

**AGENDA ITEM**

**REPORT TO COUNCIL**

**31 OCTOBER 2018**

**REPORT OF  
CORPORATE  
MANAGEMENT TEAM**

**VICTORIA ESTATE REDEVELOPMENT: PRUDENTIAL BORROWING**

**1. SUMMARY**

- 1.1 The Victoria site has been a long established component in the journey to re-purpose Stockton Town Centre to reflect the modern role of the Town Centre. With the Hampton by Hilton Hotel due to open in early 2019, the Globe restoration well under way and the demolition of Elm House scheduled for late 2018, the opportunity to provide an appropriate, modern residential offer to meet need across the community remains at the heart of this proposal.
- 1.2 In March 2018, Cabinet granted approval to support a procurement exercise to seek a potential Joint Venture partner to bring forward a comprehensive housing redevelopment proposal for the Victoria site. Following the conclusion of this exercise Cabinet in September 2018 have agreed to the establishment of a Joint Venture Company and to the appointment Keepmoat Homes Limited as the Councils joint venture partner. The freehold site at Victoria will be transferred to the JV Company.
- 1.3 The close proximity of Victoria to the heart of the Town Centre provides an ideal opportunity to ensure that the physical connection is seamless where practical. The demolition of Elm House provides the opportunity to enhance public realm and bring forward additional residential development in the form of a future development phase. The connection to Norton Road plays an equally significant role and it is essential that later phases of Victoria explore improving this vital connection.

**2. RECOMMENDATIONS**

Council are asked to:

Approve prudential borrowing of £1.6m to fund a loan to the Joint Venture Company to support the cash flow requirements of the scheme. This loan will be repayable at a market rate (as detailed in para 14/15 of this report).

**3. REASONS FOR THE RECOMMENDATIONS/DECISION**

- 3.1 The Joint Venture Company will be established for the principal purpose of delivering housing on the Victoria site. The successful regeneration of the Victoria site will both enhance the housing offer available in this town centre location as well as supporting the ongoing transformation of Stockton town centre.
- 3.2 The scheme has an immediate cash flow requirement if it is to progress. This will be met jointly by both the Council and the joint venture partner Keepmoat Homes Limited. The Council will on-lend to the Joint Venture Company at a commercial rate. The Council will achieve a margin on any lending and consequently this will deliver income for the Council.

## DETAIL

### 4. Background

- 4.1 Members will recall that in March of this year, approval was granted (Cabinet Decision Record D180022) to proceed with a procurement exercise to seek a potential Joint Venture (JV) partner to bring forward the redevelopment of the Victoria site. The March 2018 Cabinet report highlighted that a number of local authorities have entered into JV partnerships and are delivering regeneration projects on similar sites to that of Victoria (i.e. challenging brownfield sites / sites with similar constraints).
- 4.2 Following a procurement exercise, at Septembers meeting of Cabinet (Cabinet Decision Record D180071) approval was given for the business case and governance arrangement for a joint venture with Keepmoat homes Limited under which the freehold of the Victoria site would be transferred to the joint venture in order to progress the scheme.

