Agenda Item No: 3

SALE OF A PORTFOLIO OF PROPERTIES TO CAMBRIDGESHIRE HOUSING & INVESTMENT COMPANY

To:	**Commercial and Investment Committee**
Meeting Date:	**23 February 2018**
From:	**Deputy Section 151 Officer / Resources Directorate**
Electoral division(s)	**All**
Forward Plan ref:	**2018/017** *Key Decision:* **Yes**
Purpose:	**To declare the properties identified in the schedule below surplus and agree the disposal sale of the properties to Cambridgeshire Housing & Investment Company (CHIC). To confirm the associated financing arrangements.**
Recommendation:	**It is recommended that:-**

(1) The Committee approve the disposal of the properties identified in the schedule (Appendix A) to CHIC at 'best consideration'

(2) The final terms of the disposal be delegated to the Deputy Section 151 officer in consultation with the Chairman of the Committee

(3) The Committee receive feedback on the effectiveness of the process at a future meeting

(4) £11.005m of the loan facility agreed in principle by the Committee in December, now be confirmed as available to CHIC in relation to the properties listed in the schedule at Appendix A (in line with section 3 of this report)

(5) Equity to the value of £0.551m is invested by the Council into CHIC alongside the foregoing loan finance arrangements

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1. BACKGROUND

1.1 The County Council has established a wholly owned housing company to develop on land primarily owned by the Council in order to derive a financial return. The underlying objective of creating a commercial vehicle of this nature is to provide new revenue sources to support the delivery of front line services to Cambridgeshire residents. In this report, the company is referred to as Cambridgeshire Housing & Investment Company (CHIC), its registered name at Companies House. Members of the Committee have been briefed about plans for the company to operate under an alternative trading name in due course.

1.2 The financial model that the Committee have previously agreed will be adopted is that the Council will make loans to CHIC, at commercial rates in order to provide the funding to allow CHIC to purchase land from the Council and to finance the costs of construction. As the Council can borrow at less than commercial rates it will derive a financial margin on the loans. This margin has already been included as a revenue benefit within the Council's budget. The Council will receive capital receipts and eventually also dividends from the Company but this will not arise for a number of years given the debt ratios of the Company in the early years of trading and the lead times for delivery of residential housing on sites currently used for other purposes.

1.3 The Council's Constitution provides that the authority for all property disposals rests with the Commercial and Investments Committee (C&I), with an agreed delegation to the Director of Finance to exercise that authority for transactions where the capital value is less than £500,000, or the revenue value is less than £150,000.

1.4 Previously at a meeting on the 30 June 2017 the Commercial & Investment Committee when considering the principle of selling sites to CHIC agreed "to declare surplus land and property on a case by case basis to achieve best consideration".

1.5 Following initial plans to stagger sales to CHIC, at a meeting of C & I Committee on the 15 December 2017 it was agreed to bring forward the sale of all of the sites in the development pipeline in a single sale process, a "portfolio " approach, by the end of March 2018.

1.6 In December, the Committee also resolved, in principle, to grant a loan facility of up £120m to CHIC, at a commercial rate, for land acquisition, construction and associated costs. The Committee then delegated negotiation of the sale and loan agreements to the deputy section 151 officer in consultation with the Chairman of the Committee, with the outcome of further negotiations reported back. It is now reported that the independent valuations have been received for the 13 sites listed in the schedule (confidential appendix A). Approval is now requested to activate the loan facility up to the value of £11.005m against those sites, together with an equity investment of £0.551m. These amounts will then be increased following the March committee receiving further site valuations.

1.7 CHIC acts as an arm's length company and officers responsible for property deal with it on that basis. There are two loans already in place from the Council to CHIC for operating and overhead costs and for the acquisition of a site of strategic importance to CHIC from a third party.

