

CABINET

17 February 2020

Title: Purchase of the former Muller Factory Site, Selinas Lane, Chadwell Heath	
Report of the Cabinet Member for Finance, Performance and Core Services	
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: Whalebone	Key Decision: Yes
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Accountable Director: Ed Skeates, Development Director, Be First	
Accountable Strategic Leadership Director: Claire Symonds, Chief Operating Officer	
Summary It is proposed to acquire a 13 acre cleared plot (shown in Appendix 1) known as the former Muller site within Chadwell Heath currently designated as Locally Significant Industrial Site (L-SIS) by means of newly formed special purpose vehicles (SPV) which will be 100% owned by the Council. The purchase of the site will provide the Council with control over the wider L-SIS allocation that is proposed to be reallocated for mixed uses (residential and employment) in the forthcoming Masterplan and Local Plan. Following the purchase of the site, Be First will work to add value by promoting a revised mixed-use allocation via a new Masterplan and policy allocation in the emerging Local Plan and then sell the site to the private sector for it to deliver the proposed mixed-use development, subject to normal 'best consideration' objectives in any disposal. It is not envisaged at this stage that the Council or Be First would be involved in the construction phase of the development. The main reason for the intervention is to establish an appropriate planning framework to manage the co-location of commercial and residential uses and provide the private sector with best practice guidance on the delivery of the wider Chadwell Heath masterplan. Additionally, the intervention will enable the Council to capture an element of the land value uplift from the revised allocation. The expectation is the site will be held for up to 3 years before it is sold with the benefit of the revised allocation and the land value uplift is returned to the Council. The site purchase and the planning promotion costs will be funded from Council borrowing and the asset will be held in a newly 100% owned Council company to serve as a corporate Special Purchase Vehicle (comprising a Holding Co which will further hold Asset Co's) (as opposed to the General Fund). This provides the Council with the maximum flexibility for the repatriation of the eventual receipt when the site is sold to the private sector for the delivery/ construction phase. The new holding vehicle will have its	

own governance structure with the Council being the sole shareholder and decision maker. The day to day project administration will be undertaken by Be First Regeneration (BFR) and subject to existing controls including the annual business plan, shareholder agreement and board approvals. BFR will continue to be a 100% Council owned subsidiary. The proposed holding structure provides flexibility for the Council to make a part disposal, via the sale of shares in Asset Co that could enable a joint venture to be formed with a private sector partner at a later date. In the longer term it is proposed to streamline the holding structure of Be First with a Holding Co sitting above both Asset Co that will hold the Muller asset as well as Be First Regeneration Ltd. This will achieve an accountancy efficiency for LBBB. Before this change is made the Council will review the cumulative impact of accountancy benefits as well as governance and audit issues to determine its overall efficacy.

Recommendation(s)

The Cabinet is recommended to:

- (i) Agree that the Council company Be First Developments Limited shall be activated;
- (ii) Agree, as shareholder, to the change of name of Be First Developments Limited to Be First Developments (Muller) Limited and to authorise the Chief Operating Officer to take all necessary action on behalf of the Council to effect that change, to agree the articles and to negotiate and agree service contracts for the directors and any shareholder agreements;
- (iii) Agree to the proposed purchase of the former Muller site by Be First Developments (Muller) Limited on the terms set out in the report and authorise the Chief Operating Officer to negotiate and enter into all the necessary agreements on behalf of the Council and give approvals on behalf of the Council as shareholder and Chief Operating Officer, in consultation with the Director of Law and Governance, to complete on the proposed transaction subject to satisfactory due diligence and an independent valuation;
- (iv) Agree to the Council borrowing the sum set out in Appendix 2 to the report, to finance the acquisition of the Former Muller Site including site purchase planning promotion and ground investigations works subject to all necessary due diligence dependant on confirmation, or otherwise of the site being a Transfer of a Going Concern;
- (v) Agree to the formation of a new development holding company 'Be First Development (Holdings) Ltd' on the terms set out in the report, to be owned by the Council and hold Be First Developments (Muller) Limited as its subsidiary and to authorise the Chief Operating Officer to take all necessary action in connection with the creation of the company as Shareholder and Chief Operating Officer, in consultation with the Director of Law and Governance, including agreeing an interim business plan, Shareholder Agreement, making any necessary resolutions and entering any other associated legal documents and contracts to give effect to this proposal;
- (vi) Agree to the appointment of Directors to the new companies as detailed in the report and to authorise the Chief Operating Officer, in consultation with the Director of Law and Governance, to agree any changes to the Boards;

