

Shareholder review of This Land

To: Strategy & Resources Committee

Meeting Date: 27 January 2022

From: Director of Resources

Electoral division(s): All

Key decision: Yes

Forward Plan ref: 2022/024

Outcome: The Committee will receive the results of the review of This Land. Areas for action are identified, in order that the Committee, as shareholder and lender, can gain greater assurance about the company achieving long term objectives, aligned to the Council's priorities and risk exposure.

Recommendation: The Committee is invited to:

- (a) Receive the report into This Land from the reviewer;
- (b) Take account of the reviewer's recommendations, as set out at section 3.5;
- (c) Agree the actions for the Council, as set out at section 3.6; and
- (d) Note that a further monitoring and progress report on This Land will be received at the March meeting.

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1. Background

1.1 Following a commitment in the joint administration agreement, and a recommendation from the LGA Peer Challenge, the County Council has commissioned a detailed external review of its wholly owned property development company, This Land. The appointed reviewer was Avison Young (AY), a multi-national real estate services consultancy with no prior involvement with the This Land project. The AY review team comprised chartered surveyors and accountants alongside other experienced property and planning professionals. AY have now concluded their work and reported. Their findings are attached as an appendix and are introduced by this report.

1.2 The questions set for the review were as follows:

- Are the assumptions that This Land has made in its latest business plan reasonable and robust?
- Is there a clear understanding about the exposure to risk, particularly in the medium term?
- How could This Land adapt its plans to adjust its risk appetite or strategy?
- How could the firm quicken the pace of housing delivery and are there examples from other local authority related housing companies?
- Does This Land have the skills, capabilities and expertise to be expected of a housing development company of this type?
- Is the company operating effectively and with good governance in order to deliver the business plan?

AY have considered these questions and made recommendations as a result of their findings.

1.3 This Land, for their part, welcomed the commencement of the review, which followed the submission of the 2021 Business Plan to the Council as shareholder. Although the Council has previously commissioned a series of professional reports from advisors and diligence activity in relation to the company (such as appraisal assurance, monitoring surveyor and independent valuations for mortgage purposes on individual developments), this review represents a comprehensive consideration of the company's overall strategy, risk exposure and business activity and assumptions. It is the most thorough overview since the company commenced operations.

1.4 This Land was incorporated in 2016. From the outset, the primary objectives of the company have remained providing homes that are in much demand in this region alongside a revenue income stream to the County Council. As at January 2022, the financing advanced to This Land by the County Council is as follows:

| | |
|-----------------|-----------------|
| Long Term Loans | £113.851m |
| Equity | <u>£ 5.851m</u> |
| Total | £119.702m |

These figures are (as planned) unchanged from the last update to this Committee in September 2021. This Land's statutory accounts, published in October, confirm the This Land group had net liabilities on its balance sheet of £14.1m as at March 2021. It will be evident that, therefore, the Council has significant financial exposure to the company and is

invested in its business success. Diminution of the investment value or returns from This Land, or divergence from the long-term plan for overall profitability are a recognised risk in the Council's corporate risk register. Although the structure of the company has enabled the Council to receive revenue interest to date (and a £6m net contribution remains expected this financial year) there have been concerns about This Land's operations in its early years, and in particular the pace of housing delivery which is crucial to the company's commercial success. This underpins the validity of sums the company has already paid to the Council.

- 1.5 In addition to interest, the Council has also already received capital receipts from This Land in excess of £75m. Property was transferred to This Land at values assessed by an independent appointed valuer.
- 1.6 In April 2020, the company adopted a significant revision to its business plan in order to address deficiencies in its assumptions and planning that had developed in its early years. The AY review recognises that This Land is making some good progress with delivering against that April 2020 plan, but also highlights the status and position of risk and ambitions further ahead in the current plan. A key initial focus of the April 2020 plan was disposal of a number of land parcels which This Land has identified are best developed by others, and thereby reducing its commercial and cashflow exposure. Having delivered on this relatively successfully for the last 15 months or so, much improving its near-term cashflow position, the company is now at an important transition point. Attention will need to switch to housing delivery and construction at five sites during the next twelve months as well as its activities as a 'master developer' (at the largest sites at Worts Causeway, Burwell and Soham) and strategic land promoter. This makes the timing of this review particularly apposite, and an important opportunity to ensure there is confidence in the way ahead emerging from agreed recommendations and next steps.

