

CABINET

13 November 2018

Title: Development of former Abbey Sports Centre Site, Axe Street, Barking	
Report of the Cabinet Member for Regeneration and Social Housing	
Open Report with Exempt Appendix 2 (relevant legislation: paragraph 3 of Part I of Schedule 12A of the Local Government Act 1972 as amended)	For Decision
Wards Affected: Abbey	Key Decision: Yes
Report Author: David Harley, Head of Regeneration, Be First	Contact Details: Tel: 020 227 5316 E-mail: david.harley@befirst.london
Accountable Director: Ed Skeates, Development Director, Be First	
Accountable Strategic Leadership Director: Claire Symonds, Chief Operating Officer	
Summary <p>After an open marketing exercise in 2013/4, Abbey Sports Centre was placed under contract for sale by way of a long leasehold interest to Sherhill (Barking) Ltd (Sherhill), a subsidiary of Lindhill Properties Ltd, for the development of a 147 unit build to rent residential led mixed use scheme (Cabinet 18 November 2014, Minute 65 refers).</p> <p>The developer subsequently received a Resolution to Grant planning permission for the scheme in late 2015 but, with the evolving GLA policy on affordable on-site residential accommodation in the last 18 months, the scheme has required adaptation to provide affordable housing units. This has resulted in viability issues for the developer and a reduced premium for the lease. A fresh planning application was submitted earlier this year for a new scheme which has officer support.</p> <p>The revised scheme shows 170 residential build-to-rent units of which at least 35% will be affordable (at a blended 70% of market rent). It retains the original proposals in a revised and amended configuration to provide accommodation for Care City (the joint venture between LBB and North East London Foundation Trust), a small community focussed cinema proposed to be operated by the company Art House plus two retail units.</p> <p>It is also now proposed that the Council will provide development finance for the scheme on market facing terms (i.e. commercial interest rate and terms).</p> <p>This report updates the Cabinet on progress with the development and recommends a revised deal structure and proposed loan arrangements which will enable the development to proceed in the quickest way to deliver the homes and facilities.</p>	
Recommendation(s) <p>The Cabinet is recommended to:</p>	

- (i) Approve the proposed changes to the scheme design and for the Council to provide short-term development finance to Sherhill (Barking) Limited up to the sum of £28m on the terms set out in Appendix 2 to the report, to be funded via borrowing through the General Fund from the Public Works Loan Board;
- (ii) Delegate authority to the Chief Operating Officer, in consultation with Director of Law and Governance and the Cabinet Member for Regeneration and Social Housing, to scrutinise the due diligence reports, negotiate final terms and agree the contract/loan documents to fully implement and effect the proposals set out in the report; and
- (iii) Authorise the Director of Law and Governance, or an authorised delegate on her behalf, in consultation with the Chief Operating Officer, to execute all the legal agreements, contracts, loan, security and other documents on behalf of the Council.

Reason(s)

The initiative will contribute significantly to the Council's priority of 'Growing the Borough'. The project will have a significant impact at a gateway entrance to Barking town centre and provide additional homes within the borough.

1. Introduction and Background

- 1.1 In September 2015, the former Abbey Sports Centre site was placed under contract with Sherhill for redevelopment. This followed a formal competitive marketing campaign in 2013/4 with a planning brief for a residential led, mixed use development incorporating community uses.
- 1.2 Sherhill's original scheme proposed 147 residential units (all private), a three-screen cinema, two retail units and a 20,000 sqft floor of offices for Care City (the primary healthcare joint venture between the Council and NELFT).
- 1.3 During the course of negotiation, it was agreed that the land premium for the grant of the 150-year head lease on the site would be ring-fenced as a contribution to off-site affordable housing. The agreement also contained a number of conditions precedent including securing planning consent, having funding in place and having a cinema operator on board in order to ensure the land would only be handed over to the developer once the scheme could be delivered in full.
- 1.4 The agreement has since been extended twice and varied once to reduce the size of the Care City space from 20,000 sqft to 6,000 sqft (at Care City's request) enabling additional residential units.
- 1.5 Progress however stalled over the last 18 months following the Mayor's planning policy for on-site affordable units (AU). This seeks a minimum of 35% on-site AUs unless a formal viability study supports a lower figure which has impacted on the land receipt.