- (vii) Authorise the Chief Operating Officer, in consultation with the Director of Law and Governance, to agree the loan agreement and any associated guarantees and debentures referred to in the report and grant any indemnities subject to all necessary due diligence; and
- (viii) Authorise the Chief Operating Officer, in consultation with the Investment Panel, to set up Companies with a nominal share value or Partnerships in preparation for Council Projects and to appoint interim Directors to those Companies or nominee partners to the partnerships.

Reason(s)

- To promote the site and the wider Chadwell Heath area for regeneration with the redevelopment of the existing employment floorspace with new residential and employment uses;
- Assist the regeneration of a key site via a master plan in line with the inclusive growth strategy and wider vision for the borough;
- Assisting in the early delivery of new residential accommodation and the re provision of employment floorspace in line with the emerging Local Plan.

1. Introduction and Background

- 1.1 Be First Regeneration (BFR) was established to assist the Council in accelerating the building of new homes and creating additional jobs and as such the core element of the BFR Business Plan is to implement the delivery of housing regeneration projects. However, it was acknowledged in the 2018/19 BFR Business Plan that BFR have an opportunity to leverage commercial expertise to identify and create development opportunities the Council would not previously have been able to access, to unlock regeneration, and in doing so deliver financial returns. The February 2018 Cabinet resolution (minute 100) that approved the BFR business plan allowed for the formation of a Development Company (Dev Co) for the holding and trading of property assets. This resolution is being used to establish a vehicle to serve as an Asset Co in advance of this paper that resolves to create Hold Co.
- 1.2 In accordance with that strategy, it is proposed to purchase the Muller site to provide a stimulus for the wider regeneration of the existing Chadwell Heath L-SIS allocation via the preparation of a masterplan and revised policy framework in the emerging local plan and in doing the site would, when sold, deliver a profit to the Council. Therefore, although the primary purpose of the purchase is to promote the area for regeneration it is intended to secure a revenue receipt that can be returned to the Council of which the net surplus will count towards the BFR financial target.
- 1.3 The Muller Site is 12.95 acres (approx. 15% of the Chadwell Heath L-SIS area) as shown in the plan at Appendix 1. The Muller factory has recently been vacated by the Muller dairy and the current landowners have now cleared the site of buildings and are marketing the site for short term letting (open storage). It is proposed to continue short term lettings (post completion of the purchase) during the planning promotion period for a period up to 3 years.

