

## 8.14 Consideration in relation to the overarching JVLLP

- Governance and legal structure
- Procurement law
- State aid analysis
- Vires Considerations
- Land Considerations
- Taxation

### 8.14.1 Part 1: Governance and Structure

The purpose of this section is to set out a high level analysis of how the proposed structure and governance arrangements within the overarching JVLLP option (the “JVLLP”) may operate. However, this will require further discussion with the Council and the proposed PSDP (“Partner” or “PSP”).

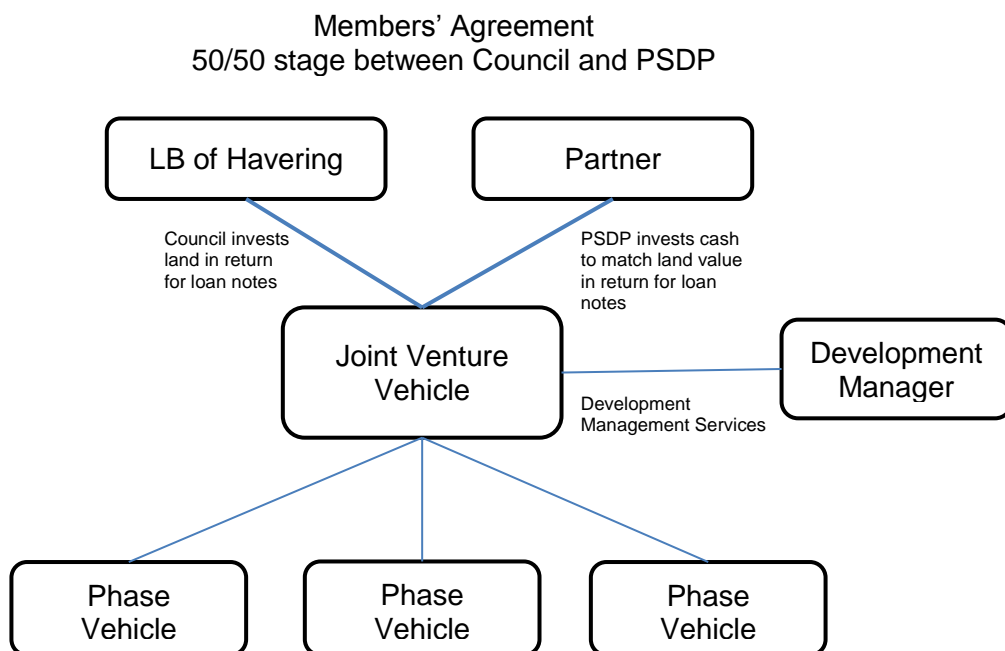
#### **Overview of the JVLLP**

The JVLLP will be a corporate vehicle in which it is proposed that the Council and the Partner will each hold a 50/50 equity interest and which is intended to carry out the development of the sites. The Council and the Partner will jointly manage the JVLLP and its assets and will each be entitled to an equal share of the profits of the JVLLP throughout the life of the JVLLP. The JVLLP is a 50:50 partnership where block voting is used and with clearly defined deadlock provisions.

Subject to more detailed tax analysis, there are some potential benefits in utilising a limited liability partnership as the corporate vehicle (see vires analysis in respect of such vehicle below). Such vehicles do not pay corporation tax; the members (equivalent to shareholders) are taxed according to their status. Local authorities do not pay corporation tax and in addition to this, there may also be SDLT savings. A detailed tax analysis will be required if the Council decide to take forward this option.

As indicated in the diagram below, it is possible that there may be Site/phase specific subsidiary vehicles within the JVLLP structure and this aspect will need to be developed with the Council and the Partner.

# Structure Diagram



## Land contribution and finance

The financial contributions of the parties to the JV would be structured through a loan note structure.

In consideration for the land contributions by the Council, the Council will receive loan notes from the JV to the value of the land at the point of drawdown (in accordance with an agreed valuation mechanism which will be regulatory compliant). Interest will be payable on such loan notes from the date of contribution of land.

The Partner will be required to provide matched funding to the JV in respect of the value of the Council's land contributions. The Partner will receive loan notes from the JV in respect of any such funding upon drawdown by the JV.