2 PROPERTY AND VALUATION ISSUES

2.1 **Valuation**. Savills have been appointed to carry out independent “Red Book” valuations of the sites taking into account known liabilities and the prospects for obtaining planning consent. A programme has been agreed and work commenced at the beginning of January. At the time of writing 13 valuations have been obtained from them. Valuations were previously obtained (from a different supplier) for Milton Rd, Russell St and the former Highways Depot at March. A similar report will be presented to Committee in March with further valuations forming the remainder of the portfolio.

2.2 Queries are resolved before valuations are accepted and Heads of Terms are sent to CHIC. LGSS Law Ltd are also instructed so that they are in a position to move swiftly to completion once the committee approve the sales.

2.3 Savills have noted a dearth of comparable valuation evidence for development sites being sold without planning consent as they are usually sold with planning consent. Valuations are more straightforward and less assumptions have to be made if planning consents are in place. This makes the overage provision (see 2.6 below) particularly important in achieving an appropriate value.

2.4 Of the initial 13 sites, Milton Rd and March Depot sites have planning consents while Willingham, Shepreth, Littlington and Burwell have planning consents subject to s106’s contributions being agreed.

2.5 Savills have valued sites as they are, assuming that planning consent will be obtained. Where planning consent has been obtained the full value will be paid otherwise a discount is applied to the value with planning consent to reflect the risk of getting a consent.

- Where planning consent has been agreed subject to s106 a 15% discount has been applied to the value with consent.

- Where planning consent has not been obtained discounts of up to 70% have been applied to reflect the risk involved in obtaining the consent.

2.6 In order to protect the Council’s interests, as much of the enhanced value as possible will be recovered using overage clauses applied when planning consent has been obtained, subject to CHIC’s reasonable costs being deducted.

2.7 Some urban sites may be subject to a later price adjustment if the developer encounters abnormal costs, for example contamination or archaeology or if the developer makes a windfall gain that could not have been anticipated at the time of planning. This would be subject to a further valuation.

2.8 **Timing.** The aim is to transfer sites on the 31 March 2018. Some sites are large and will be sold in phases and there may be unforeseen complications which may delay transfers.

3.0 FINANCING ARRANGEMENTS

3.1 At its December meeting, the Committee:

- authorised, in principle, a loan facility to Cambridgeshire Housing and Investment Company for up to £120,000,000, at a commercial rate, for land acquisition, construction and associated costs

- delegated the negotiation of the final terms of the sale and loan agreement to the deputy Section 151 Officer in consultation with the Chairman of the Committee, including the repayment and interest charging arrangements, and that the outcome of any further negotiations will be brought back to Committee

3.2 Following the progress of the valuation work set out in section 2, it can be reported to the Committee that the value of the sites numbered **1** – **13** in the confidential Appendix A, totals £11.005m. In this report, the Committee is therefore asked to agree that these sites can be transferred to CHIC at those valuations, in line with policy, and that provision of a secured loan to the same value also be made available to CHIC.

3.3 As set out in the December report, the Council will make a 5% equity investment alongside any loan financing. In relation to these land transfers this therefore requires an equity investment by the Council of £0.551m. The Council will make full use of the securable value of the loan by loaning at the 100% rather than 95% level, with the 5% headroom created used to enable initial construction spending by CHIC. This facility will be further increased by the remainder of the portfolio to be valued shortly, and to be considered at the next meeting. It is envisaged that this mechanism will provide secured finance to meet CHIC's construction and other non-land development costs until at least June 2018. Further loans for construction and other non-land costs are also envisaged in due course. By their nature construction loans will have a lower level of security, and are more likely to require phased draw down to reflect staged completion of works. A further report will be made to Committee on the financing of this activity as it progresses, and ahead of CHIC requiring this cash flow.

3.4 The loan enabling the land acquisition of the thirteen sites listed will be secured. This means that were CHIC to default on the loan, the Council would have the priority registered charge on the property. It will be necessary for CHIC and the Council to agree a legal borrower mortgage in relation to the sites. A mortgage has already been put into place for land that CHIC is acquiring, with CCC financing, from a third party. It is envisaged that a mortgage of a similar form, with minor modifications will again be appropriate for these sites. The agreement sets out obligations on the borrower in relation to the condition and value of the site that protects the Council's financial interests.