2. Reviewer's findings

- 2.1 In this section, attention is drawn to AY's key findings. This Land have assured the Council that they actively co-operated with the review and provided in the region of 1200 documents to a short turnaround. However, a general comment made by AY is that there were gaps in the information held by the company and the completeness of replies.

2.2 Are the assumptions that This Land have made in its business plan reasonable and robust?

Is there a clear understanding about the exposure to risk, particularly in the medium term?

- Overall, individual appraisals for identified properties (those already sold by the Council to This Land) are in-line with market and AY's expectations and benchmarking.
- There were some anomalies or omissions identified on individual sites and some non-standard approaches to accounting for costs (such as for marketing and contingency). AY also highlighted that the accounting for financing costs outside of individual development appraisals is unusual.
- Macro analysis of risk facing the enterprise is in place, but site-specific risk registers were not available. No specific risk management discussion on the board agenda.
- Sensitivity analysis has been carried out, but without a mitigation plan for adverse

scenarios.

- The company's financial model is output reporting tool, rather than a modelling mechanism, which reduces its transparency and functionality.
- Although there has been a 2021 Business Plan update, in several respects this is superficial and lacks detail about downside and upside of actual and projected financial performance. Effectively there has not been a full business plan review for more than 18 months.
- Crucially, the Company's business plan relies on further acquisitions and strategic land promotion, in the medium term, but identification of sites is behind schedule. In particular, the assumptions about specific purchases from the Council have not been validated. The profile and awareness of this dependency is not sufficient.

2.3 How could This Land adapt its plans to adjust its risk appetite or strategy?

- Opportunities exist for emphasis on broader objectives (e.g. affordable and key worker housing) and greater contribution towards net zero carbon homes target
- These opportunities likely to come at the cost of a negative impact on the financial return received by the Council and increased delivery risk, and will need to be considered in the context of the commercial constraints the company faces

2.4 How could This Land quicken the pace of housing delivery?

Does This Land have the right skills, capabilities, and expertise?

Is the company operating effectively and with good governance?

- More partnership working could increase the delivery capacity of This Land and provide expertise in changing areas of focus (with potential sharing of risk, and reward). Partnerships can also be strengthened with the Council, as shareholder.
- The company structure provides for good oversight and challenge, and there are indications of some recent improvements in transparency and communications.
- There is though, a lack of visibility and robustness in several areas including the downside of financial performance and reporting, meaning governance enhancements are needed
- This Land has a number of high calibre directors, but board composition has weaknesses. Opportunities to consider the size of the board and resourcing balance between different elements of the company.

3. Commentary and recommendations

3.1 The review has highlighted several shortcomings at This Land and criticisms of operations or assumptions which require immediate attention. There is ongoing constructive discussion with This Land about the areas for improvement and it is recognised that both short-term urgent actions and longer-term change will be required. This requires both effective leadership by the company, and clear objectives from the Council with robust oversight governance to hold the company to account as shareholder and lender.

3.2. Financial and commercial: A key issue is the dependency on:

- assumed future acquisition of specific land from the Council at three locations (these assumptions are not realistic in terms of timing or scale, and in one case the Council has already made a policy decision not to transfer to This Land at one location)
- strategic land promotion: this is the higher risk activity of promoting planning consent

for land, added to the company plan as a diversification in 2020, but which is behind schedule

AY identified that identification of sites is significantly adrift of the schedule set out in the company business plan.

In regular discussions with the This Land executive, they are upbeat about these deliverables and are confident that reasonable opportunities exist in the property market to meet these requirements, even if it comes forward in a different size and shape from the specifics currently detailed. Whilst this is some reassurance, it remains the case that at this stage these are unsecured and behind schedule aspects of the business plan.

