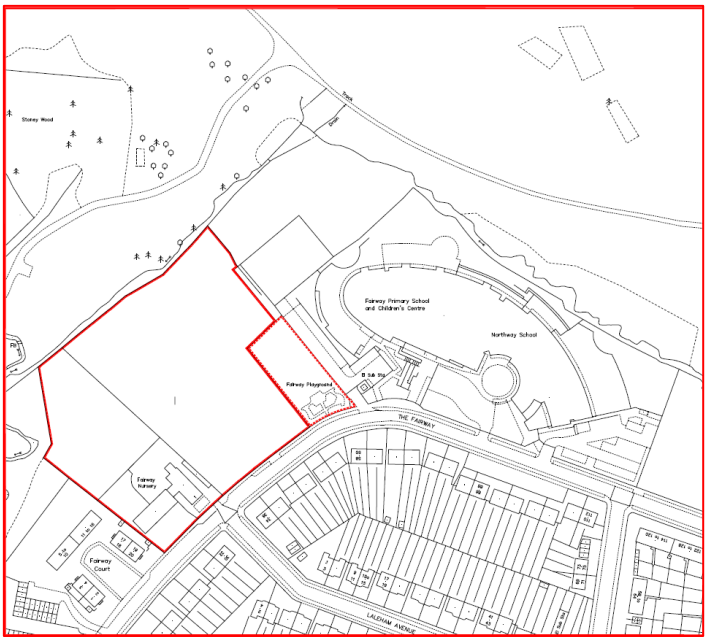
The Northway/Fairway Site

1.3 The site is on land adjacent to Northway Primary School, The Fairway, NW7 3HS and comprises of:

- 1.51 hectares (3.73acres).
- Prime residential area with good road connections and public transport.
- Mill Hill Golf Club located to the north of the site.

1.4 The intended Site is shown below. It incorporates a parcel of adjacent land to the south which is being considered for inclusion in the sale with any appropriate price adjustments to be reflected in the final disposal terms:

Figure 1: The Northway/Fairway Development Site



1.5 The disposal and future development of the Northway/Fairway site provides an opportunity for LBB to contribute to private sector and affordable housing supply targets in several ways and to raise income from rents.

2. REASONS FOR RECOMMENDATIONS The Barnet Plan 2021-2025 includes implementation of the Growth Strategy, which sets out how we will offer greater local opportunities, create better places, encourage more active lifestyles and over time increase the health and well-being of Barnet's residents. One of the key goals of the Growth Strategy is to deliver more homes that people can afford, ensuring that communities across the borough get a 'growth benefit' from investment. This proposal directly contributes to that aim.

2.2 The Northway/Fairway site is part of a rolling programme of site disposals and developments that generate capital receipts and / or revenue, all of which are designed to help close the Council's forecasted budget gap.

2.3 The population in Barnet is expected to increase by 16% from 391,500 to 466,500 by 2041. The recent Strategic Housing Market Assessment shows that there is a need to provide up to 3,060 new homes a year to accommodate this growth.

2.4 Barnet faces significant challenges when providing a suitable mix of good quality housing in meeting the changing demographic and economic make-up of the Borough. Whilst the need to tackle these challenges is not new, it will become more apparent in the future as the population continues to rise and housing targets set by the GLA / Central Government increase. The development of this site contributes to meeting this challenge.

2.5 The decline in the affordability of home ownership together with pressure on the social rented sector has prompted growth in the rented sector. Growth in the Build to Rent (BtR) sector is supported by a record level of investment of just under £3.5 billion in 2020. This has been followed up by a record-breaking £1.23 billion invested in the first quarter of 2021, signalling a fast start and continued confidence in the market (source: Savills BtR market update Q1 2021).

2.6 The Council has an important role to play in delivering government targets for housing growth over the coming years. MHCLG published figures show that Barnet delivered just under 2,000 homes per annum in the three years to 2019, 82% of its current target of 2,364.

2.7 The proposed 150+ unit scheme for the Northway/Fairway site contributes to these targets and requirements. The redevelopment of this brownfield site for

mixed use housing provides a long-term asset that will support future housing delivery objectives of the Council and create employment opportunities both during and after construction.

2.8 A key investment objective is to create stable and low risk long term returns to generate sustainable long-term returns to support the financial stability of the Council in line with its Capital Strategy.

2.9 Growth and Corporate Business Services has a set of priorities with cover the council, the borough, residents and visitors. One of these priorities is: **Thriving**: A place fit for the future, where all residents, businesses and visitors benefit from improved sustainable infrastructure & opportunity which the scheme delivers against. The scheme will also deliver against the **Healthy** priority: a place with fantastic facilities for all ages, enabling people to live happy and healthy lives.

2.10 The scheme will also contribute to long term growth in the borough by being an anchor point for long term regeneration and placemaking.

3. BACKGROUND

3.1 The proposal is to develop a BtR product which consist of a minimum of 150 residential units on the Northway/Fairway site. 50% of which will be at affordable rent levels. This will be a mix of either London Affordable Rent, London Living Rent and Discounted Market Rent.

3.2 BtR is a specific asset class designed, built & managed for the rental customer in mind. It's a lifestyle experience for the tenants. This is different from the existing Private Rented Sector (PRS) offer because it provides high-quality, purpose-built homes with professional management and longer tenancies for those who want them.

3.3 BtR can also increase the overall supply and accelerate the construction of new homes, as its model is to build and rent the homes straight away so that income can be generated. BtR delivers the following:

- Increases to the overall supply and acceleration of the construction of new homes.
- Greater choice for tenants in the rental market.
- A better quality of rental product that is professionally managed.
- An opportunity for the Council to generate a long-term income stream to invest in local priorities.