3.5 The December report outlines in more detail the state aid and procurement considerations which require the Council to enter into loans with CHIC on a commercial and arms-length basis, which is reflected in the resolution made by the Committee. The loans to be activated as part of the portfolio sale are for up to ten years in line with the CHIC business plan.

4. FINANCIAL RATIONALE AND RISK ASSESSMENT

4.1 CHIC has undertaken detailed financial modelling for the sites and developments that it will acquire as a result of the portfolio sale. The initial business case has been developed significantly to reflect site valuations, cost estimates and timings and reflects quarter-by-quarter income and expenditure estimates across the next decade for each of the sites under consideration. As with any undertaking of this type, the financial model is underpinned by a series of assumptions and sensitivities. CCC finance officers have assessed the assumptions within the model and a two-way dialogue with CHIC and their financial advisors continues to monitor, maintain and measure the variables contained within financial model.

4.2 Overall, the financial modelling continues to demonstrate that CHIC is an appealing investment prospect for the Council over the long term, with initially significant interest payable to the Council ahead of residential sales and profit making in CHIC in later years. The anticipated minimum interest receivable from CHIC in 2018/19 in relation to the sites listed as 1-13 in the appendix is also reported in that appendix. The financial model demonstrates an indicative surplus on the 13 sites following completion of residential development of between 4% and 41% compared to sums expended by CHIC, leading to a positive cash position on those sites.

4.3 Sensitivity analysis undertaken by CHIC illustrates across the whole programme that the company remains able to make full repayment of loans and scheduled interest to the Council in the event either that there is a 20% increase in cost estimates, or a 5% decrease in house prices coupled with a 15% increase in planned costs.

4.3 The Council has assessed the key risks and mitigations in relation to the project as follows:

RISK	PROBABILITY	MAGNITUDE	MITIGATION
CCC not receiving best consideration	**Low**	**High**	Property transfers at independently assessed market value by Independent Chartered Valuation Surveyors and CCC have a right to overage in addition.
General downturn in housing market	**Medium**	**Medium**	CCC will receive Market Value upon sale. Overage payments will be sensitive to market conditions but are a longer term consideration and can also increase over time.
Building cost escalation	**Medium**	**Medium**	Cost escalation will affect all competitors although may effect less mature developer without established supply chains more than longer established concerns.
Poor performance by developer	**Low**	**High**	CCC ultimately controls developer via 100% shareholding. CCC can 'step in' in certain circumstances and determine activity contract but there will be an effect on reputation
Significant planning consents not obtained	**Medium**	**Medium**	Most unlikely that all permissions will be denied and in the longer term any hindrances should erode with the effluxion of time and the increasing pressure to secure housing sites.
Construction delays	**Medium**	**Medium**	Build up efficient supply chains as soon as possible. Financial incentive (interest payments) to progress construction as soon as possible.
Abnormal costs reducing viability	**Low**	**Medium**	Largely a risk of urban sites, the developer will have made contingencies as have the valuers when arriving at Market Value. Mechanism proposed to share abnormal costs that would not have been found pre-contract.
CHIC over claim construction costs or costs of obtaining planning permission	**Low**	**Medium**	CHIC undertake to use proper procurement methods and to inform CCC of process with Financial Models of larger sites transparent for CCC inspection in order to calculate profit share so poor procurement practice can be identified if it occurs. With 100% shareholding CCC can take steps to remedy any such actions.