The Partner's loan notes will be on the same commercial terms as the Council's loan notes and will rank *pari passu* with the Council's loan notes (in relation to matched funding element referred to above) including the specified interest rate applying to such loan notes.

The JV will also require development finance which will be secured from the market or partners (at their option) and it is expected that this will be on senior debt terms.

## Activities of the JV

It is envisaged that the JV (and where applicable, its subsidiary vehicles) will undertake a direct role in some or all of the following activities:

- The master planning design process in relation to the Sites;
- Development of the Sites;

- Ongoing consultation and communication with stakeholders;
- Obtaining planning consents
- Commissioning construction phases and entering into appropriate construction contracts;
- Entering into development management contracts and housing estate management and maintenance contracts; and
- Marketing and managing sales of those phases which are deemed to be appropriate for sale by JV.

## **Governance of the JV**

The JV will have an overarching business plan which will be updated on a rolling basis being renewed annually. This will be agreed prior to the completion of the JV. In addition, prior to contribution of each Site, a Site specific business plan will be agreed which will govern the activities in relation to that particular Site. The JV will be obliged to act within the parameters of the business plan.

### **The JV governance will operate at the following levels:**

Certain decisions will be reserved to the unanimous consent of the members (the Council and the Partner). These decisions can be taken in the interest of the Council (unfettered by the interest of the JV). An example of such reserved matter would be agreement of the business plan. All other decisions shall be taken by the board (subject to delegation to the development manager or under the development management agreement) acting in accordance with the Members Agreement, the overarching business plan, a Site specific business plan and any member resolutions. The board will be obliged to act in the best interests of the JV in making such decisions. It is likely there will be further delegations to the development manager. These are likely to be day-to-day decisions by reference to financial parameters. All these decision will be clearly cast in a delegations schedule as a schedule to the Members Agreement.

## **Conflict in the JV**

Contractual provisions will govern certain areas of conflict for example, where the JV seeks to exercise some form of legal right against one of its members (most likely to be the Partner through some form of default under the Members Agreement or a delivery contract where the PSP or its group member is in default) the party concerned will be disenfranchised from voting on such matter.

## **Exit**

Three potential exit scenarios will be considered below:

- Voluntary (where either party transfers its interest in the JV or the parties agree to wind up the JV);
- Deadlock (where the “marriage” has broken down); and
- Default (where a breach of an agreement occurs).

## **Voluntary**

It is usual for there to be potential for the parties to wind up the JV by mutual consent or to transfer their interest in the JV to a third party (subject to certain parameters around the identity of such transferee) and subject to rights of first refusal in favour of the continuing shareholder/member.

### **Deadlock**

It is usual that there will be an agreed mechanism dealing with deadlock and disputes. This usually includes some form of staged level dispute process including mediation provisions and expert determination. Ultimately, where the deadlock or dispute cannot be resolved this will usually lead to the termination of the JV. This will be a controlled process with land interests not contributed at the date remaining in the control of the Council and most likely a controlled winding up of the JV (following the development of land interests held within the JV to realise development proceeds).

### **Default**

Where the PSP is in default and such default is sufficiently material and is not remedied, the Council shall have the right to purchase the PSP's interest at a discount to the market value, or to elect that the JV is subject to a controlled winding up. Council default is unlikely in context of this structure in view of the limited obligations placed on the Council (primarily to transfer land into the JV upon the satisfaction of certain conditions).

### **Procurement of Works/ Services**

It will be important to ensure that the JV is able to evidence value for money in relation to works/services that it procures. The legal documentation will include a procurement policy which will set out the procurement methodologies that JV will be obliged to follow.

Certain Partners will also undertake construction works and services for the JV. It will be necessary to make sure that the appropriate VFM protections are in place in favour of the JV in such circumstances.

It is likely that the Partner will provide development management services to the JV. These will be provided through a development management services agreement for a fee.

## **8.14.2 Part 2: Procurement Guidance**

The public procurement rules set down in the Public Contracts Regulations 2015 (as amended) ("PCR"), the Concession Contracts Regulations 2016, and supporting case law, make it clear that works, services or supply contracts with a value above the specified financial thresholds must be competitively procured using an EU procurement law compliant tender process.