### 5. Keepmoat Homes (masterplan) bid submission

- 5.1 The masterplan submitted by Keepmoat Homes is for a contemporary design, using their new range of 2018 house types. Keepmoat are heavily involved in the Healthy New Towns initiative with Darlington BC (one of ten national pilot locations). The aim of the initiative is to shape the way new housing sites develop so to test creative solutions for health and care challenges in the 21<sup>st</sup> century. As part of this project Keepmoat have developed a 'Lifetime Homes range' of dwellings, lifetime homes are designed to support the changing needs of individuals and families at different stages of life (to provide flexibility and adaptability). Keepmoat propose to bring this learning to Stockton and will build these new house types on the Victoria development. Whilst the external, green landscape will be aimed at accommodating pedestrians, cyclists and encouraging sustainable modes of transport.
- 5.2 The attached appendix provides extracts from the Keepmoat site masterplan proposal, Members will note the masterplan proposal is to deliver 144 new homes which will include a range of 2, 3 and 4 bedroom houses and 2 bedroom bungalows.
- 5.3 Of the 144 new homes, 22 (15%) will be provided for affordable rent / affordable home ownership. The affordable units will be delivered (pepper potted) in different phases of the site and as required by the tender brief Keepmoat have committed to delivering these units (to Thirteen) in accordance with Homes England strict funding timescales. The affordable homes will be constructed simultaneously with the open market housing and will be tenure blind. All affordable homes will also comply and in some cases exceed the Homes England Nationally Designed Space Standards.
- 5.4 The masterplan proposal has also been developed to ensure that it will complement and support the future redevelopment of the Elm House site. As Members are aware the Elm House site (including the ground floor extension) is owned by Thirteen, once vacant (programmed for mid-September 2018) the full building (including the ground floor extension) will be demolished. The Council is leading on the demolition of the building (on behalf of Thirteen) and it is expected that demolition will be complete by the end of this year. This will facilitate the timely redeveloped of this additional site area which Thirteen will bring forward exclusively for affordable housing.

### 6. Financial / Legal Structure

- 6.1 A financial assessment conducted as part of the procurement of the JV partner has been undertaken that has considered the funding requirements of the JV Company to deliver the Victoria housing development, in particular the necessary borrowing costs.

- 6.2 Cabinet have agreed to establish a JV Company the shareholders in which will be the Council and Keepmoat Homes Limited.
- 6.3 The potential financial benefits that accrue from establishing the JV Company are the profits distributed back to the Council after tax and margin on any lending made to the JV Company by the Council.
- 6.4 As the JV Company is being treated as a commercial operator and in order to comply with state aid rules, any lending to it by the Council must be at a commercial rate. As the Council will be able to either utilise its own resources or even if on-lending from the Public Works Loan Board there will be an opportunity to achieve at least some margin on the borrowing.
- 6.5 The *Business Case* is that Council and Keepmoat will both provide loan funding to the JV Company (intended to be in equal amounts). Over the lifetime of the development the proposed maximum value of the loan to be made by each partner will be £1.6m. The loan made by the Council will be on a commercial return basis (and will be state aid compliant).
- 6.6 The maximum value of the loan to be made by both JV partners, has been determined by as part of the procurement exercise and forms part of Keepmoat's bid. As noted previously each potential JV partner was required (as part of the procurement exercise) to complete a comprehensive financial appraisal which included details of the full costs of developing the site (including sales and marketing) and the projected sales values for the range of house types proposed within the development. The total cost of the redevelopment works proposed by Keepmoat is estimated at £18.7m. Based on their estimated sales values Keepmoat Homes Limited have expressed confidence that the site will be commercially viable and will provide both parties (after the payment of costs incurred by the JV Company for sale and professional fees) with an investment return.

## 7. Risk Share

- 7.1 Under the terms of the JV arrangements the Council will receive 30.64% of any profit and Keepmoat 69.36%. The precise shareholdings and shareholder control of the company will be structured to achieve this distribution ratio, but the Council will have additional protections to ensure that the development progresses in accordance with the Keepmoat bid through a shareholder agreement.

## 8. Principal Risks

- 8.1 As with all development projects of this size and scale there are a number of risks that are relevant to the business case.

Risk	Impact	Mitigation
Lack of organisational expertise	As this is the first time the Council has entered into a JV arrangement for the development of a housing site we have limited experience and knowledge.	This risk has been mitigated by ensuring we have held detailed discussions with other neighbouring local authorities who have entered into such partnerships to learn from their experience.
Change in Council policy	Conflicts with objectives the JV established for and stalls delivery.	Ensure that the JV is focussed on the key housing challenges at Victoria.
JV Relationship	A breakdown of the relationship between the Council and Keepmoat Homes Limited.	The formal relationship between the parties will be detailed in the legal documentation (JV Shareholder Agreement and the Articles of