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3.4 For the tenants, BtR provides an enhanced experience when compared to a normal PRS product, this may include the following:

- No deposits
- Longer term, family friendly tenancies
- Predictable rents
- Concierge
- Resident Lounges
- Gym
- Roof gardens
- Open space
- Tech-enabled management solution
- On-site staff and 24/7 security
- Superfast broadband
- Storage lockers
- Bike sheds

3.5 BtR attracts persons and families from various professions as can be seen in the illustration below. 25% are from Financial and insurance activities and 15% from IT/Information and communication, marketing and advertising. These sectors have been resilient through the current pandemic which led to continued rental revenue against such schemes during an otherwise difficult period.

Figure 2: Build to Rent occupants by employment sector.

Employment sector	Build-to-Rent
Accommodation and food service activities	4%
Administrative and support service activities	3%
Arts, entertainment and recreation	4%
Construction and Manufacturing	3%
Education	4%
Financial and insurance activities	25%
Health and social work activities	4%
IT/Information and communication, marketing and advertising	15%
Lawyer and legal professional	3%
Other service activities (e.g. recruitment consultants, photographers, journalist, fitness instructor)	20%
Public administration	1%
Real estate activities	3%
Transportation and storage	1%
Wholesale and retail trade; repair vehicles	3%
Not Working (stay at home parent, student, unemployed, retired)	6%

3.6 The current proposed transaction for the site is a sale and lease back between the developer and the Council as the best commercial structure. To note this is not a procurement of a development partner with enforceable development obligations, but primarily a land asset disposal that must satisfy best consideration. A large number of local authorities are looking to fund projects in a more flexible way, and in doing so are looking to the external markets to source a wide range of debt products. Where there's income to support the debt, products are linked to annual increase (e.g. housing) then authorities are testing out index linked products to access the benefits of cheap early year payments; thereby increasing viability.

3.7 Under this structure the Council grants the developer a major interest in the land i.e. a 125- year lease and retains the freehold, out of that interest the developer grants back to the Council a lease for 40-years if and when practical completion is achieved. There are no upfront costs as the developer takes all design, planning and development risk. Upon financial close i.e. planning consent being granted, the developer will pay a lump sum (purchase price) to the Council for the land, which will accord with the developer's bid received during the competition process.

3.8 On financial close, the land will be disposed, and ownership will transfer to the developer with an obligation to grant the Council a 40-year lease on practical completion. During the period between financial close and practical completion, the developer will have ownership of the land with the Council awaiting practical completion for the lease agreement to be in place.

3.9 Once practical completion takes place, and following the grant of the underlease/leaseback to the Council , the Council is under an obligation to pay a guaranteed and indexed linked rent to the developer for the proposed 40-year term subject to a collar (1%) and cap (4%) arrangement (this is a mechanism used to set the minimum and maximum limits that the LBB rent can increase within).

3.10 The way the commercial structure works is the rent received from the Council's occupational tenants is greater than the rent payable by the Council to the its immediate landlord under the 125 year headlease, which is intended to provide the Council with a profit rent, through the life of the development.

3.11 At the expiry of the under-lease term the Council acquires the asset back for £1.00 and can then either continue to rent, refinance, or sell the assets. Over the 40-year lease term, the assets are highly likely to increase in value due to capital growth, providing an additional return on the investment, over and above the annual revenues.

3.12 This is the optimal structure as it enables the Council (acting via a wholly owned Management Company) to create Assured Shorthold/Assured Tenancies (AST), which do not give rise to secure tenancies and, in turn, avoids the potential of any Right to Buy (RTB) interest being created. AST tenancies are commonly used by Registered Providers (RPs) but cannot be granted directly by local authorities. Managing the assets via a wholly owned management company enables the Council to do so. The Council will therefore grant an underlease of 40 years less 3 days to its wholly owned management company, which in turn will grant occupational tenancies to individual occupiers. The proposed structure has been reviewed by KPMG from a tax and VAT liability perspective and found to be compliant and tax efficient.

4. SITE PROPOSAL

4.1 The approach taken on Northway/ Fairway due to its proximity to the Greenbelt is different and not blandly conceived or passively reliant on transport links for its demand. Instead, this exciting scheme will be a destination development with uniquely high-quality design that is perfectly suited to the rapidly emerging profile of customers for BtR.

4.2 During the pandemic, many workers have increasingly experienced working flexibility, beyond a very strict 5-day office-based week. So, tenants are looking for space and more comfortable locations. The scheme is therefore seeking to cover a broader demographic than just the youngest new professionals and will also likely include a slightly older demographic. As such, a good level of on-site parking, tenant's own front door, accessing a cobbled mews street, and a safe and healthy environment for families has the potential to be extremely attractive to prospective tenants and it is this that the preferred developer is proposing.

4.3 Should the development be approved, it will provide amenities that enable it to exist as a destination community. Beyond that, it will take advantage of its exceptional location, backing directly onto the green belt woodland and a golf course. This is a unique opportunity for tenants to enjoy a lifestyle unavailable in more built-up areas and something that site will make the tenancies eminently marketable, as many renters will choose a uniquely designed, delightfully 'green' suburban location over a busier, noisier, urban location.

4.4 An area of the BtR market which is gathering momentum is suburban / single-family BtR. This is predominantly single-family houses in regional towns and locations. The site is not seeking to offer a limited product of this sort and is rather a multi-family product to attract a wider demographic and housing options.

