



Havering
LONDON BOROUGH

CABINET

PUBLIC AGENDA REPORT

13th February 2019

Subject Heading:

**Mercury Land Holdings (MLH) in-year
Business Plan and Budget Update
2019/2020**

Cabinet Member:

Councillor Damian White, Leader of the
Council

SLT Lead:

Neil Stubbings, Director of Regeneration

Report Author and contact details:

Nick Gyiring-Nielsen – Senior
Regeneration Manager
T 01708 434 612

Policy context:

Havering Housing Strategy 2014-17

NPPF 2012

Emerging Havering Local Plan 2017

Mercury Land Holdings (MLH) Annual
Business Plan – 1st April 2018

Financial summary:

This report seeks Cabinet approval to the
Business Plan proposed by Mercury Land
Holding (MLH) for the period 2019/20.

Is this a Key Decision?

Yes - Significant effect on two or more Wards,
Expenditure or saving of £500,000 or more

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When should this matter be reviewed? Autumn 2019

Reviewing OSC: Towns and Communities OSC

The subject matter of this report deals with the following Council Objectives

Communities making Havering	[✓]
Places making Havering	[✓]
Opportunities making Havering	[✓]
Connections making Havering	[✓]

SUMMARY

The Council's original decision to set up MLH on 13th May 2015 was to contribute to, and where possible accelerate the provision of housing supply in the borough, noting the potential adverse effect that an absence of sufficient housing may have on the economic and social well-being of residents and the local economy; to ensure a mix of housing, in terms of type, size and tenure, best matched to the needs of Havering; to support the Council's regeneration and growth aims, bringing forward high quality development on regeneration sites in key parts of the borough; and to generate an acceptable financial return to the Council by operating a business.

These objectives have now been aligned to the Council's Joint Venture partnerships with an over-arching vision to kick-start renewal of key town centres including regeneration and delivery of much needed homes for local people and to generate a return to the Council through prudential lending. In addition, the Council aspires to ensure good quality design of buildings and places is delivered through its role as the controlling sole shareholder of the development company. Any returns to the Council are being identified to fund future regeneration programmes and development opportunities across the borough and help fund renewal of our cherished town centres across the borough at a time when the traditional high streets are under significant threat from changing consumer habits.

When the original Year 1 Business Plan was agreed by Cabinet, this was on the basis that there would be regular (annual) reviews and Cabinet would be asked to agree material changes to the business plan on an annual basis, in line with the annual budget setting process.

The key inputs into the financial models have been reviewed and validated. The key inputs are construction costs, rental values, and cost of finance, expected sales revenues, land values plus other costs such as expectation on s106 and CIL payments. In addition, other changes such as total number of residential properties have been updated as the design and planning processes proceed alongside additional projects being added.

The updating of these numbers in the business plan and business case viability models and then into the Council's financial dashboards means that this report is able to inform Cabinet of any changes to the expected outputs from MLH as well as informing Cabinet of any changes in the financial position of MLH and our financial commitments to MLH as an investor. This report not only informs Cabinet of changes but also seeks approval of the updated Business Plan and the expected financial commitments.

In a new improvement to the Business Plan, MLH's objectives have now been aligned to the Council's Joint Ventures, notably though not limited to, Rainham along the A1306, and Romford Town Centre.

As part of the alignment with the Council's JV partnerships, key indicators have been adopted on the viability and outputs of MLH. These key indicators are: overall % return, overall financial return, initial stake (Equity in terms of borrowing and land value), impact on the MTFs from the cost of borrowing in the early years, total number

of units and number of affordable housing units. These metrics are considered to be the key indicators to identify the viability, outputs and potential financial risks. These are covered in the 'Exempt Agenda Report'

The main body of the report provides significantly more detail along with additional indicators and outputs to help inform Cabinet on progress and risk management for the project.

This report seeks approval of Mercury Land Holdings Limited (MLH) Business Plan for 2019/20.

