Havering
LONDON BOROUGH

CABINET	**5th August 2020**
Subject Heading:	**Havering and Wates Regeneration Covid-19 Options Paper**
Cabinet Member:	Councillor Damian Council and Portfolio Holder for Regeneration.
SLT Lead:	Neil Stubbings - Director of Regeneration
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Policy context:	Havering Housing Strategy 2014-2017 National Planning Policy Framework 2012 Draft London Plan 2017 Emerging Havering Local Plan 2017 HRA Business Plan 2017-2047 Romford Housing Zone - Overarching Borough Agreement with the GLA Havering Local Development Framework and Romford Area Action Plan 2008 Romford Development Framework 2015-
Financial summary:	This report presents a number of options to bring forward the development of Napier New Plymouth. The detailed financial arrangements for each site are contained within the exempt agenda report.
Is this a Key Decision?	This is a key decision

Options Paper- 20th April 2020

When should this matter be reviewed?	Spring 2020
Reviewing OSC:	Towns and Communities OSC

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

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

SUMMARY

1.1 In June 2016 and October 2016, Cabinet received reports which proposed to increase the number of affordable homes on housing sites owned by the Council. As a result of the information provided to Cabinet, 12 sites vested in the HRA were identified for regeneration and Havering and Wates Joint Venture appointed to bring forward these proposals. However, the outbreak of COVID-19 has created an unprecedented situation in which the Joint Venture must consider its ability to deliver the Schemes and ensure exposure is limited.

1.2 In October 2019 the planning application for the redevelopment one of the 12 sites, Napier and New Plymouth House was submitted by the Havering and Wates Joint Venture and approved by the Council's Strategic Planning Committee. The approved scheme proposes to deliver 197 new homes, 64% of which will be affordable, delivering 126 affordable residential units, including 87 as part of the 'right to return' re-provision for previous Council Tenants.

1.3 With the serious outbreak of the COVID-19 virus since the turn of the year, the Government has taken action to reduce its spread and the associated level of excess mortality has resulted in lock-down and a reduction in macro-economic activity.

1.4 The extended lockdown linked to the COVID-19 outbreak has resulted in a severe economic downturn, impacting on various sectors, household incomes and jobs. This has created a significant element of uncertainty in the housing market. Across the housing sector, it has been highlighted that assumptions on house-prices may need to be revisited and remain uncertain in the short term. RICS, in response to the COVID-19 outbreak had asked valuers to consider all circumstances where a material uncertainty declaration is appropriate. The uncertainty has been reflected in the share prices of the leading developers in the sector, which have seen a significant fall in value since the outbreak. The resulting loss of confidence has impacted on housing development and calls into question some of the assumptions underpinning the approved Havering & Wates Regeneration Business Plan.

1.5 The uncertainty will have a material effect on sites which are scheduled to come forward for development within the next 12 months, including Napier New Plymouth (NNP), where construction was scheduled to commence at the end of April 2020. The uncertainty in house prices has eroded confidence in the projected level of sale receipts on NNP, underpinning the approved Business Plan. In response, both the Council and Wates Construction Limited (WCL) have agreed it would not be possible to proceed to construction in accordance with the Business Plan until after either the housing market returns to pre-COVID19 levels or the Council along with its JV Partner Wates Construction Limited resolves the deterioration in viability linked to COVID19.

1.6 This report assesses the various options available to the Council to unlock the development of the Napier New Plymouth estate.

RECOMMENDATIONS

1. **Approve** the recommendation option 4 set out at paragraph 6 of this Report to progress the development of Napier New Plymouth as a 100 per cent Council scheme, at a total development cost of £57.370 million, with a final decision on the tenure of the additional 71 units to be agreed by the Director of Regeneration in consultation with the Director of Housing.

2. **Note** that the Leader of the Council, after consultation with the s151 Officer will be responsible for the approval of the revised business case for Napier New Plymouth and related viability assessment.

3. **Authorise** the Director of Regeneration to take all steps necessary to negotiate and enter into variations of any of the joint venture documentation and the planning permission and associated planning obligation to the extent required to enable the implementation of Option 4.