4.5 Private tenants will need to meet an eligibility criteria and household income must exceed a 30-x multiplier i.e. 1 bedroom rent @ £1,500 x 30 requires a household income of £45,000. This is the ratio of one month's rent x 30 being equal to the gross annual household income and is widely used as a metric across the country to provide assurances that rents are affordable. Prospective tenants are therefore expected to demonstrate this prior to entering a new lease. The typical length of a BtR tenancy is between 2-5 years in terms of occupational rent income flow.

4.6 For London Living Rent (LLR) units in the development, there is an affordability safeguard which ensures that LLR units are 20% below market rent and LLR is therefore currently capped at £1400 a month for all homes, inclusive of service charge, for household income up to £60,000.

5. ALTERNATIVE OPTIONS CONSIDERED AND NOT RECOMMENDED Whilst the Council has agreed in principle to this sale & leaseback approach to the development of the Northway/Fairway Site, several other options were considered by the project team, they are shown with their pros and cons in figure 3.

Figure 3: Other options considered

Delivery Option	Pros	Cons

Do Nothing	• Path of least resistance and change • No long-term risk associated with underoccupancy	• Does not make best use of the site • Doesn't provide significant level of income & return for LBB
Traditional Disposal	• More straightforward delivery option for LBB • No long-term risk associated with underoccupancy	• Less LBB influence on use of the site • Provides lower level of income & return for LBB than other options
LBB PWLB funded development	• LBB retains full control over scheme design and configuration • LBB retains site and all asset ownership	• There is a risk new prudential code guidance doesn't allow PWLB borrowing for this scheme where one of its objectives is income generation • LBB required to manage the development and associated risks • Requires LBB to establish delivery structures and various partners • All risk of under occupancy on future revenue streams remains with LBB • PWLB interest payments reduce contribution to LBB general fund to 25% of what an sale and leaseback could deliver over 40-years for same scheme

5.2 The sale and leaseback forward funding commitment solution was judged by the project team to be the preferred option for the development of the Northway/Fairway site and is reflective of a best consideration disposal, satisfying Section 123 of the Local Government Act 1972.

6. POST DECISION IMPLEMENTATION

6.1 The following table in Figure 4 sets out the key next steps to ensure successful project delivery in a robust and timely manner:

Figure 4: Project delivery and next steps

No.	Step	Explanation	Timing
1	Agree agreement for lease with Kuropatwa	Develop the detailed structure of deal and enter into a conditional agreement for lease with Kuropatwa after approval from Housing and Growth Committee	6 weeks
2	Establish Internal Project Governance Board.	Project monitoring	12 weeks
3	Stoney Wood Property Developments Ltd Mobilisation	Appointment of Kuropatwa's multi-disciplinary team	6 weeks post agreement closure
4.	Submission of Planning Application	RIBA stage 3	39 weeks post agreement closure
5.	Start on site	RIBA stage 4- 5	78 weeks post agreement close

7 IMPLICATIONS OF DECISION

7.1 Corporate Priorities and Performance

7.1.1 The Council's corporate plan sets out the aim to ensure Barnet is a pleasant, well maintained borough that is protected and invested in by:

a) Ensuring decent quality housing that buyers and renters can afford, prioritising Barnet residents by increasing supply, ensuring greater housing choice for residents, and delivering new affordable housing, including new homes, on Council-owned land.
b) Investing in community facilities to support a growing population, such as schools and leisure centres that will be delivered by investing in community facilities such as enhancing our indoor and outdoor sporting facilities and maintaining our 21st century libraries.
c) Responsible delivery of our major regeneration schemes to create better places to live and work, whilst protecting and enhancing the borough.

7.1.2 The Growth and Corporate Services Business Plan has a set of priorities which cover the Council, the Borough, residents, and visitors. One of these priorities is: *Thriving: A place fit for the future, where all residents, businesses and visitors benefit from improved sustainable infrastructure & opportunity*. The scheme will deliver against this priority in the following sub-priorities:

a) Delivering the borough's approach to economic growth and development

b) Developing the council's estate to deliver new homes, jobs, and sustainable council finances.
c) To enable town centres and our regeneration areas to thrive

7.1.3 The scheme will also deliver against the Healthy priority: a place with fantastic facilities for all ages, enabling people to live happy and healthy lives. The scheme will deliver against this priority in the following sub-priorities:

a) Develop the built environment improving the health of the whole community.
b) Delivering projects to improve parks, open spaces, and leisure facilities.

7.1.4 The draft London Plan and draft Local Plan recognise the need to deliver more housing in the Borough. The council's Growth Strategy continues to emphasise that delivering more homes that people can afford is a key priority and sets out how the council will deal with a number of challenges including high prices, a shortage of affordable housing and the potential threats to the qualities that make the borough attractive.

7.1.5 The Council has a forecasted budget gap over the Medium Term Financial Strategy (MTFS), and it is estimated that Northway/Fairway could contribute c.£700k pa towards closing this gap. This will continue to be kept under review as the delivery of this scheme progresses.

7.2 Benefits

7.2.1 The table below shows the main benefits of the proposed sale and lease back delivery solution with Kuropatwa as the preferred partner:

Figure 5: Sale and leaseback benefits:

Benefit	Description
Lower risk for LBB	• LBB would not have to contribute any financing to the project • Turnkey development solution under a single management structure, no development or construction risks for LBB
Contribution to housing targets	• Scheme provides 150 new homes as minimum, with the ability to increase density subject to planning permission • 50% of these will be affordable homes • Creates a variety of housing tenures

Income for LBB	• Proposal generates net income for LBB general fund of over 40-years, this includes:
	  ○ An initial lump sum payment.
	  ○ Regular revenue income.
	  ○ Additional Council Tax revenues for LBB.
	  ○ New Homes Bonus income.
	  ○ Increased Section 106 and CIL income for LBB.