Through direct development and the acquisition of properties from the market the company will also support the London Borough of Havering's (LBH's) regeneration programme, acquiring properties from the Council's joint ventures to expand its Private Rented Sector (PRS) portfolio.

It is proposed that the Council will dispose of assets (land/buildings) to MLH at market value.

The Council will provide finance to MLH through a combination of equity investment and loans. This will constitute capital expenditure for the Council within its approved Capital Programme to be financed through Council reserves or borrowing. The overall financing arrangements will be subject to an assessment of State Aid compliance, long term affordability, risk and return on investment by the Council.

RECOMMENDATIONS

That Cabinet:

1. **Approve** the Mercury Land Holdings Limited Business Plan 2019/20 attached at exempt Appendix 2.
2. **Agree** to delegate authority to the Leader of the Council, after consultation with the s151 Officer, the Director of Regeneration Programme Delivery and the Director of Legal and Governance, approves the detailed business cases and related viability assessments and funding requirement for the individual schemes noted within the Business Plan as they may be presented during the business plan period in order to enable them to proceed.
3. **Agree** in principle to provide total capital funding to MLH up to a maximum of £135.85 million in respect of projects contained in exempt Appendix 2 through a combination of equity investment and state aid compliant loans subject to detailed approved business cases made under delegated authority in recommendation 2 above.
4. **Agree** to delegate authority to the S151 Officer to agree, after consultation with the Director of Legal and Governance, the completion of all relevant agreements and appointments of relevant professionals relating to the provision of debt finance by the Council to MLH.

5. **Agree** to delegate to the sS151 Officer, following consultation with the Director of Asset Management, and the Director of Legal and Governance, the authority to determine the principles and processes by which any assets shall be disposed of and the terms of disposal to MLH.

REPORT DETAIL

1. **BACKGROUND**

Introduction

- 1.1 The Council's main objectives for entering into the private sector housing market are:
 - To contribute to, and where possible accelerate the provision of housing supply in the borough, noting the potential adverse effect that an absence of sufficient housing may have on the economic and social well-being of residents and the local economy;
 - To ensure a mix of housing, in terms of type, size and tenure, best matched to the needs of Havering;
 - To support the Council's regeneration and growth aims, bringing forward high quality development on regeneration sites in key parts of the borough, notably though not limited to, Rainham along the A1306, and Romford Town Centre; and
 - To generate an acceptable financial return to the Council by operating a business.

Strategic Context

- 1.2 One of the most significant housing changes in the UK housing market in the past decade or more has been the rise in the private rented sector.
- 1.3 It is widely viewed that the relative immaturity of the Private Rented Sector (PRS) offers institutions and larger organisations such as local authorities an opportunity to shape the sector, and the Government is encouraging this activity.
- 1.4 It is becoming increasingly difficult for Havering residents to afford homes. A quality rented sector targeting Havering residents would meet their criteria. Likewise, affordability, coupled with improved connectivity through Crossrail, will undoubtedly make towns such as Romford more attractive for tenants who are being priced out of more central London boroughs and increasingly some mid zone locations.
- 1.5 There is an opportunity for Havering to take advantage of this anticipated tenant growth and deliver quality, well located and well managed PRS developments

which will deliver a financial return to the Borough, as well as assisting in meeting its regeneration objectives.

- 1.6 Havering needs to make significant savings and generate additional income in order to meet the challenges presented by reductions in government funding and demographic growth pressures upon expenditure in statutory services in order to balance its General Fund budget over the medium term. The Council is therefore seeking to make a broader use of its asset base to generate long term revenue income streams. Traditionally, the Council has successfully sold land to housing providers and developers in order to obtain capital receipts, to provide market and affordable housing and to meet borough wide housing targets. Whilst this activity may still remain in part the involvement of MLH allows the Council to invest capital resources to generate income streams and to deliver on other Council priorities such as regeneration activities and provision of good quality housing.