AY have not suggested the overall strategy for land development is unorthodox or that the company has a clear alternative to such activities to deliver the profit expectations built into its financial plans. The Council will need to work with This Land as it identifies appropriate business opportunities to meet the profit levels that the Council is already assuming through its collection of interest.

- 3.2.1 The financial model used by the company is complex and did play a useful role in progressing the adoption of the company plan that the former Commercial and Investment Committee received in April 2020. However, the model needs to be a live tool and fit-for-purpose, as AY has described, in that it should hold fully up-to-date information and be easily manipulated to model alternative scenarios and sensitivities to aid decision making on an ongoing basis. We understand This Land has committed to additional accountancy and financial modeller capacity to enable these improvements.
- 3.2.2 As a result of the review and our own ongoing monitoring, the Council is aware that several updates need to be made to the financial model. These include:
- ensuring that the data for all development sites is up-to-date in terms of timings and costs
 - where sale disposals have been made, sales values need to be updated as actuals or as revised estimates. (This is an example of a favourable adjustment relative to 2020, which provides some capacity for downside adjustments elsewhere).
 - correcting for any individual examples of omissions or double counting highlighted in individual development appraisals as a result of AY or internal review
 - applying contingency budgets on a site specific, rather than global basis (as recommended by AY)
 - making more appropriate assumptions about future site acquisitions (addressing the issue set out at 3.2 above)

And the presentation of financial information should also be improved by clearly splitting between secured and unsecured assumptions.

- 3.2.3 As these updates are made, there is a further task to ensure options around risk exposure and broader objectives (see below) are also brought forward and illustrated using a financial model in which there is confidence. This request was first articulated by the Council at the shareholder meeting on 30th September 2021 and supplemented in view of the latest developments and the AY findings at the beginning of December 2021. It is recognised that improving the financial model will be an iterative process, requiring proactive suggestions from the company and engagement from the Council. As at 10

January 2022, Council officers have seen illustrative and high-levelling modelling results for four variations to the current business plan, after making the key adjustments above. A further layer of analysis and narrative has been requested from This Land.

- 3.2.4 To illustrate the nature of changes that This Land may consider, they have produced an initial option which addresses the points set out 3.2.2 as well as increasing the number of affordable homes delivered, which generates the following results:

| Category | 2021 Business Plan | Revised option |
|---|--------------------|----------------|
| Interest already paid to CCC | £21.48m | £21.48m |
| Interest due to CCC in future | £54.27m | £58.99m |
| Profitability required from unsecured sites by 2031 | £50.26m | £39.61m |
| Residual cash at 2031 | £9.22m | £4.82m |

This is an initial option provided here to illustrate the dependency on unsecured sites alongside the scope for reducing risk and meeting wider objectives. It is anticipated that the company will engage further with the shareholder, through a planned workshop to look at these factors in detail, before recommending final options to its board.

3.3. Resourcing and personnel:

- 3.3.1 2022 is an important transitional year for the company as it shifts its focus from land selling, to house building and land acquisition/promotion, whilst also addressing the reforms arising from the AY review and summarised in this report. Further progress can be made with culture, communications, governance and meeting any broader objectives agreed with the Council. The leadership of the company in this context is crucial. The chairman of the company completes his term of office shortly, having made a valuable contribution to the progress made to date. The shareholder will take forward the appointment of a successor to lead the board through the important developments ahead.
- 3.3.2 Inside the company, AY's findings suggest that, whilst recognising the strengths of the current board, there are opportunities to bring wider perspectives and diversity of background into the company over time, and to consider refocusing resource from non-executive input to internal resourcing. Recent steps have been made by the company to secure additional land (acquisition/promotion) expertise and to undertake more financial analysis and modelling directly. The review suggests this is needed, to identify and progress key aspects of the business plan and to accurately understand this through management reporting.
- 3.3.3 For the Council's part, the proposal from AY to establish "mirror board" type arrangements will be adopted, as a way of formally considering the same information that the This Land board is receiving. The Council will review the additional resource it is engaging to oversee This Land, as well as the commissioned support from professional advisors.
- 3.4. **Strategy and objectives:** The AY report acknowledges that This Land began with reference to both housing supply and financial objectives, that the company has an arms-length and commercial character and its *structure* accords with good governance standards. The company was set very stretching financial targets and return expectations, and although these were reduced in April 2020, they remain demanding today; further

changes may be necessary once the detailed financial update described in 3.2 is complete. Financial return, and security of loans and interest payments has been the overriding priority. Associated with the maturing of the company to house building at greater scale, and the improvements identified as a result of this review, further consideration of strategy and ranking of objectives is needed. Following the shareholder meeting scheduled for 20 January 2022, a further workshop is planned for February 2022 to advance this further.