Additional benefits for LBB	• Creation of employment and training opportunities throughout the build phase. • Improved use of the site and estate environment that will be secured by design. • Improved quality of accommodation including new communal facilities, e.g., gardens, café etc. • Facilitates a new Build to Rent development in Barnet. • Improved public realm within Barnet with quality architecture. • Contribution towards improved health and wellbeing.

7.3 Resources (Value for Money and Procurement, Property, Finance)

Value for Money and Procurement

7.3.1 The Council placed an advert in the Estate Gazette for a period of four weeks seeking expressions of interest from potential private sector partners to deliver the Northway/Fairway development. Bids that allowed the best possible assessment of delivery and financing options were invited. This marketing process confirmed that the sale and leaseback approach to the delivery of the site is the preferred option.

7.3.2 The Council received thirteen expressions of interest from a range of organisations by the advert deadline of 21 May 2020. The evaluation and moderation process were as follows:

- Identification of thirteen organisations who could meet the Council's objectives for the site.
-
- Initial evaluation and moderation reduced the shortlist to six potential bidders taken forward to stage two of the evaluation.
-
- These six organisations were invited to submit their design and innovation proposals for the site along with their financial models.
-
- The Council issued a financial model proforma based on the delivery of 150 units on the site, for completion by the bidders, to enable a direct and fair comparison of the bids.
-
- The six bids were individually evaluated, followed by a moderation scoring exercise to confirm the top three ranking bids who were shortlisted and taken forward to the interview stage. This included post tender clarifications and due diligence work that included company health check reports, ratio analysis and stress testing.

7.3.3 The Kuropatwa proposal meets the best consideration test from a s123 perspective and delivers the greatest positive impact for the Council's general fund, the greatest contribution to the Council's housing targets and was the best conceptually designed scheme. The proposal scored 92 out of a possible 100, significantly higher than the other bidders. Complete analysis of the financial exercise is set out in the exempt report. Further details are in the exempt report.

7.3.4 Kuropatwa scored the highest in the bidder's financial due diligence exercise and as such represent the lowest overall risk of the shortlisted bidders. Complete analysis and outcomes of the procurement exercise are in the exempt report. Further details are also in the exempt report.

7.3.5 The primary purpose of the transaction is a land transaction and, as such it falls outside of the Public Contracts Regulations 2015.

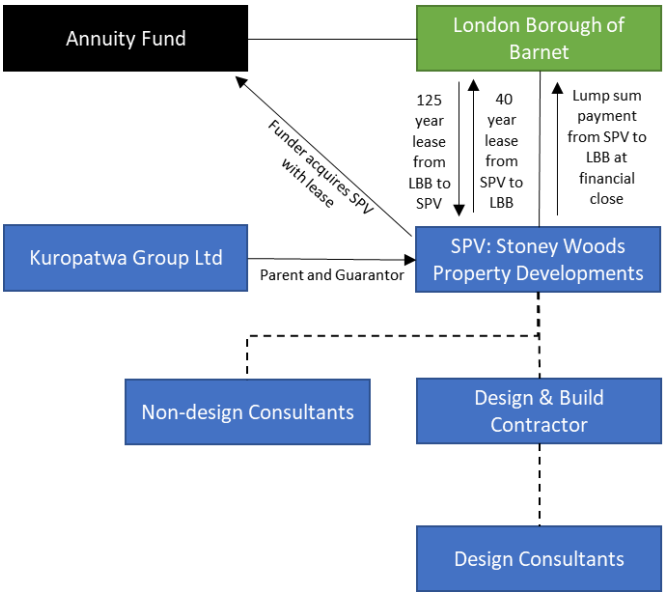
Property

7.3.6 It is proposed that the developer Kuropatwa will establish a development company (Stoney Woods Property Developments) to deliver the scheme under the agreement. This will deliver the build in two phases:

Phase 1 - Preparation for site development and all activities up to obtaining planning permission (RIBA stage 3).

Phase 2 - Construction and delivery of the scheme (RIBA stage 4 and 5).

Figure 6 -This delivery structure is illustrated below:



7.3.7 Once the preconditions to start on site have been satisfied (e.g. planning permission), the Council will grant a 125-year lease of the site to Stoney Wood Property Developments

7.3.8 Upon practical completion (RIBA stage 6).

- Kuropatwa Group will sell 100% of its shares in Stoney Wood Property Developments, to its long-term annuity funder. However, because this is a share sale rather than a transfer of the long lease, the Council's relationship will still be with Stoney Wood Property Developments with the annuity funder now being the parent.