2. OPERATION OF MERCURY LAND HOLDINGS

- 2.1 The Company will continue to develop or acquire from the market a portfolio of homes for market rent and sale.
- 2.2 The Company will own the market rent units, and will market and manage the rental of those homes.
- 2.3 Units owned by the Company will be let on Assured Shorthold Tenancies and will not be subject to Right to Buy, or to the allocations provisions of Part VI of the Housing Act 1996.
- 2.4 Any provision of affordable housing units resulting from MLH development activity will be transferred to an appropriate housing partner, which may include the Council as registered provider.

Resourcing

- 2.5 MLH has sufficient capacity to deliver its 2019/20 business plan. As the company grows and its portfolio expands, its level of resourcing will be reviewed to ensure it operates as an efficient and sustainable business.

3. GOVERNANCE

Council as Shareholder in MLH

- 3.1 The Council's Cabinet are the prime body acting as the shareholder, agreeing MLH's business plan on an annual basis.
- 3.2 The Council's rights as shareholder will be exercised by the Leader of the Council with Cabinet Member for Finance and Property, the Director of Legal Services and the Section 151 officer whose main role is to protect the Council's interests as owner of the company. This will be managed through the Council's corporate governance structure, which includes the Council's joint ventures.

MLH Director Roles

- 3.3 As MLH continues its journey of growing, and until it gets to an appropriate level of critical mass, the Council will continue to support MLH's board through the secondments of the Council's Chief Executive, acting as Chairman on the company board of MLH alongside MLH's own staff and an external, unconnected person who has relevant experience in the house building sector. It is noted that all Directors must, amongst other duties, act in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole and must avoid a situation in which they have, or may have, direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.
- 3.4 The Directors have ultimate responsibility for directing the activities of MLH, ensuring that it is well run and delivering the outcomes for which it has been established. Directors' responsibilities include the following:
- Delivering the MLH annual Cabinet approved business plan
 - Setting budgets, policies and plans and monitoring performance of MLH, and setting a framework for internal controls.
 - Ensuring compliance with MLH's objectives, purposes and values.
 - Ensuring the financial strength, solvency and good performance of the company.
 - Ensuring MLH complies with all relevant regulation, laws as well as the requirements and policies of the Council.
 - Dealing with the appointment and appraisal of staff.
 - Procuring services necessary for the execution of MLH's objectives.

Council as Funder

- 3.5 The Council will continue to act as a bank credit committee, whose primary task will be to assess MLH's viability (as an entity) and the viability of each project which loan funding will be used for and, using this analysis, to determine whether to release loan funding to MLH.
- 3.6 The Council will annually monitor and analyse financial information generated by MLH during the lifetime of each loan to ensure that MLH is not in breach of key financial requirements (which will be stipulated as funding conditions in each loan).
- 3.7 The key areas which the Funder Role will want satisfied prior to providing funding for a development are:
- That the financial metrics demonstrate that the loan will be repaid;
 - There is confidence that the projected rental stream can be maintained;
 - That base level sensitivities (which will trigger warning signals) for MLH's general performance and each proposed development are properly set and that a sufficient margin is added to the base level to provide reassurance to the Funder Role. (This will form part of the company's obligations under each loan); and

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- That evidence is provided that the terms of financing for each project (loan and equity funding), is State Aid compliant. This advice will be acquired from an expert third party.

4. Progress and Scheme Review

4.1 Mercury Land Holdings has been successfully operating for over 2 years and has delivered against its previous business plan. This includes:

4.11 Cathedral Court

MLH has completed the development of Cathedral Court with all 65 units currently let. The returns generated by the site are noted in the MLH business plan.

4.12 North Street

MLH has obtained planning permission for 44 PRS units at 75 North Street in Hornchurch. A contractor has been appointed and construction commenced in May 2018. Practical completion is due in September 2019.