- 1.4 Chadwell Heath will be subject to significant development pressures as Cross Rail (the Elizabeth Line) is planned to open in 2021/22 that will provide faster train connections to Central London (Liverpool Street/ Bond Street) and West London (Paddington and Heathrow/ Reading). This service will be available at Chadwell Heath over-ground station which is 220m from the edge of the L-SIS allocation or 820m from the Muller site in particular. This will result in land price speculation (shifting from secondary industrial to prime residential land values) and the Muller purchase is aimed to secure a significant proportion of the land value uplift and allow the Council to take a leading role in further land assembly and the co-ordination of development in the Chadwell Heath L-SIS area.
- 1.5 The process of change at Chadwell Heath is already reflected in emerging policy. The Issues and Options paper published in July 2018 identified the Chadwell Heath L-SIS allocation in Table 5 as a suitable location for the introduction of up to 2,960 residential units to meet the emerging housing target. The Chadwell Heath L-SIS area has been included in the Call for Sites ending in May 2019 and is included in the draft Local Plan for 3,400 units.
- 1.6 Policy E7 of the London Plan permits the conversion of employment land to residential provided that there is “no net loss”. Employment floorspace should be re-provided either within the SIL/ L-SIS area or the Borough as a whole provided there is an overall strategy. Re-provision and intensification is to be targeted towards well located and established industrial areas with better access to the A13 so that other less well located industrial sites (Chadwell Heath) can be developed more intensively for residential uses and in overall terms there will be “no net loss” of employment floorspace in the Borough as a whole. Therefore, the Chadwell Heath Masterplan and the Muller site purchase forms an important part of the Borough’s overall housing and employment strategy. The GLA has approved a grant of up to £270,000 in July 2019 for the Council to complete a masterplan for the Chadwell Heath SIL. BFR has already appointed a consultant to co-ordinate the overall masterplan, procurement, preparation and consultation process.
- 1.7 Officers have recently completed research to determine the quality of the existing employment stock in Chadwell Heath and the Borough as a whole. It has concluded that the scale of employment floorspace (1.4m sqft/ 138,700sqm) at Chadwell Heath can be reduced to maximise the area’s residential capacity and the lost employment can be re-provided on other sites better related to the strategic road network. This work is in the process of being formalised into evidence base documents as part of the Local Plan Review and the publication of the Regulation 18 Draft Local Plan.
- 1.8 The Council has been approached by a number of developers keen to secure an interest in Chadwell Heath given its proximity to improved train services to Central and West London. However, none of the developer proposals have demonstrated an ability to comply with the objectives of Policy E7 that requires “no net loss” of employment floorspace at the same time as providing a satisfactory environment (sufficient schools, parking amenity space and civic facilities). To maximise the area’s attractiveness for residential development given its close proximity to the Chadwell Heath Elizabeth Line Station there is a need for an overarching strategy to relocate lower value employment uses to other parts of the district to maximise planned public transport improvements. Additionally, there are some existing businesses that want to stay and upgrade the quality of their accommodation.

Without a masterplan and the co-ordination of the phased development of the area by the Council there is a danger that poor design and amenity will result which will fail to maximise the area's inherent potential.

2. Proposal and Issues

Options for the legal structure

- 2.1 As part of the Business Case for the creation of BFR it was recognised it may need to establish additional companies to deliver specific projects and that these special purpose vehicles (SPVs) could be either stand-alone public sector companies, joint ventures between BFR and the private sector, or solely private sector. It was also outlined that these SPV's may need to sit as subsidiaries of a separate development/holding company to give maximum flexibility in delivering project outcomes. The 2018 Cabinet resolution approved the BFR business plan and the set up of a Dev Co SPV. This resolution is being used to create the vehicle which will hold the Muller Site asset.
- 2.2 A number of options have been considered regarding the legal structure for the transaction and advice has been sought from commercial law firm advisors Gowlings and PWC (Accountants) to determine the most cost-effective structure to achieve the optimum outcome. It is proposed that a new 100% Council owned holding company (Be First Developments (Holdings) Ltd ("Hold Co") and a subsidiary SPV, Be First Developments (Muller) Ltd ("Asset Co") should be created.
- 2.3 One of the options considered and discounted was for the Hold Co or Asset Co to be a subsidiary of the existing BFR, however, this structure is not recommended as it is considered that the private sector may be invited to participate in the company (Asset Co) which would effectively mean the company could no longer benefit from Teckal status, and due to the size of its turnover this would compromise the Teckal status of BFR itself. Accordingly, the proposed Hold Co and Asset Co companies are proposed to be financially separate from BFR. Additional advice has confirmed that BFR can be a subsidiary of Hold Co in the longer term to achieve an accountancy efficiency whilst not effecting the Teckal status of BFR itself. The proposed phased set up of the of the SPV is summarised in Table 1 below. Before Step 3 is implemented (putting BFR under Hold Co) the Council will examine the accountancy benefits of this change relative to governance and audit issues to ensure it represents the preferred solution and does not result in unintended consequences.
- 2.4 In the proposed structure, Hold Co will administer the revenue receipts to LBBD and Asset Co will hold the loan and the asset and deal with the project specific activities. Both of the companies would be overseen by an independent Board consisting of the directors drawn from BFR. The full BFR Board will sit on the Hold Co and a subset of BFR Directors who currently sit in the BFR Audit Committee will be Directors of the Asset Co. The organisation structure is set out in Table 2 below. The Hold Co will be subject to a shareholder agreement meaning that its directors cannot make strategic decisions (such as selling the asset or selling shares in the company) without approval from its shareholder, LBBD. The Asset Co is 100% owned by Hold Co so indirectly controlled by the shareholder agreement. In any event to provide complete control there will be a shareholder agreement between Hold Co and Asset Co as shown in Table 2.