7.3.9 Stoney Wood Property Developments grant a 40-year lease back to the Council.

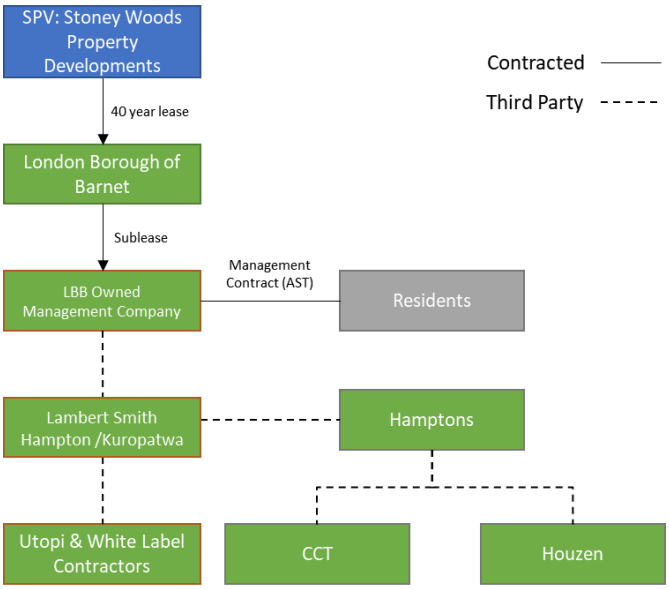
7.3.10 The full operating, maintenance, insurance, and occupancy of the units will strategically be managed by the Council in collaboration with the developer, with day-to-day management outsourced to a management company who specialise in the rental sector with all services white labelled. The management company will be a wholly owned subsidiary of the Council and responsible for its own financial statements i.e., profit and loss, Tax, VAT, auditing etc. It will take an underlease from the Council of the whole of the site, for a term of 40 years less 3 days, enabling it to grant occupational tenancies of the individual units.

7.3.11 This management company (ManCo) will be a wholly owned company (WOC) of the Council with its own financial statements i.e. profit and loss. This is the optimal structure as the Council (via the ManCo) can create AST tenancies (Assured Shorthold Tenancies) which do not give rise to secure tenancies which in turn avoids the potential of any RTB interest being created. AST tenancies are commonly used by registered provides but cannot be granted directly by local authorities, the management company enables us to do so. The proposed structure has been reviewed by KPMG from a tax and VAT liability perspective.

7.3.12 The Council has been in discussions with consultants who specialise in advising clients in the BtR sector on the most efficient delivery of management services, in order to inform the procurement of a suitable partner, closer to the time that the development is completed.

The following illustration shows the bidder proposed structure of the management services arrangement.

Figure 7 – Management Structure



7.3.13 Kuropatwa have committed to making a contribution to cover any shortfall the operating expenditure of the site in year one between c.£450k to £1m. The full details will be covered in the agreement for lease.

Finance

7.3.14 The transaction structure is a sale and leaseback arrangement between the Council as the Freeholder and Kuropatwa (Developer), acting through its SPV Stoney Wood Property Development Limited. Under this arrangement Kuropatwa Group Ltd will provide the Council with a guarantee in relation to Stoney Wood Property Developments. The guarantee is provided by a developers/contractor's parent company in connection with the obligations under a disposal and lease agreement. If the developer/contractor should default on its obligations, as per the guarantee, liabilities can fall on the parent company to complete the contracted obligations of the subsidiary.

7.3.15 Upon practical completion of the development, Kuropatwa Group Limited will sell 100% of the shares in Stoney Wood Property Development to its identified external annuity funder. The Stoney Wood Property Development Limited will remain in place within the lease structure but its ownership will change.

7.3.16 The Council takes no design, planning or delivery risk but will pay a guaranteed and Consumer Price Index (CPI) linked rent, subject to a collar of 1% and a cap of 4% for a period of 40-years to the landlord. At the end of the 40-year lease the Council acquires the revisionary interest back for £1.00 and can continue

to either rent the properties, sell them or refinance with a significantly enhanced asset value at the expiry of the long lease term.

7.3.17 The proposal in this report would help deliver the investment objectives of the asset acquisition strategy. Under the terms of the arrangement the Council will not provide any capital funding, all development risk will remain with the developer.

7.3.18 The 40-year lease-back to the Council will be deemed a finance lease as all the risks and rewards associated with the asset are passing to the Council.This will result in the asset being recognised on the balance sheet with an equivalent liability recognising the payments to be made to the developer over the lease term.

7.3.19 Upon the satisfaction of conditions i.e. planning, a lump sum will be payable to the Council.

7.3.20 It is estimated for each affordable housing offered at the site; this would lead to a £3,400 per unit indirect saving to the Council's temporary housing budget.

7.3.21 An assessment was undertaken comparing the option of the Council self-delivering the scheme through Public Works Loan Board (PWLB) borrowing and the sale and leaseback proposal. Further details are in the exempt report.

Key points to note are:

- This model uses the Kuropatwa proposal as its base, as this is the housing redevelopment scheme preferred by the Council and it also makes the greatest contribution to housing targets and objectives.
- The financial outputs outlined in this report are indicative only and will be reviewed and finalised prior to financial close.
- Amendments to paragraph 45 of the prudential code state that borrowing for debt-for-yield investment is prohibited unless incidental to the main function e.g. regeneration. There is a risk, therefore, that PWLB cannot be used for this scheme and until further case studies are available. PWLB borrowing was only used as a comparator from a value for money perspective for completeness, the modelling took into account the option for the council to borrow the development costs from PWLB at 2.42% over 40-years.
- The model was run based on 3 scenarios:
    - CPI at 0.6% (as per developers' submission).
    - CPI at 2.0% (as per Bank of England current target).
    - CPI at 3.0% (contacted cap).
- With the above scenarios, CPI at 0.6% and 2.0%, sale and lease produced a greater return than PWLB borrowing when discounted to Net Present Value (NPV). When taking into consideration the lump sum with the 3.0%

modelling, sale and lease produced the greater monetary return overall, when discounted.

Combined with other risk factors of a self-build option and PWLB borrowing, this makes the Kuropatwa sale and leaseback model the most viable option, when comparing to PWLB and accounting for Net Present Value (NPV), for the development of the Northway/Fairway site.