Objectives for 2019/20

4.2 The Company's business plan for the third year of its operation can be found at Appendix 2.

The plan anticipates the on-going asset management of Cathedral Court and continued growth through development and acquisition across a number of sites as set out below. As units are completed or acquired, they will be added to MLH's portfolio to further its objective to become a leading housing provider in Havering.

4.21 Cathedral Court

MLH will continue the asset management of Cathedral Court, generating income to meet loan arrangements with the Council and providing 65 good quality rental units in the locality.

4.22 North Street Hornchurch

MLH will complete the development of the site, currently under construction by the end of September 2019. There is strong demand for a bespoke rental product in Hornchurch, with a high degree of interest from prospective tenants. Post construction the objective is to achieve a fully let scheme at or above projected rents.

4.23 Quarles

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MLH will submit a planning application on the site for residential development & thereafter arrange for construction to commence with completion of the initial phase projected for late 2020/21, subject to terms being agreed.

4.24 Hornchurch Opportunity Site

MLH will seek to acquire the site and implement the agreed delivery option, subject to terms being agreed.

4.25 Short Term Lease Project

MLH will commence the acquisition of street properties and lease on commercial terms. This project will be subject to further review as part of a comprehensive housing strategy.

4.26 Rainham Opportunity Site

Working in partnership with the Rainham and Beam Park Regeneration LLP on planning and development processes, MLH will acquire land for PRS delivery, subject to terms being agreed.

4.27 Waterloo Road

MLH will continue to negotiate the acquisition of properties from the 12 Estates Regeneration Programme. The details and structure of this purchase are emerging and assumptions have been made in the Business Plan which are subject to change. The release of funding for Waterloo Road will be subject to the outcome of further modelling and a neutral / positive revenue impact of the Council over the life of the MTFs.

Financial Review

4.3 The plan shows that by the year ending 31 March 2024 the company will have a total of 203 units in the PRS market (and a further 185 units from the Waterloo Road Scheme may be added at a later stage)

4.4 The financial details are contained in the exempt agenda report.

REASONS AND OPTIONS

5. Reasons for the decision:

5.1 The 2019/20 business plan meets the objectives stated in 1.1 and contributes to the financial objectives of the Council.

6. Other options considered:

- 6.1 A review of the alternative options of do nothing was not feasible as it would not fulfil the objective of growing the company.

IMPLICATIONS AND RISKS

7. Financial implications and risks

See Exempt Public Agenda Report

8. Legal implications and risks:

8.1 General

Members established MLH, a company limited by shares and wholly owned by the Council subject to Part V Local Government and Housing Act 1989 and the Local Authorities (Companies) Order 1995. The company's business is the provision of homes for market rent, sale and if required through compliance with planning obligations the construction of affordable homes. Agreement in principle is sought to provide funding to MLH in the form of either equity or loans, and other support and to dispose of Council land to it. Delegations are sought to make such decisions and finalise the various documents that will be required to facilitate the above as detailed in the recommendations to this report.

- 8.2 s1 Localism Act 2011 provides the Council with General Power of Competence, to do anything an individual may do subject to statutory limitations. The Council may exercise this power for its own purpose, for a commercial purpose and/or for the benefit of others. Operating a business to let homes at market sale or rent with the intention of making profits is considered a commercial purpose and the Council, in compliance with s4 Localism Act 2011 undertakes that activity through its Company, MLH.

- 8.3 s4 Localism Act 2011 prohibits the Council from engaging in activities for a commercial purpose if legislation requires the Council to fulfil those functions under statutory duties.

Finance

- 8.4 s24 Local Government Act 1988 provides the Council with the power to provide a wide range of financial assistance to MLH including making a grant or loan to it and as MLH is a body corporate the Council may under Section 24 (2)(d) acquire share or loan capital in it.