		<p>Association) will include dispute resolution.</p> <p>In addition, the Council has extensive experience of working with Keepmoat Homes Limited at sites across the borough (Mandale, Hardwick and Norton Park), we have worked collaboratively to ensure that these sites have delivered and all potential problems were overcome.</p>
Reputational risk of non-delivery	Council commit public money but does not deliver on objectives.	Communications plan delivered to explain the ongoing delivery of the site. Significant due diligence at procurement stage selection, with appropriate legal structure to support delivery.
Change in local authority / private sector borrowing costs	Increasing finance rates or changing funding conditions for both the public and private sector reduces viability of development.	Robust financial appraisal as part of the procurement phase partnering with an experienced housebuilder who is familiar with the market conditions.
Staff Changes /	Loss of expertise and project knowledge with the potential to impact upon decision making.	Ensure knowledge is shared internally and that adequate succession arrangements are in place.
Non-performance of partner / developer/ contractor	Non delivery of development, cost of aborted processes, need for Council step-in or re-procure.	Significant due diligence at procurement stage selection, with appropriate legal structure to support delivery.
Joint Venture company is not fit for purpose and does not operate effectively	Delay in progress, reduced quality of works, risk of loan repayment default, ineffective spend and potential unbudgeted increases in operational costs of the JV.	Robust and deliverable bid provided during the procurement phase.
Loan Default	Risk of joint venture company default or being unable to service the Council loan	Loan secured by a legal charge on the land
Planning permission for site is delayed or not forthcoming	Delay in planning permission leading to delay in site delivery.	Effective pre-development liaison with planners. Keepmoat have extensive knowledge and experience of working to secure a successful planning outcome.
Construction risk - timing and quality	Delay in delivery of development, poor build quality.	Due diligence at procurement stage. Legal structures.

Inflation Risk / Cost Increases	Impacts viability of the scheme and reduces potential return to Council or leads to joint venture losses.	Working in a JV partnership with a commercial housebuilder who has extensive market and commercial knowledge. Some flexibility in delivery model to adapt to new circumstances but subject to the Council's consent as shareholder in the JV.
Risk in movement of market values	Poor performance of residential market, sales performance does not meet expectations.	Working in a JV partnership with a commercial housebuilder who has extensive market and commercial knowledge.
Unforeseen site/ technical issues	Impacts viability of the scheme and reduces potential return to Council or leads to joint venture losses.	Mitigated through extensive survey due diligence.
Higher operational costs of vehicle than envisaged	Impacts viability of business case and returns to the Council	Mitigated through procurement and ongoing role in the JV.
Risk of product not meeting market or housing needs	Slower sales rates increase costs and delay receipts which may be needed for reinvestment in the development. Joint venture fails to deliver for local residents and therefore reputational risk if sales rates do not reflect the business case.	Working in a JV partnership with a commercial housebuilder who has extensive market and commercial knowledge will be key to mitigating this risk. In addition the JV Company Executive Board (where the Council and Keepmoat are equally represented) will receive regular updates on costs/sales achieved etc. and discuss potential remedial action required.
Wider legislative change e.g. (stamp duty) SDLT or Corporation Tax	Increase costs to the Joint Venture impacting on the viability of the business plan and potential financial.	Some flexibility in delivery model to adapt to new circumstances but subject to the Council's consent as shareholder in the JV.

8.2 Having evaluated the tender submission made by Keepmoat Homes Limited it is considered that the development of the Victoria site through a JV partnership is a viable proposition and that both parties will work collaboratively through the JV Company towards common and consistent goals (that are consistent with the Council's vision for the site) and will provide the Council with an income (share of the profit). In addition, the JV partnership option offers a more advantageous development proposal than the Council leading (in isolation) on the development of the site, developing the site through a traditional development agreement, selling the site on the open market or the Council deciding not to proceed with a development proposal.