REPORT DETAIL

2.1 Background

2.2 The recovery phase has begun with an easing of the restrictions by the UK but the UK economy will contract in 2020, adversely impacting on jobs and household incomes in the UK and the world economy. The UK along with most countries will need to consider intervention, underpinned by an increased level of national debt to both maintain existing jobs and support growth in the future.

2.3 There will be a period of uncertainty across a range of sectors including housing and construction as we go forward. The short and long term impacts of COVID-19 outbreak on the Havering and Wates Joint Venture (Havering and Wates Regeneration LLP (the JV/HWR)) are still unfolding, however a softening of the revenues on the 12 Estates is a significant risk, with an independent open market valuation obtained by the Council running some 20% below the approved Business Plan projections. Given the level of uncertainty and risk, both the Council and WCL cannot endorse the assumptions, which underpin the current Business Plan, approved 12th February 2020 by Cabinet. Viability is a Condition Precedent required to vest the first site Napier New Plymouth (NNP) to the joint venture and crystallise the Council land value.

2.4 It will not be possible to vest NNP into HWR until the adverse impact on viability linked to COVID-19 outbreak is resolved. As a result, construction, which had been scheduled to start with the vesting of NNP (end of April 2020) has been delayed.

2.5 Given a potential softening of revenues in the short to medium term, it is likely that to continue with the development as currently proposed by the approved Business Plan would result in the forward funding commitment for NNP increasing. It may be possible that some of this may be offset by a reduction in build costs, given a potential collapse in demand.

2.6 In response to the COVID-19 outbreak, HWR must review contract terms, putting in place mitigation measures. Where possible, in such unprecedented times, the JV may need to be pragmatic in order to find short term solutions to safeguard the viability of the project, including measures to best retain resources, materials and general capabilities during and after the pandemic period.

2.7 It is anticipated that any adverse impact linked to the COVID-19 outbreak would be short term, and is unlikely to impact on sites which are earmarked for completion beyond the next two years. It is therefore proposed to continue with the proposals for Waterloo and Queen Street and Solar Serena Sunrise estates in line with the approved Business Plan, pending a review at the next Business Plan refresh, scheduled for November 2020.

2.8 Discussions are ongoing with the GLA to ascertain what support they can provide to bring forward stalled developments. The formation of a housing recovery task force which will bring together key stakeholders to assess the measures needed to keep development moving forward. The GLA have noted the long term the fundamental strength of London's economy and its property market would remain.

2.9 Applications for gap funding and other financial support from the GLA are over-subscribed, and it is therefore unlikely the Council will receive any additional funding from the GLA in the short term. The scope of discussions has been limited to information gathering, to support a GLA application for additional funding from Central Government. Any additional funding from the GLA in the short term would be limited to additional affordable housing grant, linked to an increase in affordable housing on existing schemes.

2.10 The options available to the Council and WCL to bring forward the development of NNP are summarised below: -

Option 1 - Pause on activities

3.1 Without an immediate solution to address the deterioration in viability and the effect on the approved Business Plan, both JV partners could consider placing the development of NNP on hold. The pause would have to remain in place until either: -

- Confidence returns to the housing market, with sales values recovering to at least pre-COVID19 levels.
- The Council or GLA provides additional gap funding.

3.2 Placing a pause on activities would expose the Council to cost escalations on NNP, with an extension of the Pre-Construction Services Agreement (PCSA) contract made between the HWR and WCL currently running at £80k per month. This contract is scheduled to terminate in advance of the commencement of the building contract. It will also be necessary to continue to secure the site at the cost of £25k per month. Other monthly payments include the Development Management fee £43k per month, Professional Fees £18k per month and financing £30k per month.

3.3 Therefore, the cost of delays to HWR (of which the Council funds 50%) is running at £178k per month on the NNP site. This is further compounded by the loss of rent and other income as the completion of the units is pushed further back.

3.4 For an extended pause, ongoing holding costs would need to be reviewed by HWR. There is scope to reduce some costs, including not committing to an extension of the PCSA and suspending all design and consultant activities. A pause would require the JV to stand down its service and works providers, with a resumption of activity adding delays and costs to the programme. If there was an extended pause the parties would also need to consider whether they needed to or should agree an extension to the Programme in relation to the development of NNP.