- 3.4.1 In their review, AY are careful to highlight that there is a potential tension between maintaining the expected levels of financial return from the company, some reduction in the company's risk exposure, and greater regard to broader objectives such as affordable or key worker housing and the net zero agenda. As improved reporting and analysis is brought forward and taking account of the upside on recent land sales, the Council expects there will be some limited potential to make progress in each of these areas but is also realistic about the tight parameters inherited from earlier company plans.
- 3.4.2 As set out at section 1.4, current borrowing by This Land is within the £150m envisaged as at the April 2020 submission and given recent favourable cashflows from land sales, This Land have suggested it may not be necessary to actually request all of the £6.3m that had been planned for the near-term. This will remain an uncertainty pending the updated financial modelling and options discussion mentioned elsewhere in this report.
- 3.4.3 AY draw attention to the tighter stipulations on PWLB borrowing that were implemented in 2020-21, which will need to be considered if, in future, any new lending to This Land is brought forward as part of the capital programme. In that context, ensuring the company prioritises objectives broader than a commercial return looks well-placed. Although the company has ongoing commercial targets which mean it must secure land acquisitions in future, it has exceeded its targets around land disposals and is projected significant surplus cash by 2031 alongside meeting all its capital repayment and interest obligations. On that basis, in accordance with the capital strategy, the Council has assessed that a minimum revenue provision (MRP) does not apply to the lending made to This Land. Draft changes to the MRP regulations nationally may prevent local authorities from excluding any part of our capital financing requirement from the MRP calculation, which would reduce the net revenue benefit that the Council can recognise in interest each year from This Land. This is not yet a certain outcome, as there has been significant sector feedback, and the Council is monitoring the position carefully.

3.5 The full recommendations made by AY, which are accepted by This Land, and submitted to this Committee, to take account of are:

| Target Area / Specific Activity to Address | Success Criteria | Timescale | Impact / Outcome |
|---|--|--|--|
| Develop a new financial model to support business decision making and improved governance | Board has full visibility of secure / unsecure income and expenditure and Board papers reflect enhanced financial sensitivity analysis | 1-3 month development period / 4-6 month implementation & full data transfer | A fully integrated and consistent financial management and monitoring tool. |
| Shareholder and Board Reports to be expanded to reflect secure and unsecure income and expenditure | Improved Board and Shareholder visibility of the financial gaps | 0-1 month | The Council will have a better understanding of This Land's ability to meet its loan payments over coming years |
| Establish a risk orientated approach to the allocation of contingency rather than a blanket 10% | Better shared awareness and visibility of key project risks. Information should be shared with the Board through the Board papers | 0-3 months | Improved risk analysis and quantification of key risks on a site-by-site basis leading to a more robust financial position |
| Greater emphasis on risks and potential mitigation measures | Improved visibility of key risks both impacting on the financial and operational aspects of the business | 0-1 month | Inclusion of a "live" risk register within the Boards pack and shareholder briefings |
| Diarise quarterly shareholder meetings, and agree information pack in advance | Well attended shareholder meetings | 0-1 month | Fully briefed shareholder with clarity of business direction as well as an in depth understanding of key risks and mitigations |
| Formal Shareholder review of This Land's strategic objectives in the context of new political objectives | Providing clarity to This Land of the Shareholders longer term vision for the company | 0-3 months | Improved balance between financial and non-financial outcome that better align to the Council strategic objectives |
| Establish a "Mirror Board" meeting, to take place prior to the This Land Quarterly Board meetings. | Provide greater oversight, challenge and support of the business | 0-3 months | Preparation of briefing for Council representatives on the Board in advance of Board meeting |
| This Land needs to review the sufficiency of internal resources allocated to the production of development appraisal information. | Better awareness of costs and income | 0-3 months | Improved robustness of information contained in the financial model which supports Board reporting |