- 2.6 Asset Co will be administered by directors comprising the members of the BFR Audit committee together with Pat Hayes (Managing Director) and the Company Secretary. Asset Co will be controlled by Hold Co which is in turn controlled by LBBB via the shareholder agreement. The BFR Board members, who will be directors of Hold Co have been drawn from a wide skill base to cover public sector, private sector, architecture and community issues and therefore provides an inclusive management approach.
- 2.7 Therefore, Asset Co will be subject to the same controls imposed by LBBB onto Hold Co. Additionally, Asset Co will be subject to the provisions of the loan agreement with LBBB. It is proposed that the Directors of Hold Co and Asset Co will have Service Agreements to define their respective roles.
- 2.8 The Asset Co will have a Service Agreement with LBBB and would be able to procure the services of BFR via LBBB as a 100% LBBB owned company. This will ensure complete compliance with the Public Contract Regulations (PCR). Additionally, there will be a Service Agreement between BFR and Asset Co so that BFR can undertake various roles (planning and asset management etc) and Asset Co will not have to undertake a separate procurement process.
- 2.9 Advice has been sought from PWC to confirm that the proposed approach to form SPV's represents a better outcome for the Council compared with utilising the General Fund. PWC have confirmed this position and that the eventual disposal can be treated as revenue as opposed to capital. Advice on the SPV structure indicates that it has the advantage of reducing the stamp duty land tax liability (SDLT) on disposal (the sale of shares), in the newly formed Asset Co to 0.5% rather than the sale of assets at 5%. This generates a gain/ saving for both LBBB and the potential purchaser at the point of sale. However, the SPV will incur a latent gain that will be subject to corporation tax when the eventual assets in the SPV are sold (i.e. when the completed residential or commercial units are sold and a profit realised). Potential purchasers may discount their bid price to offset this future liability. However, this liability is neutralised by the saving achieved in the SPV structure attracting a lower rate of SDLT. In a base case, while the latent gain may reduce the eventual receipt (being roughly equal to the receipt achieved by the GF holding structure) the receipt can be treated as revenue as opposed to capital which is the key to this transaction.
- 2.10 Asset Co will be property trading companies paying corporation tax (currently 19% for FYE 2019 falling to 17% FYE 2020) as opposed to investment companies paying capital gains tax for which there are different tax reliefs. The differences between a trading company and investment company are key to the justification for the proposed SPV arrangement. A trading company (Asset Co) is able to return the profit from a transaction to its shareholder (Hold Co and subsequently LBBB), without paying any tax provided the shares have been held for more than 12 months, this is known as a Substantial Shareholdings Exemption (SSE).
- 2.11 While Asset Co will have to pay corporation tax on any income earned during the period the project cash flow suggests that this will be minimal as expenditure will exceed income. Therefore, the profit from the sale of the shares in the Asset Co (cost of sale less cost of purchase, interest, planning and site preparation costs) can be returned to Hold Co without incurring any corporation tax. In contrast an investment company would pay corporation tax on the capital gain that is realised

on disposal as well as tax on annual income during the hold period. Therefore, a trading SPV company has significant advantages over an investment SPV company.

2.12 The trading SPV tax status is broadly similar to the GF arrangement (with no tax being paid on the sale of shares) but has the additional advantage that the receipt can be treated as revenue, whereas in the GF it has to be treated as capital. While the SPV will suffer a potential deduction for the latent tax gain this is off set by the lower stamp duty on the sale of the eventual shares. Therefore, the eventual receipt for the SPV versus the GF will be virtually identical but the SPV generates a revenue receipt which has advantages for the Council. For this reason the SPV structure is LBBB's preferred route. A summary of the differing tax and financing options between the SPV and the GF are summarised in Table 3. Appendix 2 sets out the Business Case for the purchase and the project cash flow – this document is in the exempt section of the agenda as it contains commercially confidential information (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,.