3.5 It should also be noted that if there were to be an extensive pause, the procurement law risk implications of the cumulative costs would need to be reviewed. Currently, a brief pause appears low risk, due to the value involved, however a more extensive pause may require further procurement law consideration.

4.1 **Option 2 - Underwriting Sales Risk**

4.2 The development manager has put forward an option which would see the Council underwrite the sales risk linked to COVID-19 outbreak. Given the market uncertainty, it is difficult to pre-determine. However, the two scenarios below have been assessed: -

- 10% reduction in sale revenues, £2.4M
- 20% reduction in sale revenues, £4.8M

4.3 With the Council underwriting any sales risk and viability resolved, both JV partners could agree to take forward the development of NNP following the parameters laid out in the approved Business Plan.

4.4 Under this scenario, the Council would need to set aside up to an additional £4.800 million of capital funding to cover any shortfall in revenues as compared to the Business Plan. Any shortfall payment from the Council would be made once the sales programme has completed.

4.5 While this could unlock the development, this option undermines the principle of sharing risk, and would in effect remove most of the risk to WCL as a joint venture partner.

4.6 Also, the Council would need to put in place additional HRA capital approvals, which would need to be approved by Cabinet and Full Council. This option would also raise both state aid and procurement issues. This option removes the JV partner sales risk and changes the economic balance of the contract in favour of WCL. This increases the risk that this change would be seen as an unlawful material change to the contract, which, had it been detailed in the procurement documentation at the time of OJEU advertisement in the market, may have attracted different bidders.This option has, therefore, been discounted.

5.1 **Option 3 - Early Works Agreement**

5.2 A third option would be to bring forward some elements of the building contract within the scope of the Early Development Agreement (EDA). The EDA would facilitate the commencement of works on the NNP site in advance of the vesting of the site in the JV. The Development Manager (DM) has earmarked up to

£6.615 million of construction works for six months, which could be brought into the scope of the EDA.

5.3 The costs of the works would be directly charged to HWR and would, therefore require both members to advance funds. However, without a resolution to viability it would not be possible for WCL to advance funding to support the construction works. As a result, it would not be possible to progress the EDA, without intervention from LBH.

5.4 As the Development Agreement is not unconditional yet (due to the lack of viability) there is no obligation on either partner to advance B Partner Loans. The partners would therefore need to agree to vary the Members Agreement to enable C Partner Loans to be advanced where the parties agreed to it. Under such a proposal, the Council would advance £6.615 million to bring forward the works under the EDA, covering 100% of the cost. The C Partner Loans take priority in the event of a liquidation / winding up of HWR.

5.5 A coupon of 15% is attached to the C Partner Loans, which the Council would benefit from. However, there are insufficient profits now to settle this liability without additional forward funding. It would, therefore, be necessary to adjust the development margin payable to WCL down to reflect the additional risk assumed by the Council and avoid increasing the level of Forward Funding. It would also be necessary to secure agreement from WCL to vary the Members Agreement before advancing C Partner Lending.

5.6 The works package would need to be compliant with the need to maintain social distancing and health requirements.

5.7 The advantage of this option would be to minimise delays to the commencement of construction activities on NNP, which would have the benefit of reducing abortive and holding costs. The PCSA would be terminated, saving £80k per month and other holding costs minimised through the avoidance of delays.

5.8 This option does not however resolve the underlying viability issue on NNP. A Business Plan refresh would be necessary to assess the current funding gap linked to the COVID-19 outbreak. Progressing with the Early Works would be at risk. Therefore, this option could only be advanced if the Council, as JV partner is prepared to introduce further forward funding to address the likely viability gap. In addition, if this option were to be considered further, the Council would need to carry out an analysis of whether this option would constitute a material change for procurement law purposes; if it had been detailed in the procurement documentation at the time of the OJEU advertisement could it have attracted different bidders. If it did constitute a material change the Council would also need to consider whether it could fall under the specific criteria for any relevant procurement law exemption, (for example, could it be argued that it is not a substantial change within the meaning of Regulation 72 (1)(e) of the Public Contracts Regulations 2015 (as amended)).