The selection of a joint venture partner on its own by a public sector contracting authority is not a works, services or supply contract and thus is not a contract which should normally be

procured in accordance with EU procurement law. Likewise, the procurement of investment falls in the same category.

Where the Council wishes to exercise control over the shape and form of development that takes place and receive completed developments undertaken through the award of works, services or supply contracts (on behalf of the public sector JV partner), there is a risk that the joint venture could be seen to be an artificial mechanism for the public sector partner to circumvent EU procurement law requirements. In such circumstances, specific provision for the public procurement rules must therefore be made. In this case, this could be done either by:

- i. Using EU procurement law compliant procurement process to select the investor and the scope of the work to be carried out, thus ensuring that subsequent contracts awarded by the JV which fall within this scope do not require further EU procurement law processes; or
- ii. Placing contractual or constitutional limitations upon the JV to ensure that it uses EU procurement law compliant procurement processes every time it awards a regulated works, service or supply contract.

The formal legal definition of a 'public works contract' is very wide, and there have been a number of EU court decisions addressing the question of how and when EU procurement law applies in a development context. Whether a public works contract arises is very fact-dependent. As such, it may be possible that the JV arrangement itself, or subsequent development activity, will be seen to constitute a regulated works contract.

There are several tests which must be established before a works contract will be held to exist. In summary, these are:

- i. A legally enforceable obligation on a contractual party to deliver works; and
- ii. A requirement for works specified by a public body with an immediate (i.e. direct) economic benefit to that body; and
- iii. 'pecuniary interest' (i.e. a monetary interest) passing to the purchaser for carrying out those works.

All elements of the definition must be met in order for there to be a 'public works contract'. If any element is missing (e.g. there is no legally enforceable obligation to carry out works or there is no pecuniary interest) then there will not be a public works contract.

It is likely that the transfer of land by the Council into the JV with additional controls and/or receipt of development services or developed land from the JV will be seen to involve works contracts due to the development obligations and specifications which the Council will want to impose. As such, the most prudent way forward would be for the Council to put the entire project opportunity (including the selection of the project JV partner) out to market using an EU procurement law compliant process.

The principal PCR compliant procedures are the:

- i. Open Procedure;
- ii. Restricted Procedure;

- iii. Competitive Dialogue; and
- iv. Competitive Procedure with Negotiation.

In the context of this project, it is considered however that it would not be possible to deliver the Council's stated objectives under either the open or restricted procedures due to inherent risks and complexities involved in the potential JV. In our experience, in most cases where the PCR applies, contracting authorities will use either the Competitive Dialogue (CD) Procedure, or the Competitive Procedure with Negotiation (CPN). The market is familiar with CD and the CD procedure is also often the procedure preferred by contracting authorities due to the ability to undertake clarification and minor, non-substantive negotiations once a preferred partner has been selected. This flexibility is not available with the CPN. Therefore, it was concluded that the Council would procure the project using an approach similar to the competitive dialogue procedure which provides the opportunity for a structured approach to procurement. However, as this is more in the nature of a concession contract, the Council reserved the right to deviate from the formalities of this process in conducting the competition due to the flexibilities permitted by the Concession Contracts Regulations 2016 (CCR 2016).

Certain Partners will also undertake construction works and services for the JV. It will be necessary to make sure that the appropriate VFM protections are in place in favour of the JV in such circumstances.

It is likely that the Partner will provide development management services to the JV. These will be provided through a development management services agreement for a fee.

### **8.14.3 Part 3: State Aid Analysis**

#### **State Aid**

When assessing whether State aid is present in respect of a project, it is necessary to consider whether Article 107(1) of the Treaty on the Functioning of the European Union ("TFEU") is satisfied. Article 107(1) provides as follows:

Save as otherwise provided in the Treaties, any aid granted by a Member State or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.

This Article gives rise to the "Four Part Test" for State aid. This Four Part Test is cumulative and State aid will only exist if all four parts of this test are met. For State aid to exist, the following must be satisfied:

- i. Aid is granted by a Member State or through State resources;
- ii. To a certain undertaking (carrying out economic activities);
- iii. Thereby creating a selective advantage; and
- iv. The transfer of resources distorts or has the potential to distort competition and trade between Member States.