2.13 The tax allowances for interest charges are addressed later in the report. However, they do not adversely effect the profit calculation

Table 3 Summary of Key Variables SPV versus the GF

	SPV	General Fund
Interest	<ul style="list-style-type: none"> Interest at 'Arms Length' rate (8%) on part (£20m) of total project cost (£52m) No impact of write down/ impairment on revenue account 	<ul style="list-style-type: none"> Interest at LBBB Internal Rate (3.25%) on entire project cost but no rolled up interest
Stamp Duty	<ul style="list-style-type: none"> 5% stamp on purchase 0.5% stamp on share capital on exit 	<ul style="list-style-type: none"> 5% stamp on purchase and 5% on exit
General Taxation	<ul style="list-style-type: none"> No VAT on purchase provided TOGC De Minimums Corporation tax on annual income due to rolled up losses Final Dividend exempt from tax as SSE Latent Gain crystallised on sale of shares (£2.8m deduction) 	<ul style="list-style-type: none"> No VAT on purchase provided TOGC General Fund exempt from Income and Capital Gains
Net Receipt	Revenue	Capital

2.14 Gowlings have advised on the proposed drafting of the Articles of Association, Loan, Shareholder and Debenture agreement that will provide LBBB with control over the asset and the associated holding companies. The key controls are as follows:

- To manage the asset with the objective of seeking to maximise any eventual profit;
- To pay interest on the loan and any further advances;

- To repay the outstanding amount on demand;
- To maintain accounts, hold meetings and keep records consistent with good business practices;
- Follow prescribed routes to draw down funds and any further advances;
- Not to
 - a. dispose of the asset in whole or part,
 - b. issue new share capital,
 - c. take additional borrowing,
 - d. enter into any contracts,
 - e. change bank accounts,
 - f. charge the property
 - g. offer any further mortgage or debenture, without the express consent of the shareholder.

2.15 These controls ensure that LBBB can manage the asset and its eventual disposal via the shareholder agreement and ensure that the eventual sale will secure the maximum benefit to the Council. As the loan includes the cost of purchase, planning promotion, site preparation and interest costs the total loan amount exceeds the initial purchase price. This effectively means the newly formed company will be insolvent at day one, albeit that the loan is not due for repayment for 3 years from commencement. While this potentially undermines the security of the loan, in the case of a default the Directors of the Asset Co owe an obligation to LBBB as both the lender and creditor. Therefore, they are under an obligation to protect the over-arching interests of LBBB. The existing BFR service agreement with Directors includes a clause that prevents LBBB forcing the company into insolvency if its assets do not cover its liabilities. The current Directors are seeking a similar reassurance in this case for Asset Co.

2.16 While LBBB is the ultimate shareholder the Directors have wide discretion to act in the best interest of LBBB. In the case of insolvency, the Directors duty would be to LBBB as creditor to the loan, the same organisation to which they owe a duty as the debtor on the loan. Therefore, in reality the prospect on an insolvent position is unlikely to arise without careful discussions between LBBB and the Directors and agreement is mutual reached. It is proposed that LBBB will provide a written re assurance that an insolvent position will not be created by means of a side letter rather than incorporate the undertaking in any of the formal loan/ shareholder or service agreements.

The Loan and the Interest Rate

2.17 It is proposed to finance the acquisition, planning promotion and site preparation costs using Council borrowing. Interest will be rolled up, which means it will be added to the loan. Interest and the full loan amount will be repaid from the sale of the asset. There are limitations imposed by HMRC on the level of interest charges that can be deducted from income. Essentially the level of interest charges cannot be fixed at an artificially high rate to effectively avoid paying tax. HMRC have issued guidance that dictates what interest charge deduction is allowable regardless of the actual loan rate. Detailed advice has been sought from PWC. It confirms that in the initial stages of the project interest charges (regardless of the rate) will not be an allowable deduction against the eventual profit. This is based on established tax treatments by HMRC of similar projects. As the loan exceeds the

existing land value (by including the land and planning costs etc) it is considered a high-risk loan by HMRC and not one that a conventional bank would lend.