6.1 **Option 4 - Council acquire all Units**

6.2 Given the current uncertainty in the housing market, the Council could agree to acquire the additional 71 open market units but change the tenure. This option would eliminate the JV sales risk as the Council would commit to acquiring all the housing on the development.

6.3 This option increases the quantity of housing in the Borough at a time when the demand for affordable housing linked to COVID-19 outbreak is likely to increase With the Council's support, the joint venture can continue with the programme dedicated to providing good quality affordable family housing with enhanced design to meet the need of local residents.

6.4 Should the Council proceed with option 4, the Council would be responsible for 100% of the development cost of NNP of £57.370 million, with the Council securing a reduction of £4.382 million from the total development cost as agreed at the approved business plan. This would be internally funded by HWR from compensating cost savings coming from the sales and marketing budget, financing and the development margin, 50 per cent of would have been payable to the Council and is instead passed on through a reduction in the cost of development.

6.5 This option has the advantage of unlocking the development, commiting the Council to a total development cost of £57.370 million. It would be necessary to increase the amount set aside to cover the residual development cost from £36.558 million under the approved Business Plan to £57.370 million, an increase of £20.812 million.

6.6 This option would require variation of the Development Agreement between the Council and the JV to address the introduction of this new affordable tenure, the mechanism by which the Council will pay for these units and to recognise that the JV will not receive its Development Margin. The JV Partners would be required to approved the changes to the revised business case for NNP, as set out in the attached Phase Viability Plan (PVP).

6.7 Any change to the tenure of the scheme would require an amendment to the section 106 agreement by a Deed of Variation. It would be a commercial decision for the Council to decide if it can proceed to enter into contract with HWR in advance of formal approval for the changes in tenure.

Proposed Timeline to Start on Site on NNP

Milestone	Dates	Notes
Appropriation	August (28 days)	Notice to served for 28 days
Confirm tenure changes	August	Delegated to the Director of Regeneration
JV Approval of Phase Viability Plan	August	Will require approval fro both JV Partners

Amendment to Planning Approval / s106 - Submission	August	To cover both changes to tenure and minor amendments to design
Enter into contract with HWR	End August / Early September	Dependent on confirmation from planning
Start on site	September (mid to end)	One to two weeks after contract approval.

6.8 The Council would have the discretion to determine the tenure of the 71 affordable units from the following: -

6.9 Option 4a, Shared Ownership (71 units). The Council would be exposed to some sales risk but this would be mitigated by a disposal of a part interest, which must be at 25% of market value. Grant would be made available by the GLA at £28,000 per unit under the 16-21 programme to bring forward the development. Again this would maintain the mixed tenure approach. This maintains the principle of a mixed tenure development.

6.10 The Council could benefit from potential upside on sales as the market recovers from the end of the lockdown but with some flexibility to hedge against sales risk in the short term. The Council would retain some element of sales risk linked to the disposal of the initial interest.

6.11 Option 4b, Shared Ownership (36 units) with open market sale (35 units). The Council would retain the option to sell up to 35 units on the open market, with the remaining 31 provisioned for shared ownership. This would have the potential benefit of bringing forward the recovery of its investment. The delivery of the open market units would be incidental to the main objective, which is the delivery of affordable housing. Any cross subsidy would be used to reduce the overall cost of the development. This would maintain the principle of a mixed tenure development.

6.12 The Council would need to set aside a provision for CIL and sales and marketing fees for the open market units, estimated at £25,000 per unit. The Council could benefit from potential upside on sales as the market recovers from the end of the lockdown. With the current depressed valuations, it would be difficult to justify a policy of open market disposals, as they are unlikely to recover cost. However, should revenues return to pre-COVID-19 when construction is completed, the disposals could yield an overall net return to Council.

6.13 Option 4c, London Affordable Rent (71 units). Letting the units at London affordable rents, would improve the overall scheme viability if combined with a claim for RTB 1-4-1 funding. This option would see the Council move away from the mixed tenure approach.