## 9. The JV contractual arrangements

9.1 Cabinet have agreed the establishment of a JV Company, the JV Company will be governed by Articles of Association. In addition there will be a Joint Venture Agreement, a Loan Facility Agreement, a Services Contract, a Construction Contract and a legal Charge.

- 9.2 It may also be necessary to enter into an Interim Services Agreement with Keepmoat Ltd to enable initial works to progress but before the formal establishment of the company.
- 9.3 As noted previously the JV Company will be jointly owned by the Council and Keepmoat Homes Limited and the principal business of the JV Company is the acquisition of the site at Victoria for the development of homes for sale at this site.
- 9.4 The Joint Venture Agreement will specify the services to be provided by the contractor (Keepmoat Homes Limited) that will be required to deliver to the JV Company, these include:
- Project management of the development of the site.
  - The full requirement of financial and administrative and legal services to enable the JV to carry out the development.
  - Sales and marketing services to enable the JV to carry out and deliver the sales of the development as detailed in the appraisal.
  - Such other services as required in the delivery of the development by a competent contractor.
  - In addition, the JV Company will ensure that both parties have control and influence over the operation of the company to ensure that their primary objectives for the development are met.
  - The shareholder reserved matters will be agreed by both shareholders in writing.
  - A clear process to resolve disputes or deadlocked decisions of the board is included.
  - The JV Company will incur costs and execute sales in accordance with the scheme appraisal.
  - The Agreement can be terminated under defined circumstances.
  - The full requirement of financial and administrative and legal services to enable the JV to carry out the development.
  - Sales and marketing services to enable the JV to carry out and deliver the sales of the development as detailed in the appraisal.
  - Such other services as required in the delivery of the development by a competent contractor.
- 9.5 In addition, the JV Company will ensure that both parties have control and influence over the operation of the company to ensure that their primary objectives for the development are met.
- 9.6 It is envisaged that the initial board of the joint venture company will have 6 members three from the Council and three from Keepmoat.
- 9.7 The legal documentation will include provisions that the shareholder reserved matters (red lines) will be agreed by both shareholders in writing. A clear process to resolve dispute is included. The JV Company will incur costs and execute sales in accordance with the scheme appraisal and the joint venture may be ended under defined circumstances

## **10. Next steps**

- 10.1 Should Council confirm the borrowing requirement the table below provides an indicative site development timeline:

Submit planning application	Nov 2018
Secure planning consent	Feb 2019
Site preparatory works / building works commence	Post planning approval through to summer 2019
Sales Centre opens	Dec 2019
First legal completions	Feb 2019
Overall scheme completion	Jun 2023

- 10.2 As highlighted in previous reports, the sites connectivity with Norton Road (as a key gateway into the Borough) is significant and work is ongoing to ensure the Victoria sites redevelopment complements ongoing town centre regeneration, improvement activity (i.e. Townscape Heritage).

### **COMMUNITY IMPACT IMPLICATIONS**

11. The Councils regeneration vision for this central Stockton location is clearly documented (in previous Cabinet reports (see under Background Papers) and the delivery of housing on this site was also detailed in the consultation process undertaken as part of the Councils emerging Local Plan. Development of the site will be subject to securing a planning approval and as part of this process, further consultation will be undertaken with surrounding residents and local businesses.
12. The successful regeneration of the Victoria site will both enhance the housing offer available in this town centre location providing accommodation for a range of potential residents including families and older people through outright sale, affordable homeownership and affordable rent. The redevelopment of the site will also support the ongoing transformation of Stockton town centre.

### **FINANCIAL IMPLICATIONS**

#### **13. Loan Agreement**

- 13.1 As detailed within the body of the report, Council are asked to approve prudential borrowing of £1.6m. Subject to the borrowing requirement being approved, Cabinet have agreed to provide a loan to the JV Company to support the cash flow requirements of the scheme.
- 13.2 The on-lend to a maximum of £1.6m to the JV company by the Council will be on a commercial return basis and would be conditional of the completion of the JV Agreement.
- 13.3 The Council's JV partner, Keepmoat Homes will also loan the JV Company the equivalent amount (again on a commercial return basis).