7.3.22 Further modelling was undertaken by an independent consultant, 31ten Consulting to determine the value for money for sale and leaseback against PWLB borrowing (both annuity and maturity loans) and self-build on a like for like basis. This modelling was based on Monte Carlo simulations which involves undertaking 1000 simulations linked to inflationary history with trends and patterns applied a set of base assumptions. The key outputs from the model are:

- 99% of the simulations showed sale and leaseback as the financially favourable delivery model.
- 1% of the simulations showed PWLB annuity as the favourable delivery route.
- PWLB maturity did not show as favourable in any of the scenarios.
- A risk adjusted position was calculated by applying the result at the lowest possible output (when discounting outliers). This showed the sale and leaseback model to be financially favourable by an NPV of £6.7m

Further details are in the exempt report.

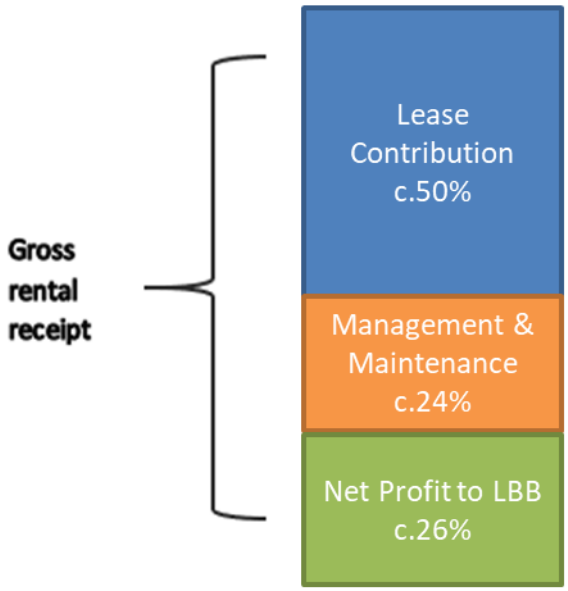
7.3.23 The Kuropatwa proposal and financial model has been thoroughly tested and analysed by the Council. The developer assumed a 3.5% rate of voids and bad debts throughout the 40-year life of the proposed scheme.

7.3.24 Key points to note on this sensitivity analysis, carried out by the LBB project team, are:

- A drop in revenue of 20% still produces an income to the Council, but at a lower level (reduced by 45%).
- Voids and bad debts would have to increase to 37.35% of the estate total for the scheme to not produce any return for the Council.
- Similarly, revenue would need to drop by 44% to not give the Council a return. This would equate to an average of a further 64 units being unoccupied out of 150.
- Kuropatwa has taken independent advice into the assumptions underpinning the rental assumptions proposed in their financial model.
- The expected split of gross rent revenues would be, c.50% income to the developer, c.24% to cover maintenance and estate running costs and c.26% to the Council. Figure 7 illustrates a typical gross rental revenue split under the sale and leaseback model.

Further details are in the exempt report.

Figure 8: Indicative gross rental receipt splits



7.3.25 An exercise was undertaken to determine the average minimum rental inflation needed for the scheme to break even. It was discovered that at 3% (2% CPI + 1%) the minimum average annual rental increase will be 0.327%. At 4% (3% CPI + 1%) this would be 1.458% per annum.

7.3.26 As a part of the financial exercise, the Council played out several scenarios which put forward prudent and worse case scenarios to identify the impact to the general fund. The following scenarios were modelled as a part of this exercise and average general fund impacts identified:

Original Bid

Scenario 1 = Kuropatwa bid. This provides the council an average general fund return of £1.7m per annum.

Breakeven Case:

Scenario 2 = a 44% reduction in revenue to achieve cost neutral position when making lease payments to the developer based upon the original model

Worse Case:

Scenario 3 = a 4% indexation (maximum possible because of the cap) on the lease payment year on year. i.e. lease payment increases, with revenue inflation as per original bid (1.6%) results in a c.£174K loss per annum

Scenario 4 = Indexation of 4% (maximum possible because of the cap) on the lease payment, plus a 44% revenue reduction results in a £1.9m loss per annum. Rent increase remain as per original bid (1.6%)

- If the 44% of the units were converted to temporary accommodation, this would reduce the average loss to £1.0m per annum.

Scenario 5 = Indexation of 4% (maximum possible because of the cap) on the lease payment, plus a 20% revenue reduction results in a £0.9m loss per annum. Rent increase remain as per original bid (1.6%)

- If the 20% of the units were converted to temporary accommodation, this would reduce the average loss to £0.6m per annum.

Scenario 6 = If zero properties were let, based on the bidder model, this will result in an average negative impact of £2.7m

- If used as temporary accommodation, the general fund impact would be a loss of c.£0.2m per annum.

Scenario 7 = As above plus 4% (maximum possible because of the cap) lease payment would result in a loss of £4.7m per annum

- If used as temporary accommodation, the general fund impact would be a loss of c.£2.1 per annum.

Further details are in the exempt report.

7.3.27 Market intelligence was sought due to the current economic uncertainty. Upon discussions with the market it was discovered that area rents may decrease by 10% and management costs are expected to be 27%. This was modelled further to understand the impact to the previous bidder's proposal.

Key points to note are:

- Revenue decreases by 9%
- Expenditure reduces by 2.9%
- General fund impact reduces by 24% from £69.536m to £53.352m which is a reduction of £16.184m.

Further details are in the exempt report.

7.3.28 On-going to market to obtain a funder, the market may demand a higher yield which can adversely affect Council income. During this time Red Book

valuations by external advisors and further modelling take place to identify any risks.

8 Social Value

8.1 Increasing the utility of existing assets through mixed use redevelopment will enable the Council's portfolio of assets to go further towards supporting local needs by helping to provide new opportunities for housing, (in particular, affordable housing) and new, improved community facilities.