- 1.6 The developer has therefore chosen not to progress the original scheme as planning would not be approved for a viable scheme but instead negotiate a revised arrangement with the Council. The new plans show 170 residential units, a two-screen cinema, a 6,000 sqft ground floor office and two retail units. A planning application was made in March 2018 and pre-application meetings have been positive. Subject to approval by the Council to the revised deal and agreement from the GLA on the revised AU element, the scheme is capable of being progressed through planning and works starting on-site without further delay early next year.
- 1.7 Whilst the building was empty it was let on a temporary arrangement at a peppercorn to a Food Bank charity. There is a requirement to carry out intrusive survey work and boreholes within the building to inform the demolition and remediation strategy and foundation design followed by a number of pre-demolition and enabling works hence the charity were served notice.
- 1.8 The updated Investment and Acquisition Strategy identifies a potential commercial lending asset class with an allocated value of £200m, which is yet to be approved by Council Assembly. The proposed development finance falls into that asset class. Whilst this report is in advance of approval of the commercial lending evaluation process and procedures being in place, it covers the key areas requiring consideration including due diligence, an independent report on the interest rate addressing state aid and loan security issues.

2. Proposals

- 2.1 In order to move the scheme forward, it is proposed to revise the arrangements with Sherhill as follows:
- A new scheme comprising 170 build to rent residential units, a two-screen cinema, 6,000sqft of offices for Care City and two retail units (a CGI of the scheme forms Appendix 3).
 - The developer will provide at least 35% AUs on-site for the duration of the head lease (to be let at a blended 70% of market rent)
 - The premium for the head lease will be lowered as per the terms set out in Appendix 2
 - The Council will provide development finance of up to £28m as per the terms set out in Appendix 2
 - Planning approval will be sought this autumn, with works commencing on site in early 2019 and completion expected in early 2021.
 - The other terms of the original development agreement will remain as drafted including the obligation to professionally manage the block upon completion. It is understood that it remains Sherhill's intention to sell the completed scheme to a PRS fund.
- 2.2 The current agreement with Sherhill contractually runs until December 2018, however it can be extended if there is a pending planning application (which there is). The option therefore exists to let the contact run until planning determination, it would be feasible to regain control of the site upon a refusal and the option would be to promote an LBB/Be First scheme. Further delays would be experienced whilst a new scheme is prepared and planning permission sought. This option is assessed further below.

On balance, the preferred option will deliver new homes and facilities in the quickest way by some 12-18 months assuming the scheme is commenced and progresses without delays (whilst generating a short-term return for the Council against a higher expenditure figure but long-term income).

3. Options Appraisal

The following options have been assessed:

3.1 Option 1: Proceed with Sherhill as proposed with the Council providing development finance – The Preferred Option

This option would allow the enhanced scheme which includes affordable housing to proceed through planning without further delay and therefore aligns with the Council's aim of accelerating regeneration within the Borough. Planning consent is likely to be secured and GLA Stage 2 cleared by the year end for a start on site in early 2019. The existing documentation will be varied to reflect the revised scheme and a separate loan agreement prepared. Any development upside will be protected by overage clauses. As a result of the variations to deliver the affordable housing, the Council is foregoing the currently contracted land receipt. Further details are provided in Appendix 2, which is in the exempt section of the agenda as it contains the commercially confidential financial and legal advice (relevant legislation - paragraph 3 of Part 1 of Schedule 12A of the Local Government Act 1972 (as amended)) and the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

Compared with Option 2, the provision of loan funding will give the Council greater control to ensure the development is completed within the proposed timescale alongside a short-term revenue return on its investment. Options 1 and 2 (below) ensure the Council receives New Homes Bonus, council tax and business rates income at least 18 months earlier than Option 3 and are expected to deliver additional revenue income of £750k (£300k for NHB, £300k for Council Tax and £150k for business rates) in addition to its investment income during the period Option 3 would be developed.

3.2 Option 2: Proceed with Sherhill as Option 1 but without the provision of development finance

This is Sherhill's preferred option and allows a Private Rented Sector investor to pay for the investment on a drawn-down basis. It still reduces the head rent in accordance with the preferred option as detailed in Appendix 2 but precludes the Council making a financial loan return. Otherwise similar to Option 1 in both security and timescale.