- 8.5 s111 Local Government Act 1972, provides Councils with the power to do anything whether or not involving the expenditure, borrowing or lending of money or the acquisition of property rights which is incidental, conducive or calculated to facilitate the exercise of any of their functions. This would include the exercise of functions under s1 Localism Act 2011. The Council could rely on this power to provide the company with loans and other support such as providing staff and the use of premises. Any support provided must be state aid

compliant (see below) and will be the subject of agreements between the Council and MLH.

- 8.6 If the Council intends to borrow to lend to MLH, Reg 25 Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (SI 2003/3146) treats the giving of a loan by a local authority to a third party (such as MLH) towards expenditure (e.g. works on a new buildings) as capital expenditure providing that if the local authority itself incurred that expenditure (it borrowed to undertake the works itself) it would treat that expenditure (under proper accounting practices) as capital expenditure. It should be noted that the Council borrowing to lend to MLH in connection with revenue funding is not permitted.

Land disposal and financial assistance

- 8.7 s32 Housing Act 1985 requires the Council to obtain the Secretary of State's (SoS) consent for the disposal of land held under the Council's HRA. The SoS has issued the General Housing Consents 2013 (the General Housing Consents) which set out circumstances in which the SoS pre-approves/pre-consents to a local authority disposing of HRA land and property. Consent A 3.2 of the General Housing Consents permits the Council to dispose of vacant land. Members should note that vacant land means land where there are no dwellings and/or where any dwellings are no longer capable of human habitation and are due to be demolished.
- 8.8 The Council is entitled to dispose of land held by its General Fund (including buildings) to a third party provided it complies with s123 Local Government Act 1972. This requires it to obtain a consideration which is not less than the best it could reasonably obtain. If the Council disposes of a property at an "under-value" it does require the consent of the SoS (except for limited circumstances such as short term leases).
- 8.9 If the Council was able to sell at an under-value (and remain State Aid compliant) the Council may be able to rely on Circular 06/03 (the Local Government Act 1972 – disposal of land for less than best consideration) which sets out circumstances in which the SoS pre-approves/pre-consent to the disposal of General Fund land at an under-value. If this consent is to apply then the "under-value" (in relation to a disposal) must not exceed £2m and the Council's purpose in making such a disposal must be to contribute to the economic social or environmental well-being of the authority's area and/or its residents.
- 8.10 The finance which Members are requested to approve in principle (whether on commercial terms or otherwise) constitutes 'financial assistance' under the terms of s24 Local Government Act 1988 which permits the Council to provide financial assistance to any other person for the provision of "privately let accommodation". If the Council exercises its powers under this section then under s25 it must obtain the consent of the SoS to do so. The SoS has set out pre-approved consents in the "General Consents 2010" (July 2011 updated in 2014). If the circumstances of financial assistance meet one of the criteria in the General Consents then the SoS consent is given.

- 8.11 s24 Local Government Act 1988 provides the Council with the power to provide a wide range of financial assistance to MLH including making a grant or loan to it and as MLH is a body corporate the Council may under Section 24 (2)(d) acquire share or loan capital in it. The current version of the General Consents 2011 contains Consent C. Under this consent the Council could provide financial assistance to any person.
- 8.12 When exercising its powers, the Council must, as with any other power, have regard to its own procedural rules, the Wednesbury principles of reasonableness and its fiduciary duties. It must also ensure that its powers are used for the proper purpose.

Fiduciary Duties

- 8.13 The Council's fiduciary duties could be briefly summarised as it is acting as a trustee of tax and public sector income on behalf of its rate and tax payers. The Council in effect holds money but does not own it; it spends money on behalf of its business rate and Council tax payers.
- 8.14 In making the decisions concerning MLH, consider whether making investment and or extending loans to that body (and similar activities) should give proper consideration to the risks and rewards of approving the recommendations. In practice Members will want to consider whether the Council will achieve an appropriate return for its risk and that the Council has minimised the risk and potential cost to it if MLH became insolvent and/or defaulted on its loan(s).
- 8.15 Consideration should also be given to whether the Council's involvement in this arrangement is proportionate and properly balanced against the anticipated benefit as well as the wider interests of its local business rate and tax payers. On a practical basis this means that Members should consider whether the monies they are requested to approve for investment/lending, could be better used by the Council for the wider interests of its local tax payers. This should include considering the impact on the Council (and therefore its local tax payers) if MLH became insolvent or otherwise defaulted on loans it had taken from the Council.