- 2.18 Therefore, the loan is treated as equity rather than debt and therefore no allowance is allowed as a tax deduction. PWC advise that over the term of the project (following the preparation of the master plan and the creation of short-term letting income) some interest charges might be allowable deductions. In a worst case scenario if no interest charges are allowable deductions this reduces the project's base costs and therefore increases the potential profit and any subsequent corporation tax liability. However, if the shares in Asset Co are sold to a future purchaser this receipt will be treated as a SSE and not liable for corporation tax. So the loan rate and its tax treatment as an allowable cost has no effect on the overall tax liability and net receipt to LBBDD.
- 2.19 Avison Young has advised on the loan rate that the open market would fund (given the risk associated with the project). This is used to establish the 'arm length' loan rate that dictates its acceptability under State Aid rules (that no unfair competitive advantage has been offered through a concessionary rate). Based on the characteristics of the project they advise a loan rate of 7.95% pa (being a 7.2% pa margin on the UK base rate). This rate can only be charged on part (50%) of (as opposed to the whole) project cost/loan due to the speculative nature of the scheme, i.e. a lender will not advance funds in excess of the unimproved value of the asset which is a discount to the actual purchase price.
- 2.20 The proposed 'arms length' rate creates a margin over and above the likely loan rate and provides the Council with an enhanced revenue stream via increased interest charges paid by Asset Co as it services the loan from LBBDD. Nevertheless, the increased cost of the loan is not an allowable deduction for tax purposes in the early stages of the project. This should be monitored over the term of the project.
- 2.21 Appendix 2 sets the overall project cost including the site cost as well as an allowance for purchase costs, planning and site clearance. The site will be held for between 3 years while the masterplan and a planning permission are completed. Current interest charges are calculated on a three-year hold. It is proposed to review disposal options after 2 years from the date of purchase to ensure compliance of the project's initial objective to deliver a revenue receipt to the Council as quickly as possible.
- 2.22 Additional advice has been sought from PWC in relation to the accountancy implications of the proposed project loan for the Council's Comprehensive Income and Expenditure Statement. It has concluded that the loan will be treated as a capital transaction. While there may be a difference in the size of the loan (i.e. site cost plus planning and promotion costs for the hold period) relative to the initial value of the asset (its value as existing employment use) the 'impairment' in value can be recorded in the Capital Adjustment Account and will have no impact on the GF balances. Therefore, PWC advise that the proposed holding structure and the size of the loan relative to its initial value (the impairment) will not have an adverse impact on the Council's overall accountancy position. The Council is seeking final confirmation of this approach with its auditors to ensure all eventualities have been assessed.

Property Matters

- 2.23 A report on Title prepared by GWLG has been reviewed by Legal Services. The key issues are highlighted below. During the course of the project it is proposed to let the site for short term open storage use that will mitigate the Council's holding cost but not eliminate it completely. The cashflow in Appendix 2 suggests there will be little income generation during the hold period given the allowance for site preparation and planning promotion cost. The losses recorded in years 1 and 2 will be carried forward so that no corporation tax will be due in year 3. Should there be improved income generation there would be a corporation tax liability and then the surplus income can be returned to the LBBD via the Hold Co.
- 2.24 The current vendors are in the process of agreeing the terms of a small scale letting. When complete this will enable the asset to be treated as Transfer of a Going Concern (TOGC). This ensures that VAT will not be payable on the purchase price and VAT can be charged on the short-term rental income. The appropriate Option to Tax will be made prior to purchase to ensure treatment as a TOGC. The election can only be done when the holding vehicles are in existence. If the current letting is not achieved before completion VAT will be chargeable on the purchase price and Stamp duty will be levied on the combined amount, effectively increasing the cost of purchase by about £0.5m. While the VAT amount can be recovered in the first VAT return subject to a suitable letting being agreed post transfer, but there will be an increased SDLT charge and the cost of borrowing on the VAT for the first quarter. To ensure the overall project return is maintained there would have to be an adjustment to the purchase price to neutralise this increased cost of purchase. This is set out in Appendix 2. The 2018 Cabinet resolution is to be used to create Asset Co (and provide a Co No for VAT registration) and enable these issues to be resolved before exchange and completion takes place.
- 2.25 When complete the masterplan will support a planning application for the redevelopment of the site and an allowance has been made in the cash flow for planning application costs as well as further site preparation costs prior to the site's disposal. If the Council were to implement a planning application Policy H5 of the London Plan would require affordable provision at 50%. However, if a speculative application is submitted there is no restriction and when the site is sold bidders would be asked to make their bids on the basis of the requirement for the private sector to provide affordable at 35%. Accordingly, the intervening ownership by a public body will not undermine the eventual revenue receipt.
- 2.26 The vendors are selling a cleared site and the following steps are proposed during the holding period:
- Year 1**
- Set up Asset Co (pre cabinet)
 - Open bank accounts and complete loan documents etc
 - Set Up Hold Co and draw down the loan to Asset (post cabinet)
 - Complete purchase;
 - Retain existing local agent to secure short term letting income from open storage uses;
 - Undertake ground investigations surveys;
 - Commission a masterplan consultancy team and prepare a data room for the future marketing of the site;