3.6 Although a number of these activities require initiative from This Land, the actions which emerge for the Council are as follows:

- Confirm and update the company's objectives, through a shareholder/board workshop, including consideration of financial modelling options
- Confirm forward diary of shareholder meetings and review the shareholder agreement to ensure this is up-to-date and fit for purpose
- Establish the 'mirror board' arrangements, including senior officer and Member representation and commissioned professional advice
- Commissioned external assurance that the requested improvements to the company's financial model are implemented
- Implement consolidation of shareholder loans to This Land into a smaller number of loan parts, alongside an update to land/asset valuations for mortgages purposes
- Consider which future property disposals by the Council are most suitable for This Land, making any changes to the current disposal protocol as a result
- Consider the results of a forthcoming board effectiveness review and identify timescales for future board nominations and succession
- Provide an update on progress at the meeting of the Strategy & Resources Committee in March

4. Other This Land updates

4.1 The recent update from This Land include:

- Demolition work has started / imminent at three sites (Worts Causeway, which will be a 230 home development in South East Cambridge; Landbeach, which will be the location for two homes, and Fitzwilliam Road, where three town houses will be constructed close to Cambridge City Centre).
- Rebuilding work has started for three plots at Cityglades (Ditton Walk), this follows concerns about the steel frames constructed by the original contractor which have needed to be replaced.
- At Over, where 52 homes will be provided, groundworks are nearing completion and brickwork has begun. The Council and This Land will take forward releases of property charges and remaining overages at Over, in order to enable home sales to begin.
- This Land completed planned sales at Milton Road (Cambridge) and Hartford in late 2021.
- The company has been shortlisted for three industry awards for stakeholder and community engagement

5. Alignment with corporate priorities

5.1 Communities at the heart of everything we do

Through its housebuilding, This Land is committed to shaping places in order to contribute to the Council's efforts to create thriving places for people to live.

5.2 A good quality of life for everyone

There are no significant implications under this heading

5.3 Helping our children learn, develop and live life to the full

There are no significant implications under this heading

- 5.4 Cambridgeshire: a well-connected, safe, clean, green environment
The company has priorities to reduce its landfill to waste, commits to sustainable energy at its developments and engaging with communities

- 5.5 Protecting and caring for those who need us
There are no significant implications under this heading

6. Significant Implications

- 6.1 Resource Implications
The amount on loan to This Land is set out at section 1.4. Future interest expectations are summarised at 3.2.5. The forward looking assumptions the Council has made rely on the company's commercial success. This report as a whole is concerned with the operations of the company so as to provide increased assurance on the delivery of those expected returns.

- 6.2 Procurement/Contractual/Council Contract Procedure Rules Implications
There are no implications for procurement or contract procedure rules.

- 6.3 Statutory, Legal and Risk Implications

Assessment of principal risks:

| Description | Impact /Likelihood | Response/Mitigation |
|--|--------------------|--|
| <i>Construction:</i> cost, defects, materials, milestones | Impact: Medium | <ul style="list-style-type: none"> - Monitoring surveyor reviews of cost, progress and quality - Construction contingency budget - Insurance cover / warranties |
| | Likelihood: Medium | |
| <i>Planning & regulation:</i> timing, obligations & cost of meeting planning and building regulations approval | Impact: Medium | <ul style="list-style-type: none"> - Reviews of project plans/budgets for obtaining planning consent, progress and performance - Staff expertise - Land promotion diversifies planning authorities involved |
| | Likelihood: Medium | |
| <i>Workforce & Expertise:</i> attracting and retaining talent, capacity and experience | Impact: High | <ul style="list-style-type: none"> - Director recruitment process - Monitoring turnover & performance - Diversity of experience of team members, succession planning |
| | Likelihood: High | |
| <i>Health & Safety</i> - heightened by the coronavirus pandemic | Impact: Medium | <ul style="list-style-type: none"> - External independent H&S team - Review by monitoring surveyor - Company policy and procedures |
| | Likelihood: High | |
| <i>Governance risks:</i> securing best value, acting | Impact: Medium | <ul style="list-style-type: none"> - Ongoing legal representation, advice and review |