8.2 Any contractors or parties involved in the development will be encouraged to provide opportunities for employment, training and apprenticeships for local people and use local suppliers where appropriate.

9 Legal and Constitutional References

9.1 The financials are included in the exempt section as it contains commercially confidential information (relevant legislation -paragraph 3 of part 1 of schedule 12 A of the Local Government Act 1972 (as amended) and the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

9.2 The Council's Constitution, Article 7 – Committees, Forums, Working Groups and Partnerships sets out the responsibilities of all council committees. The H&G Committee includes responsibility for:

- housing matters including housing strategy, homelessness, social housing and housing grants, commissioning of environmental health functions for private sector housing
- regeneration strategy and overseeing major regeneration schemes, asset management, employment strategy, business support and engagement.

9.3 Council, Constitution, Article 10 Table A states that the Housing & Growth Committee is responsible for authorising all disposals of land for over £500k and any disposal which is not for best consideration.

9.4 Council Constitution- Article 7- Committees Forums Working Groups and Partnerships- Policy and Resources Committee- the remit of this Committee includes responsibility for Strategic policy, finance and corporate risk management including Capital and Revenue Budget, Medium Term Financial Strategy and Corporate Plan to Full Council and to be responsible for those matters not specifically allocated to any other committee affecting the affairs of the Council.

9.5 Specific legal /title matters for the Sites will be explored as part of the process to identify any legal risks or constraints.

9.6 Where land is subject to third party rights it may be prudent to appropriate the land for planning purposes to extinguish third party rights thereby engaging sections 203 and 204 of the Housing and Planning Act 2016 ("HPA 2016"). Section 122 of the Local Government Act 1972 ("LGA 1972") empowers a local authority to appropriate land held by it from one statutory purpose to another if it considers the land is no longer required for the purpose for which it is currently held and appropriation is in the public interest. Such matters will be explored through the process of Site and legal review. The Council in contemplation of the justification of its use of planning appropriation powers will need to satisfy the same criteria as those set out for the use of its compulsory purchase powers, that is that the use of these powers is necessary to promote the social economic or environmental wellbeing of all or any or all resident persons in its area. There are particular considerations relating to the appropriation of public open space land which must be adhered to by the Council in reliance on section 122(2A) of the LGA 1972 and appropriate recommendations are contained in this Report.

9.7 The Site listed for development are held in the general fund. Local authorities are given powers under Section 123(1) of the Local Government Act 1972 (as amended) to dispose of land held by them in any manner they wish but the disposition must be for not less than best price that can be reasonably obtained as assessed by a valuer. Any disposal at less than best price that can be reasonably obtained requires the express consent of the Secretary of State unless there is a general consent available on which the Council can rely. The general consent (Circular 06/03: Local Government Act general disposal consent (England) 2003) will apply where the Council considers the disposal of the site will contribute to the achieving or securing the promotion or improvement of the economic, social or environmental well-being of its area and the difference between the restricted and unrestricted value does not exceed £2,000,000, in which case no specific Secretary of State consent is required.

9.8 Where any of Site comprises public open space the advertising requirements for the disposal of open space pursuant to S.123 (2A) of the Local Government Act 1972 apply. The proposed disposal must be advertised for two consecutive weeks in a newspaper circulating in the area in which the land is situated, with any objections to the proposed disposal being considered by the Council during such time as specified in the notice. Any objections made to the disposal will have to be considered before the disposal proceeds.

9.9 The disposal of land which has been used as school playing fields is regulated by the Schools Standards and Framework Act 1998 ("the SSFA") and any disposal or change of use of qualifying land which is used or has been used as a school playing field in conjunction with a maintained school in the last ten years will pursuant to s 77 of the SSFA require before it can lawfully be disposed of, the prior consent of the Secretary of State.

9.10 Section 1(1) of the Localism Act 2011 bestows a general power of competence on local authorities which permits them to do anything that private individuals generally may do, but this is subject to the general principles of public law. The Council will need to have regard to the account in which any housing stock is ultimately to be held and the provisions of s 74 of the Local Government and Housing Act 1989 including any financial adjustments between the Councils general fund and Housing Revenue Accounts which may be required to be made.

9.11 Section 4 of the Localism Act 201e enables the Council to do for a commercial purpose anything that it is empowered to do under section 1 of the 2011 Act.

9.12 Section 95 of the Local Government Act 2003 allows a local authority to do for a commercial purpose anything which they are authorised to do for carrying on any of their ordinary functions, provided that they do so through a company.

9.13 The stock that is to be held by the Council will be mixed tenure. Any stock that is intended to be let as social rent housing, will be held for the purpose of Part II of the Housing Act 1985, and accounted for through the Housing Revenue Account as mentioned above. with the required accounting adjustments to reflect the appropriate consideration/value of the land being transferred from General Fund to the HRA. In relation to other stock, where the Council is acting for a commercial purpose then as set out above it should do so through a company. Therefore, the Council intends to either incorporate a new company, or utilise an existing wholly owned company, to let and manage any non-social-rented stock within the scheme.

10 Risk Management

10.1 Transactions of this nature carry a range of risks which are effectively detailed below. A number of risk factors, including planning, title investigations, commercial terms, warrant early due diligence. For example, if planning permission regulating the development in terms of scale, nature/use class and restrictions do not materially align with the annuity funders pitch or value assumptions, the associated risk may impact on usage of the completed development and consequential income.

10.2 The covenant strength of the developer has been considered by the Council by obtaining company health check reports and parent company guarantees will be put in place.