4.4 Summarised alternatively, the key measures for risk mitigation that are in place include:

- **Externally assured valuations according to globally accepted methodology** – ensuring that property transferred to CHIC is at an appropriate value
- **Overage and profit share provisions within sales agreements, commitment to best value procurement approach by CHIC –** protecting the Council's interests where values change following the land transfer due to the stage in the development pipeline at the point of transfer
- **Ultimate control of CHIC as shareholder –** appointment of board of directors and through shareholder accountability to ensure performance of the company to expected standards

and objectives

- **Loan and mortgage agreements –** security of the Council's loan financing, protection of the value of the asset and reference back to the Council in terms of alterations and obligations related to sites; recovery of investment in event of sale of asset.

- **Visibility of CHIC's financial planning, assurance and viability –** confirming overall financial logic and targets remain robust, appropriate and favourable to the Council's budgetary objectives.

5. ALIGNMENT WITH CORPORATE PRIORITIES

5.1 Developing the local economy for the benefit of all

Sites developed across the county will undoubtedly contribute to the local economy creating additional jobs in the house building industry. In turn those employed in the industry will create secondary spend in the localities where they work and live.

5.2 Helping people live healthy and independent lives

There are no significant implications for this priority.

5.3 Supporting and protecting vulnerable people

There are no significant implications for this priority.

6. SIGNIFICANT IMPLICATIONS

6.1 Resource Implications

The sale of assets to CHIC are included within the Council's Business Plan. Delays to the original profile of sales is causing an in year pressure and this has already been reported to GPC within the Integrated Finance Report. This reports seeks to ensure that the sale of sites takes place within a portfolio sale within the current financial year thereby mitigating further capital and revenue implications. These are highlighted in the report. Overall, the report sets out the favourable resource implications to the Council from progressing the housing development vehicle described.

6.2 Procurement/Contractual/Council Contract Procedure Rules Implications

Bevan Britain LLP and LGSS Legal Ltd have advised on procurement, best consideration, lending and security, accelerating implementation and State Aid. Specific procurement considerations related to delivery of an ongoing "public sector" segment of the Milton Road site have been considered and addressed.

6.3 Statutory, Legal and Risk Implications

Specialist legal advice has been sought jointly from Bevan Brittain LLP on procurement, best consideration, lending and security, accelerating implementation and State Aid. LGSS Law have also advised.

The legal requirement for the Council to achieve best value in the sale of its assets is set out in the report. In addition the legal requirement for the wholly owned commercial company to maintain independence from Council governance processes has been identified.

6.4 **Equality and Diversity Implications**

There are no significant implications within this category.

6.5 **Engagement and Communications Implications**

There are no significant implications within this category.

6.6 **Localism and Local Member Involvement**

Local Members have been notified of the proposed site for transfer.

6.7 **Public Health Implications**

There are no significant implications within this category.

Implications	**Officer Clearance**
Have the resource implications been cleared by Finance?	Yes Name of Financial Officer: Tom Kelly
Have the procurement/contractual/ Council Contract Procedure Rules implications been cleared by the LGSS Head of Procurement?	Yes/No No implications raised.
Has the impact on statutory, legal and risk implications been cleared by LGSS Law?	Reference made to the Disposal Process of Property Assets that was agreed at the Committee's meeting on 30 June 2017. LGSS Law lead on disposal is Mickaela McMurtry.
Have the equality and diversity implications been cleared by your Service Contact?	Yes Name of Officer: John Macmillan
Have any engagement and communication implications been cleared by Communications?	Name of Officer: Christine Birchall Head of Communications and Information
Have any localism and Local Member	Yes

involvement issues been cleared by your Service Contact?	Name of Officer: John Macmillan
Have any Public Health implications been cleared by Public Health	N/a

Source Documents	Location
Schedule of properties to be declared surplus (Confidential)	**Appendix A (Confidential)**
Site-by-site listing of properties for transfer as part of this phase of the portfolio sale	**Appendix B (Confidential)**
Paper to C& I Committee 30/06/17	https://tinyurl.com/y73aq6u5
Paper to C& I Committee 15/12/17	https://tinyurl.com/y7nosuat