- Prepare a business plan for entering into Planning Promotion Agreements with adjacent land owners to capture an element of the land value uplift.

Year 2/3

- Finalise the masterplan;
- Progress planning application on the Muller and other sites that benefit from separate Planning Promotion Agreements;
- Prepare a business plan to determine the most profitable route for the Council to exit;
- Disposal of the Muller site.

- 2.27 The main buildings have been cleared and the site is left level with hardstanding including the former factory concrete floor or crushed material. This is suitable for letting for open storage subject to the provision of secure compounds if let on an individual basis. The site is secure and benefits from a security gatehouse and operational weigh bridge.
- 2.28 The Report on Title identifies that there is a single electricity substation that requires regularisation with UK Power Networks. The vendors have indicated this process will be complete before exchange. In any event they are providing an undertaking to complete this process before completion or alternatively there is a financial retention if the substation lease is not completed in time.
- 2.29 Initial intrusive ground investigation works have been undertaken and have shown levels of contamination consistent with the previous industrial use. An allowance for £1.7m has been allowed for the final site clearance cost (removal of foundations and contamination etc) which is considered reasonable. More detailed intrusive surveys will be completed during the intervening period so that remediation costs are established and accounted for in the eventual disposal price.
- 2.30 A valuation has been undertaken by Strutt & Parker and is supported by a pricing report prepared by Savills. The reports adopt current market evidence to estimate the value of the completed residential and commercial elements of the scheme and the associated cost of construction with an allowance for site remediation assuming that planning permission is granted for the proposed mix of uses (the re-provision of the existing employment floorspace and circa 1,300 residential units). No allowance has been made for house price inflation in the period between the date of purchase and disposal. The conclusions of these reports have been adopted in the cashflow to demonstrate that the project should provide a healthy return assuming constant market conditions.

Risk Assessment

- 2.31 The Red Book valuation (undertaken by Strutt & Parker) has confirmed the purchase and assumed exit prices. Legal and tax advice has been obtained to determine the most appropriate holding vehicle to deliver a revenue receipt to the Council. Therefore, the main project risks are:
- Planning: Delays in agreement with the GLA on the “no net loss policy” and downstream masterplan and planning application milestones; *Mitigation; early engagement with the GLA (who are funding the masterplan preparation) and the progress with other industrial intensification projects in*

the Borough that will generate a surplus of employment floorspace (Welbeck, Remploy, CoL Markets);

- **Site Conditions:** Abnormal ground conditions resulting in increased cost: *Mitigation: GIS scoping survey pre contract and more detailed survey post contract to refine likely remediation costs relative to proposed building heights/ foundation design;*
- **Exit Values:** Stagnation in the housing market, changes to the Help to Buy scheme, delays in Crossrail, *Mitigation: accelerate masterplan and planning applications to allow early exit if values are declining, develop JV with funding partner to secure rental exit (as opposed to owner occupier) that is less vulnerable to Help to Buy and compatible with the Council's own housing rental products. While the purchase price is a margin on the existing use value for industrial use the market is assuming a premium for the residential hope value in Chadwell Heath. The pricing report prepared by Savills supports the exit valuation assumed by Strutt & Parker in their valuation assuming a residential consent. No allowance has been made for growth in residential value over the hold period. Data from land Registry shows that Barking house prices have outperformed adjacent Boroughs, as they have started from a lower base. Therefore, it is likely that the estimate of an exit at £65m in three year's time is conservative.*

3. Options Appraisal

3.1 Option One – Acquire the Site in a New SPV Holding Company

Advice from Gowlings and PWC indicates that the creation of a new 100% owned company (as opposed to making it a subsidiary of the existing BFR) is the best way to protect the existing status of BFR as a Teckal company (where LBBB can procure BFR without having to undertake an OJEU procurement each time) and providing the Council with a revenue receipt from any land sale.