Parts 1, 2 and 4 will all likely be satisfied as the Council's land contributions will constitute State resource as will any other public sector funding; it is widely accepted that property

development is an economic activity; and usually only the most obscure activities are found to not have a potential to affect cross-border trade. As such, if State aid is to be avoided, it will be important to demonstrate that the Council's investment or provision of public sector funding does not confer a selective advantage upon the JV.

If any of the Council's funding was found to constitute unlawful State aid, and if discovered by the European Commission or challenged in court, it would be liable to repayment by the recipient of the aid together with interest at the prescribed rate. The Council could also be subject to damages claims from third parties who have not received aid. Unlawful State aid therefore represents a significant commercial risk to both the Council and the joint venture partner, and is something which should be avoided.

### **Market Economy Investor Principle**

In order to assess whether such an advantage has been conferred, the Market Economy Investor Principle Test ("MEIP Test") should be applied to the assessment. The MEIP Test involves an analysis of the commercial rationale of an investment made by a public body. If it can be said that the terms of the investment constitute normal market terms that would be acceptable to a private sector undertaking in similar circumstances, then the investment will not be deemed to confer an advantage and will not therefore constitute State aid. It is important to note, however that the Council, rather than individual facets of the project structure should apply the MEIP Test to the overall investment decision, and that it should do so before a decision to invest is made.

Pari passu investment (namely investment on equal terms and with equal return and risk) with a private sector investor is deemed to automatically satisfy the MEIP Test.

If the MEIP Test cannot be satisfied, because the investment is not made on commercial terms or does not generate a fully commercial return, alternative State aid solutions may be available and can be explored with the Council.

### **Services of General Economic Interest**

The Council will be receiving funding from the GLA that in broad terms will be used to fund the provision of affordable housing in this project. There are potential State aid implications caused by this, but as explained in the Legal Implications to the Cabinet report dated 12 January 2018 the Council can rely on the exemption for services of general economic interest, which includes the provision of affordable housing.

#### **8.14.4 Part 4: JVLLP vires**

The Council has a broad power to provide housing accommodation under section 9, Housing Act 1985 that can be relied on in this project. Section 9 contains no restriction on the type of tenure that must be used if the Council decides to provide the accommodation, or on whether the Council must retain ownership. The power can be relied on where some properties will be developed for market sale as long as that element is undertaken to cross-subsidise the affordable housing, which we understand is the case here.

The Council has the power to make expenditure from the HRA in respect of houses within the HRA (Item 2, Schedule 1, Local Government and Housing Act 1989). This includes acquiring share capital, and can be relied on in this project as the Council will be purchasing completed units from the JVLLP for social rent and shared ownership.

Whilst there are no explicit powers for participation in a JVLLP, reliance is often placed upon s111 Local Government Act 1972 (and the Greater Manchester Trusts case) to participate in companies or other bodies such as a JVLLP. The form of vehicle is a subsidiary matter to the housing and other related powers that the Council would use to redevelop the estates. Alternatively (or additionally) the Council may rely upon the general power of competence in section 1 of the Localism Act 2011, which enables the Council to undertake any activity an individual could undertake, subject to any statutory constraints on the Council's powers.

Since an individual would be able to participate in a corporate joint venture, in the same way the Council would be able to participate in a JVLLP, by subscribing equity and providing loans and other financial investment for the redevelopment of the 12 estates. Since the regeneration is being pursued for housing purposes rather than commercial purposes no reliance needs to be placed upon section 4 Localism Act 2011.

#### **8.14.5 Part 5: Land Contribution**

##### **Land Contribution**

The land interests contributed to the model by the Council will need to comply with the following elements:

##### **Appropriation and Disposal of Housing Land**

Local authorities have a power to override easements and other rights under section 203, Housing and Planning Act 2016 and this could be used for the property to be disposed of to the JVLLP. To do so, the Council must first appropriate the land for planning purposes. Under section 19(2) of the Housing Act 1985, land held for the purposes of Part II housing (commonly referred to as HRA land) cannot be appropriated without Secretary of State (SoS) consent when it includes a house or part of a house. The Council will therefore need to apply for SoS consent. The Council has the power to dispose of property appropriated for planning purposes to the JVLLP under section 233 of the Town and Country Planning Act 1990.