6.14 The addition of the 71 London Affordable Rent units would improve the current projected scheme payback to the HRA.

6.15 The table below summarises the key impact of the various options below: -

TABLE 1 – Summary of Napier New Plymouth Options

	Option 1 - Pause	**Option 2 – Underwriting Sales Risk**	**Option 3 – Early Works**	**Option 4 – 100% Council**
Affordable Housing units	126	126	126	197 *
Development Cost Movement	Increased (holding costs)	Neutral	Neutral (subject to delays)	Reduced
Resolves JV viability	No	Yes	No	Yes
Forward Funding Impact	Increase	Increased	Neutral (subject to delays)	Neutral
Start on site	On pause	Late 2020	Aug 2020	Aug 2020
Payback to the HRA	Extended	Extended	Neutral	Reduced
Council Cost	Increased, linked to length of delay	Up to £4.900M	Neutral but viability not resolved	£20.812M + £25k per unit sales / CIL costs for open market disposals

* The Council would retain the option to market some of the units for open market sale.

6.16 Further financial details are captured in the exempt agenda report.

REASONS AND OPTIONS

7.1 **Reasons for the decision**:

7.2 The adoption of option 4 by the JV is a consent matter. Without the Council's approval, as a Member of the LLP, the revised Business Case for NNP could not be adopted and the current approved Business Plan would be maintained. The Council is in contract with WCL as a commercial partner for the delivery of the regeneration of sites within work package one and to share the associated costs. These commitments will need to be upheld.

7.3 In order to set aside the necessary funding for NNP, it will be necessary to approve the revised business case underpinning the change to a 100 per cent Council scheme. Not approving the revised Business Case will delay the delivery of the Napier New Plymouth development, which may have a negative impact on the

Council's ability to deliver on targets including affordable housing delivery and achieving targets agreed with the GLA in the Overarching Borough Intervention Agreements.

7.4 Not adopting option 4 may also give rise to negative market sentiment with a consequential impact on the wider development market that this scheme would otherwise seek to stimulate.

IMPLICATIONS AND RISKS

8.1 **Financial implications and risks:**

8.2 Detailed financial information (paras 8.1 to 12.11) are contained within the exempt appendices

13.1 **Financial risks:**

13.2 The impact of COVID19 will require a refresh of the Business Plan. With viability uncertain, both JV Partners have agreed not to advance funding to support construction on NNP. The impact of the COVID-19 outbreak and the resulting lockdown had effectively put the housing market on hold. With the relaxation of the restrictions, it is hoped that the demand should return to pre-COVID-19 levels. However, the lockdown is likely to have an impact in the short to medium term on demand for new housing, linked to increasing levels of unemployment and job insecurity.

13.3 It is anticipated that sales revenues will reduce in the short term, due to a reduction in household income and increasing job insecurity. A reduction in construction costs could offset the impact but the net impact cannot be quantified at this stage. COVID-19 will likely harm viability in the short term. NNP as the first site to go forward could see further erosion of viability, increasing the forward-funding requirement from the Council.

13.4 Under options 1 and 3, there is a risk that both partners would not agree the Business Plan refresh, with progress suspended on all sites. Both partners would have invested funds which they cannot recover unless the development is unlocked. The Council will have to consider if it is willing to progress the build contract and sales programme on NNP at risk or bring the joint venture to a close, crystallising the abortive costs on the programme.

13.5 Option 2 and 4 exposes the Council to additional financial commitment and risk but option 4 delivers an additional 71 affordable units to the Council, which would generate an enhanced rental return to service the associated borrowing.

13.6 Under option 3, the advancement of C Partner Loans is at risk, with the repayment contingent on the agreement of a revised Business Plan, with potentially an increased level of forward-funding committed by the Council.

13.7 The move to 100% Council scheme under option 4 changes the risk profile of the development, as effectively this moves away from an affordable housing fixed price agreement to a build contract. A contingency of 5% including a developer's contingency has been set aside to manage risk. This site has been extensively surveyed and the level of contingency has been validated to be sufficient under the worst-case scenario by IKON, the employer's agent for the development.