10.3 As the Council has no direct funding obligations, upon practical completion the Council will enter the lease structure with Stoney Wood Property Development. The Council will retain step in rights as a part of the agreement for lease arrangements. The funder acquiring the shares in Stoney Wood will have every incentive to enforce the build obligations against the developer in the agreement for lease to arrive at the point where practical completion is achieved and it can require the Council to take the 40 year lease back and obtain the income that flows from that.

10.4 The arrangement with the Council acting as a tenant is not without risk. Due diligence has been undertaken on the financial modelling. If further due diligence is required, this will be undertaken by independent advisors.

10.5 Inflation was stripped from all the bidder's financial models to establish a baseline position and compare all bidders on a like for like basis. Financial sensitivity analysis has also been undertaken to understand at what thresholds the Council are exposed to any losses.

10.6 On-going to market to obtain a funder, the market may demand a higher yield then what has been modelled by the developer. Thus, reducing the possible modelled rental income to the Council. Red Book valuations will be undertaken to mitigate this risk.

10.7 Although there is no borrowing required to enter into this deal, the Council will be assuming obligations under the 40-year lease with Stoney Wood Property Development to with an obligation to pay an index linked rent for the lease term, the rental modelling demonstrates this. The 40-year lease is not assignable, so the Council remains liable to pay the index linked rent throughout the term regardless of the rental income it itself is achieving from occupiers.

10.8 There are options to mitigate the rental risk in the event of market downturn for example an option could be to use the units as temporary accommodation or to convert any vacant private units to affordable.

10.9 Planning risk can either add or remove value however this is borne by the developer.

10.10 Construction risk- All development and construction risk are borne by the developer

10.11 Market risk- External agency reports have been produced a detailed report included valuation will be commissioned prior to entering into an agreement to lease

10.12 Operator default- This will be managed and operated by a wholly owned company who will commission an operator to manage day to day activities. On N/Fairway the developer has committed to contributing towards year 1 management & operating costs, in the event of any shortfall.

10.13 Funding Risk- No direct funding obligations, the Council only enters the lease at practical completion i.e. once the units are built.

10.14 Contractual issues- The Council will be obligated to pay guaranteed rent on a non- assignable basis (this means we cannot transfer the lease to a third party). Prior to planning consent being granted we will negotiate with the developer the option to convert the units for alternative use should this ever be required – This will require a capital sum as planning consent would be required.

10.15 Financial risks- Payments to the developer will be fixed with annual indexation. The model shows a c.20-25% rent profit that can be held in a reserve to offset any shortfall in rent, this will provide security; the current model assumes 3.5% void rate.

10.16 The lease from the developer will be deemed a finance lease all risk and reward with the asset sit with the authority from practical completion.

10.17 The table at Figure 9 outlines key risks at this stage of the project, gives an assessment of their severity and details proposed mitigating actions:

Figure 9: Risk analysis, impact, and mitigating actions:

Risk	Impact	Mitigation
Development risk	**None** – Due to the developer taking on all development risk	Mitigated through Sale and Leaseback as developer is burdened with the entire development risk (both financial and delivery)
Developer default/failure	**Low** – Parent Company Guarantee in place. Step in provisions in place from the developer/annuity funder to find alternative contractor. Council not committed until practical	Financial due diligence taken place with Parent Company Guarantees to be in place

	completion therefore can appoint own contractor.	
Reduced profits due to lease inflation outstripping market rent inflation	**Medium** – Allocated council savings will need to be met by reserves or other means.	Change tenure from London Living and London Affordable Rental units to Discounted Rental units to increase revenue
Inflation linked lease payments outstrips rental affordability leading to a reduction in profits	**Medium** – Allocated council savings will need to be met by reserves or other means.	Profits held in reserve to top up any shortfall to the lease payment. Collar & Cap arrangement in place at 1:4% to ensure protection against hyper- inflation
Under occupancy	**Medium** - Empty units with zero income which will impact council savings targets.	Adjust rents to compete with market and adjust again with upturns – current modelling assumes 3.5% voids and bad debt.
40-year non assignable lease	**Low/Medium** - No break clause 'on the hook for 40-years.	To ensure the product remains attractive in the marketplace and offers consumer choice maintaining high occupancy over the long term.
Asset falls into disrepair	**Low** - Possible additional costs and reduced profits due to poor operational and management	Management and operational costs to include reserve to manage any repairs and large maintenance issues. KPI's to be in place with operator and reviewed monthly. Council to appoint Asset manager.

11 Equalities and Diversity

11.1 The 2010 Equality Act outlines the provisions of the Public-Sector Equalities Duty which requires Public Bodies to have due regard to the need to:

- Eliminate unlawful discrimination, harassment and victimisation and other conduct prohibited by the Equality Act 2010.
- Advance equality of opportunity between people from different groups and foster good relations between people from different groups.

11.2 Any Equalities Impact Assessments will be undertaken on individual schemes as they are brought forward, and the proposals outlined will give appropriate consideration and where required consider any matters raised in these assessments. However, the proposals in this report are not considered at this stage to raise any negative impacts for equalities and demonstrate that the Council has paid due regard to equalities as required by section 147 of the Equality Act 2010.

12 Consultation and Engagement

12.1 Consultation and Engagement plans will be developed for sites that are deemed suitable for development and stakeholder engagement undertaken as the designs progress.

13 Insight

13.1 The Council's Housing Strategy and emerging Local Plan respond to evidence such as the Strategic Housing Market Assessment and other needs assessments that have identified a need for increased housing delivery.

14 BACKGROUND PAPERS

14.1 Development Portfolio Programme.pdf (moderngov.co.uk) Agenda for Housing and Growth Committee on Monday 6th July, 2020, 7.00 pm (moderngov.co.uk)