Section 32 of the Housing Act 1985 allows Local Housing Authorities to dispose of housing land but only with the consent of the Secretary of State. The Secretary of State (CLG) has published a series of general consent since 1985, the latest being The General Housing Consent 2013 published in March 2013. The 2013 General Consent includes a number of separate consents with the most relevant being "A: The General Consent for the Disposal of Land held for the purpose of Part II of the Housing Act 1985-2013. Consent "A" draws a distinction between vacant land and dwellings. A Local Housing Authority may dispose of a dwelling provided it is at market value subject to certain exceptions including where the dwelling is occupied by a tenant(s) where consent of the Secretary of State is required. The



General Consent allows a local authority to dispose of vacant land. This can be at any price (market value or less (subject to compliance with State aid rules)). Vacant land is defined as *“land on which no dwelling houses have been built or where dwelling houses have been built such dwelling houses have been demolished or are no longer capable of human habitation and are due to be demolished”*.

If there is any HRA land that will not be appropriated, or if appropriated land is returned to the HRA before development, such land will need to fall within the latter definition if it is to be transferred by the Council to the JVLLP, or will otherwise require a specific consent. There is no qualification or limitation on the form of disposal of vacant land to entities in which the local authority has an interest. A disposal can be by way of conveyance of the freehold or grant of a lease of any duration.

### **Disposal of non-housing land**

Under Section 123 of the Local Government Act 1972, Local Authorities have the power to dispose of land held by them in any manner they wish. However, save for with the consent of the Secretary of State, Local Authorities cannot dispose of land for a “consideration less than the best that can reasonably be obtained”.

Disposal of land includes the sale of freehold interest, granting a lease of assigning any unexpired term of a lease, and the granting of easements.

There is a general consent for section 123 in “Circular 06/03 The General Disposal Consent” which may assist where a Local Authority wishes to dispose of land for less than best consideration, if it considers that this will achieve the promotion or improvement of economic, social or environmental well-being of its area:

- i. Subject to a maximum undervalue of £2million; and
- ii. Provided the disposal is State aid compliant; and
- iii. It is satisfied that the land is not held as housing land or under the Planning Act.

### **State Aid and the Sale of Land and Buildings**

Any transfer of land by the Council must be transacted in accordance with the state aid rules in order to avoid the transaction being deemed to include the grant of State aid to the acquiring entity. This will be satisfied where the land is transferred at an open market value as determined by an independent valuation, commonly in accordance with the RICS Red Book principles (in compliance with section 103 of the Commission Notice on the notion of State aid (2016/C 262/01)).

#### **8.14.6 Part 6: Taxation**

##### **General**

Commonly, public sector asset based development vehicles are structured as either an LLP or an LP, as the tax transparent nature of these vehicles has certain benefits for the partners, including stamp duty land tax (“SDLT”) benefits.

## **SDLT**

The transfers of land from the Council to the JVLLP may have an SDLT advantage over a company structure. In general, it is expected that there would be an SDLT charge on the transfer of private land from the Council to the JVLLP of 50% of market value as the Council's interest in the JVLLP is exempt from SDLT.

SDLT charges may, however, be triggered if value is returned to the members in a three year period following the contribution of land or if a member's interest is transferred or a new member joins the LLP. If the JVLLP were structured as a company, SDLT would be paid on the full market value.

## **Tax on Returns**

The JV, set up as an LLP, will not itself be subject to tax. JVLLPs are tax transparent vehicles, that means that returns generated from the activities for the JV would be taxed in the hands of the members (the Council and the Partner) rather than the JVLLP in accordance with their usual regimes. For the Partner this means that their share of profits arising from the JV would (assuming the Partner is a company) be subject to corporation tax.

The Council of course is not subject to tax and would retain its tax-exempt status in respect of its share of the profits of the JVLLP. If the JVLLP were set up as a company, it would be subject to corporation tax. The Council could not recover tax paid by the JVLLP.

## **VAT**

The VAT treatment of the contribution of assets and development of those assets will need to be analysed to ensure that VAT recovery incurred on construction and other costs is maximised. VAT recovery issues may arise in relation to residential elements, which are to be used for letting rather than sale, and in relation to infrastructure linked to such residential elements.