#### **14. Sale of the Victoria site**

- 14.1 The site will be disposed of at market value which (through the JV tender exercise) has been assessed at £1.00. The Council will benefit from a share (30.64%) of the any profits generated through the JV Company.

## LEGAL IMPLICATIONS

15. The Council has the power to enter into the JV pursuant to the general power of competence under Section 1 of the Localism Act 2011. In exercising this power the Council is still subject to its general duties, such as its fiduciary duty, and must exercise the power for a proper purpose.
16. Under Sections 1 and 12 of the Local Government Act 2003 the Council may borrow or invest for any purpose relevant to its functions or for the prudent management of its financial affairs. Any lending to the JV will be structured on market terms and rates and so would not constitute State Aid.
17. Under section 123(1), Local Government Act 1972, the Council cannot dispose of its land for consideration less than the best that can be reasonably obtained in the market, except with the express consent of the Secretary of State. There is no requirement that the best price payable be an upfront payment, consequently the approach to how the 'best price' is paid may vary and can include a deferred return, so long as it is valued and captured in legally enforceable documentation. The transaction in this instance taken as a whole, has been determined through officer professional advice, as being the best that can reasonably be obtained.

## RISK ASSESSMENT

18. As noted in the body of the report as with all development projects of this size and scale there are a number of risks. A risk assessment has been completed and scored as high, before mitigation.
19. A robust process of risk mitigation as evidenced in the principal risk table (paragraph 18 of this report) has been completed to ensure that all known risks are both identified and carefully managed. Risk review and the establishment of appropriate risk control measures will be undertaken by both the Council and through the JV Company.

## COUNCIL PLAN POLICY PRINCIPLES

20. The proposal appoint Keepmoat Homes as the Councils JV partner and to establish a JV Company to bring forward the regeneration of the Victoria site directly supports the following Council Plan themes:

Economic Regeneration and Transport: the redevelopment of Victoria will support the economic regeneration of Stockton town centre.

Environment and Housing: the revised proposal will enhance the quality of the housing offer available in this town centre location.

Safer Communities: any future redevelopment would be designed to ensure a sustainable and safe community.

Health and Wellbeing: good quality, sustainable housing will have a positive impact on the health and well-being of future residential occupiers.

Adults: the proposed redevelopment would create a high quality environment for both current and future generations of the Boroughs population as they age, in a vibrant, safe and healthy environment.

Arts Leisure and Culture: the proposed scheme provides the opportunity to integrate the provision of arts, leisure and cultural activities.

## **CORPORATE PARENTING IMPLICATIONS**

None.

## **CONSULTATION INCLUDING WARD/COUNCILLORS**

Consultation briefings have taken place Cabinet Members for Regeneration and Housing.

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Education related?

No.

### Background Papers

- Victoria Estate Redevelopment. Report to Cabinet 27.9.2018
- Victoria Site: Update on the Revised Scheme Redevelopment Proposal
- Victoria Estate Regeneration – Revised Scheme Proposal. Report to Cabinet 16.11.2017
- Victoria Estate Regeneration – Urban Village Living. Report to Cabinet 16.3.2017
- Victoria Estate Regeneration – Urban Village Living. Report to Cabinet 14.1.2016
- Victoria Estate Regeneration Proposal. Report to Cabinet 6.11.14
- Housing Regeneration Scheme Update – Victoria Estate. Report to Cabinet June 2012.
- Housing Regeneration Scheme Update – Parkfield/Mill Lane (Phase 2) and Victoria Estate. Report to Cabinet 9.2.12
- Housing Futures: Transfer of Housing Stock to Tristar Homes. Report to Cabinet 18.11.00

### Ward(s) and Ward Councillors

Councillor Kirton – Stockton Town Centre ward

Councillor Hewitt – Stockton Town Centre ward

### Property

As detailed within the body of the report.