13.8 The various tenure sub-options under Option 4, have different risk profiles, with Option 4c, London Affordable Rent assessed to present the lowest financial risk to the Council given would not expose the Council to sales risk.

13.9 Sub-options 4a and 4b provide an element of sales risk to the Council but would maintain the principle of mixed tenure. There is a significant element of uncertainty linked to open market values at this time, with valuations depressed in response to COVID-19. However, it is possible that values could recover to pre-COVID-19 levels once the units are completed. Disposals at pre COVID-19 values would deliver a modest gain to the Council and would accordingly reduce the level of overhanging debt and risk. The government have extended support for the Help to Buy scheme to 2023, which would increase demand for outright sale.

13.10 Shared ownership presents an element of sales risk, but it is reduced by the requirement for a disposal of a part interest (minimum 25%). This government extension of Help to Buy to 2023, could dampen interest as qualifying households are likely to favour acquiring an outright interest (with government support) as opposed to a part interest. The Council would receive a rent based on 2.75% of the market value of residual interest held by the Council. This exceeds the current marginal rate of PWLB housing borrowing, 1.51% (30-year maturity loan), and therefore would provide a net return against Council investment. The tenants have the right to increase their interest in the property (staircasing), which would yield further capital receipts to the Council, but also lower the rents linked to the property.

14.1 **Legal implications and risks:**

14.2 This report follows a number of previous reports to Cabinet and most recently in February 2020.

The Cabinet is being asked to approve the development of Napier New Plymouth as a scheme to be funded by and owned by the Council and either:

- a 100 per cent affordable scheme with the exact affordable product to be determined in due course. [; or
- a mixed tenure scheme of at least 126 affordable units with the remainder being either affordable, shared ownership or private market sale (or a combination

of tenures), to be determined by the Director of Housing]/Director of Regeneration/Both?

The Leader will approve the revised business plan in due course

14.3 The Council has entered into the joint venture LLP with Wates pursuant to a number of powers including the Housing Act 1985, the Housing and Regeneration Act 2008, the Local Government Act 1972 and the general power of competence in section 1 Localism Act 2011. The general power of competence will enable the Council to make the necessary chages to the scheme as described.

14.4 The Council is contractually committed to progress the project in accordance with the agreements that have been entered into with Wates and the JV LLP, unless variations are agreed by the parties. In order to implement Option 4, the Development Agreement will need to be varied to allow for the acquisition of and the payment for units other than Low Cost affordable units by the Council and to acknowledge that the NNP scheme is viable without the JV receiving a Development Margin.

14.5 This report seeks approval for the 71 units which were previously intended to be open market units acquired by the JV to be funded by and retained by the Council. The report sets out the financial and other implications of proceeding with the scheme in the manner recommended.

14.6 The additional financing is capable of being met from the Councils existing budgets as set out in the MTFS 2020/21.

14.7 The Council will pay the JV the build contract sum. This is a lump sum of £52.277 million. The Council has received advice from Ikon that the costs payable pursuant to the build contract are a market price on the basis of the specification, the acquisition will therefore be compliant with the state aid rules.

14.8 The Council has the power to make market sales of housing developed out of the HRA where it is part of a housing decision taken for the purposes of meeting housing need under Part 2 Housing Act 1985. This can include cross-subsidy models where there are elements of market sale in a scheme to make the provision of sub-market housing, which is needed to meet housing need, viable.

14.9 Further legal implications are contained in appendix 1.

15 Human Resources implications and risks:

15.1 There are no Human Resources implications arising from this report.

16 Equalities implications and risks:

16.1 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.

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

16.2 The Council is committed to all of the above in the provision, procurement and commissioning of its services, and the employment of its workforce. In addition, the Council is also committed to improving the quality of life and wellbeing for all Havering residents in respect of socio-economics and health determinants.

16.3 A update to the existing EqHIA will be carried out linking to a final decision on tenure as proposed under Option 4.

BACKGROUND PAPERS

NONE
Appendices

- Appendix 1 – Exempt Appendix
- Appendix 2 – Draft Phase Viability Plan (Napier New Plymouth) - EXEMPT