State Aid

- 8.16 The Council is required to provide funding and ensure it and MLH operates in accordance with the state aid requirements. Article 107 (1) of the Treaty on the Functioning of the European Union 1957 (**Treaty**) declares that state aid, in whatever form, which could distort competition and affect trade by favouring certain undertakings or production of certain goods, is incompatible with the common market, unless the Treaty and in practice the European Commission (through regulations and decisions) allows otherwise.
- 8.17 It is important that any loans/credit or other support provided to MLH are state aid compliant. Loans/credit which the Council generally makes available to MLH must be made on commercial terms and at a commercial interest rate. If the Council subsequently chooses to make an equity investment into MLH its must

ensure this is done on commercial terms. It will be necessary for the Council to obtain independent confirmation that such arrangements have been made on commercial terms prior to them being entered into.

9. Human Resources implications and risks:

- 9.1 The MLH business forms part of the Council's overall regeneration programme and requires continued involvement of officers from the Regeneration team and other Council services from time to time.
- 9.2 Section 2.5 of this report confirms MLH has sufficient capacity to deliver its 2019/20 business plan. Accordingly, it is not anticipated that the update to and approval of the MLH Limited Business Plan 2019/20, and its related development activity, will have any adverse human resources implications or risks. As the company grows and its portfolio expands, its level of resourcing will be reviewed to ensure it operates as an efficient and sustainable business.
- 9.3 Should further resources be required, consideration needs to be given as to whether the company's employees should be directly employed by the company, or be agency workers/consultants engaged directly by the company or by the Council on behalf of the company or be employed by the Council and 'seconded' to the company either temporarily or on a permanent basis. Each option will be considered from time to time in the light of the needs of the company to be able to attract, recruit and retain their employees by paying an appropriate 'private sector' market rate salary and the possible risk to the Council of creating comparators from an equal pay perspective should the Council act as the employer.
- 9.4 In a similar manner the Company will need to establish suitable company infrastructure such as accommodation, ICT.

10. Equalities implications and risks:

- 10.1 The Public Sector Equality Duty (PSED) under section 149 of the Equality Act 2010 requires the Council, when exercising its functions, to have due regard to:
- (i) the need to eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Equality Act 2010;
 - (ii) the need to advance equality of opportunity between persons who share protected characteristics and those who do not, and;
 - (iii) foster good relations between those who have protected characteristics and those who do not.

Please note 'Protected characteristics' are: age, sex, race, disability, sexual orientation, marriage and civil partnerships, religion or belief, pregnancy and maternity and gender reassignment.

- 10.2 An Equality Impact Assessment was undertaken on the establishment of a private sector focussed Council Owned Housing Company, the results of which led the Council to believe its operation will have a positive impact on local residents, businesses and staff.

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- 10.3 As the Company was established by the Council, its development had to be compliant with the Public Sector Equality Duty (PSED) in the Equality Act 2010 (EA10).
- 10.4 Once established, the Company will to be operating in compliance with the general duty of the EA10 and will be required to carry out Equality Impact Assessments on relevant projects and initiatives so as to ensure that positive equality outcomes are optimised and any potential/likely negative implications are mitigated.
- 10.5 The officers consider the existing Equality Impact Assessment continues to be of relevance to the Company and for the purpose of seeking the agreement by Cabinet of the MLH Limited Business Plan 2019.

BACKGROUND PAPERS

None