3.3 Option 3: Council to allow the current agreement to run until natural determination upon refusal/withdrawal of planning and deliver itself

This will allow the Council to retain the assets and move forward with their own development, or to seek a new partner. However, Sherhill would stand to lose both their initial deposit and considerable fees incurred to date if this option is progressed. Sherhill would seek to resist this option which could generate legal costs, delays to scheme delivery and would introduce additional risk and delay.

It is estimated that direct delivery would result in delivery of new homes, Care City space and the cinema being delayed by at least 18 months which is counter to the Council's aim of accelerating regeneration. It would also allow the Council to retain the developed assets which would yield long term income. It could present a reputational risk by not progressing with a selected development partner who are currently progressing a supported scheme in planning. However, these considerations are also impacted by sensitive commercial and legal issues which need to be evaluated and are addressed in the Appendix 2 (due to commercial sensitivity).

The 18-month delay to practical completion of the scheme, as proposed in this option would mean the loss of £750k from NHB, council tax and business rates as well as the loss of the initial short term investment return. It would also lose the opportunity to re-develop this strategic town centre site in the most expedient way.

3.4 Option 4: Sell existing building

This option envisages the retention of the existing building which is either let out or sold for existing use value. Be First's valuation advice highlights that a disposal for existing use would realise the highest consideration, avoiding the significant costs of redevelopment and the affordable housing requirement. Retaining the existing building however would fail to transform the area and would not secure the new homes and other facilities (and the associated income to the Council) from the larger regeneration.

3.5 Conclusion

On balance, despite the potential long-term investment returns that could be secured through direct delivery (the figures are set out in Appendix 2), the proposal to bring forward the development in the quickest way is seen as the favoured option particularly given Be First's significant programme of direct development activity on other sites and the aim of accelerating regeneration. Disposing of the property at existing use value (Option 4) will forgo a major regeneration opportunity and, potentially, future control of the site, hence, it is discounted.

4. Consultation

- 4.1 There has been significant consultation on the development proposals in advance of and as part of the statutory consultation process which saw broad support for the proposals.
- 4.2 Officer consultation has occurred through the Investment Panel assessing the due diligence information and reports from external advisors.
- 4.3 The Be First Board in October considered the report.

5. Financial Implications

Implications completed by: David Dickinson, Investment Fund Manager

- 5.1 The report seeks to gain approval for a loan to the developer, Sherhill Barking Ltd (a subsidiary of Lindhill Properties Ltd), for a proportion of the construction costs. The Heads of Terms and initial due diligence have been reviewed by Investment Panel.
- 5.2 The development is not one of the 44 schemes agreed as part of the Investment and Acquisitions Strategy (IAS) and the proposal for commercial lending is currently not an asset class within the IAS.
- 5.3 The full financial implications are set out in Appendix 2.

6. Legal Implications

Implications completed by: Suzan Yildiz, Deputy Head of Commercial Law and Governance

Council Powers

- 6.1 There are several relevant powers facilitating the Council power to participate in the preferred option. The general power of competence under section 1 of the Localism Act 2011 provides the Council with the power to do anything that individuals generally may do. Section 1(5) of the Localism Act provides that the general power of competence under section 1 is not limited by the existence of any other power of the authority which overlaps (to any extent) with the general power of competence provided that there are no other statutory restrictions or prohibitions against the proposed activity (section 2)). The use of the power in section 1 of the Localism Act 2011 is, akin to the use of any other powers, subject to Wednesbury reasonableness constraints and must be used for a proper purpose.
- 6.2 Whilst the general power of competence in section 1 of the Localism Act 2011 provides sufficient power for the Council to participate in the transaction and enter into the relevant project documents, further support is available under Section 111 of the Local Government Act 1972 which enables the Council to do anything which is calculated to facilitate, or is conducive to or incidental to, the discharge of any of its functions, whether or not involving expenditure, borrowing or lending money, or the acquisition or disposal of any rights or property.
- 6.3 Section 123 Local Government Act 1972 obliges the Council to secure the Secretary of State's consent to a disposal at less than the "*best consideration reasonably obtainable*" for its land. On the assumption that this is the relevant disposal power (i.e. the land is not held for planning or housing purposes), a general consent exists for disposals at 'up to' £2 million of undervalue. Section 24 of the Local Government Act 1988 requires the Secretary of State's consent to the provision of financial assistance (the loan in this case) for funding the delivery of residential property for rent – a general consent has been issued by the Secretary of State. In reaching a decision, the Council must carefully consider the options considered and also have regard to the following:

- i. Compliance with the Statutory Guidance on Local Government Investments;
- ii. Fulfilling its fiduciary duty to tax payers;
- iii. Obtaining best consideration for any disposal of land;
- iv. Compliance with state aid and procurement regulations;

The Proposals

- 6.4 In 2013/14, the Council procured Sherhill Barking Limited (whose obligations are guaranteed by its parent Lindhill Properties Limited) (the Developer) for an earlier iteration of the development scheme, and effectively entered into an agreement for lease (an option to acquire an interest in the land) with a premium being payable by the Developer. However, the original scheme has since become financially unviable, resulting in variations to the original contract which extended that option. It is now proposed to allow the Developer to pursue a revised scheme (in planning terms) (the details of which are set out in section 2 of the report). The consequential impact of this is a variation of the original agreement, as the scheme now includes affordable housing (unlike the previous scheme) and reducing the land receipt (as set out in Appendix 2) due under the current contract because the scheme with affordable housing tenure results in a negative residual value of the land. It is notable that the current agreement with the Developer could lapse unless extended to allow pursuit of a planning application which has been submitted or it could lapse if unconditional funding is not secured by the Developer.
- 6.5 The full legal implications which are intended to aid members in their consideration of the options and issues are set out in Appendix 2, which contains commercially sensitive material and legal advice.

7. Equalities and other Social/Customer Impacts

- 7.1 These issues will be considered as part of the assessment of the planning application for the scheme.

8. Other Implications:

8.1 Risk Management –

- **Construction Risk** – Sherhill will retain the construction risk during the development programme, thereby limiting the Council's exposure. Security arrangements for the performance of Sherhill and, in turn, the contractor is set out in the Heads of Terms. Be First will monitor the scheme during construction and be live to any issues of construction and funding.
- **Market Risk** – The scheme has recently been financially appraised with Sherhill having a contractor lined up with a priced scheme. Sherhill will be obliged to deliver and manage long term 35% of the units as AUs irrespective of leasing of the market value units.
- **Funding risk** – Initial financial due diligence on the borrower and guarantor by both Be First and GVA have not given cause for concern. The Council will retain ownership of the land throughout. The head lease will only be granted once the scheme is practically complete. Appropriate safeguards will be built into the documentation including step-in rights in the event of developer default, direct

warranties secured with consultants with principle design responsibility and copyright of designs obtained. Loan advances will only be made on independent certification of expenditure. Sherhill will need to put their funding into the scheme prior to the Council's development funding and providing proof of funds is a condition precedent.

- **Ground contamination** – Full ground investigations are being undertaken by Sherhill as part of their due diligence process.

- 8.2 **Contractual Issues** - Contractual implications are as described and covered within the Legal Implications section of this report.
- 8.3 **Staffing Issues** – The project will be managed on behalf of the Council by Be First, with the main element of resource being required to get the scheme in to contract. Surveyors will be appointed to monitor construction and expenditure during the construction phase of the project.
- 8.4 **Safeguarding Children** – Through the planning process the scheme has been designed to ensure it addresses policy requirements.
- 8.5 **Health Issues** – There is considerable evidence that improvements to housing and the local environment can improve health and well-being outcomes for local people. Health issue will be taken into consideration during the development process, where applicable, with a view to improving health and well-being for new and existing residents.
- 8.6 **Crime and Disorder Issues** – Section 17 of the Crime and Disorder Act 1998 places a responsibility on councils to consider the crime and disorder implications of any proposals. The proposals set out in this report will help make the areas safer by improving the quality of the environment, creating safer more natural surveillance for public areas and pedestrian routes. The development makes use of a currently vacant, brownfield site, which is currently at risk of illegal occupation. The development proposals will therefore have a positive impact on the local community.
- 8.7 **Property / Asset Issues** - The transaction will see the Council leasing the site for a term of 150 years.

Public Background Papers Used in the Preparation of the Report: None

List of appendices:

- **Appendix 1: Site plan**
- **Appendix 2: Financial and Due Diligence Summary** (exempt information)
- **Appendix 3: Sherhill scheme CGI**