| | | |
|--|--------------------|--|
| at arms-length, legal challenge by competitors, state aid | Likelihood: Medium | - Adopt formalised memorandum(s) governing Council:Company interface - State aid reference rates adopted for loans |
| <i>Performance of strategic land promotion:</i> competitive area, securing agreements, reputation | Impact: High | - Council seeks independent validation - Careful site selection - Work closely with communities - Risk and sunk costs within financial model - Build successful track record |
| | Likelihood: High | |
| <i>Master developer and non-residential development models:</i> complicated and capital intensive | Impact: Low | - Monitoring surveyor reviews progress and performance - Regular review of complex commercial schemes - Full prior appraisal by This Land's Development & Investment Committees |
| | Impact: Medium | |
| <i>Housing demand and economic risks</i> | Impact: High | - Sales strategies prudent and based on regular review of local market - This Land to develop relationships with mortgage brokers and agents |
| | Likelihood: Medium | |
| <i>Future land sales to This Land:</i> land availability | Impact: Medium | - Promotion of land within local plans - Seeking alternative land across wider geography |
| | Likelihood: Medium | |
| <i>Underlying company value and security/collateral, impairment to inventory</i> | Impact: High | - Valuations to validate ongoing value of the firm - Internal appraisals to update This Land financial model - Security over work in progress and visibility that amounts invested lead to increased value |

In considering this report, the improvements recommended and next steps for the company, the Committee will be mindful of its fiduciary duty to Cambridgeshire taxpayers, with regard to best value, security of funds, risk and commensurate returns.

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

This Land executives have committed to enhancing engagement with Members. The next shareholder update meeting is scheduled for 20 January 2022.

6.7 Public Health Implications

There are no significant implications in this category

6.8 Environment and Climate Change Implications on Priority Areas

- 6.8.1 Implication 1: Energy efficient, low carbon buildings.
Positive – This Land is considering how it can enhance its contribution to lowering carbon in its building plans. The homes the company is building are heated by air source heat pumps rather than gas.
- 6.8.2 Implication 2: Low carbon transport.
Neutral - No changes proposed in this report
- 6.8.3 Implication 3: Green spaces, peatland, afforestation, habitats and land management.
Neutral - No changes proposed in this report
- 6.8.4 Implication 4: Waste Management and Tackling Plastic Pollution.
Neutral - No changes proposed in this report
- 6.8.5 Implication 5: Water use, availability and management:
Neutral - No changes proposed in this report
- 6.8.6 Implication 6: Air Pollution.
Neutral - No changes proposed in this report
- 6.8.7 Implication 7: Resilience of our services and infrastructure, and supporting vulnerable people to cope with climate change.
Neutral - No changes proposed in this report

Have the resource implications been cleared by Finance? Yes
Name of Financial Officer: S Howarth

Have the procurement/contractual/ Council Contract Procedure Rules implications been cleared by the Head of Procurement? Yes
Name of Officer: C Ellis

Has the impact on statutory, legal and risk implications been cleared by the Council's Monitoring Officer or Pathfinder Legal Services? Yes
Name of Legal Officer: F McMillan

Have the equality and diversity implications been cleared by your Service Contact?
Yes
Name of Officer: T Kelly

Have any engagement and communication implications been cleared by Communications?
Yes
Name of Officer: C Birchall

Have any localism and Local Member involvement issues been cleared by your Service Contact? Yes
Name of Officer: T Kelly

Have any Public Health implications been cleared by Public Health?
Not applicable

If a Key decision, have any Environment and Climate Change implications been cleared by the Climate Change Officer?
Name of Officer: E Bolton

7. Source documents

7.1 Appendix 1 Report on This Land from AY (with commercial redactions at Committee)