3.2 Option Two – Acquire the Site in an Alternative Structure

The GF provides an alternative holding structure. However, there will be no revenue generation during the hold period and the eventual disposal, while free from capital gains tax, would have to be used to repay existing debt and could not be used to help the Council with its immediate revenue requirements. Moreover, it would not count against the BFR target to return a revenue receipt to the Council. According this structure would not achieve any of the stated project objectives. The Council could procure a JV partner, via a Limited Liability Partnership as an alternative holding vehicle. However, this procurement has not been undertaken to date and will likely result in an unacceptable delay to the vendors. In any event a JV arrangement can be accommodated in the proposed corporate holding structure set out in Option 1 via the part disposal of shares (at a later date).

3.3 Option 3 – Do Nothing

Not purchasing the site would protect the Council against any risk associated with the project. However, it would also result in the Council missing out on a potential revenue receipt that can assist with short term funding requirements. More

importantly, it will remove the opportunity to maximise the residential capacity of the site that will shortly benefit from the introduction of Crossrail services. Additionally, it will prevent the Council having a comprehensive solution to the regeneration of the other industrial areas where existing business could be re accommodated in other parts of the Borough subject to industrial intensification.

4. Consultation

- 4.1 Given the confidential nature of the transaction no external consultation has taken place.
- 4.2 The proposals in this report have been considered and endorsed by the Council's Investment Panel.

5. Commissioning Implications

- 5.1 The purchase of site to hold on a short term basis while wider strategic planning and planning promotion work is carried out on the site offers a number of benefits from an inclusive growth perspective. The main one being that ownership of the land will provide the council with a greater level of control over the future use of the site. If this site was sold to a private developer at this stage it could be subject to a speculative planning application, which would potentially not support the delivery of our wider regeneration aspirations for the Chadwell Heath area.
- 5.2 Holding the site for up to three years will allow the council to prepare a masterplan for this area which reflects the fact that cross-rail will be operating in the area by 2022, and work with the GLA to consider options around dealing with the possible loss of industrial space, linking into the wider work which is already under way to develop a strategic approach to industrial land in the borough.
- 5.3 Following this work a planning application can be submitted to seek permission for a planning policy compliant scheme, which would provide for a mixed use development on the site that addresses our wider strategic objectives. This means that the council would not need to deliver the site through its own resources, but would be selling it on to a developer, who will then be expected to deliver the project in line with the planning permission.

6. Financial and Investment Implications

Implications completed by: David Dickinson, Investment Fund Manager

- 6.1 The proposed purchase seeks to generate a revenue receipt that can be returned to the Council at the time of disposal to assist the Council with its long-term revenue funding requirements. To achieve this end the asset will be placed in a special purchased vehicle as opposed to the GF which would be the default position for most Council assets. As this proposal will be a trading asset, i.e. it will be bought and sold within a relatively short period, as opposed to a long-term hold, it is more appropriate to put it in a special purpose vehicle. Any revenue generated from a disposal will be subject to corporation tax at the prevailing rate. The site will be held for 3 years while the masterplan and a planning permission applicated are completed. Current interest charges are calculated on a three year hold. It is proposed to review disposal options after 2 years from the date of purchase.

- 6.2 Whilst the asset could be held in the GF the receipt on disposal would have to be treated as a capital receipt and used to repay existing council debt, although it can also be used to fund relevant transformation costs. Currently the priority is to generate a revenue stream to cover the borrowing costs and this is put forward as a justification for the asset to be held in a special purchased vehicle (SPV). The SPV has a further additional benefit in that a subsequent resale of the asset will incur stamp duty on share capital at 0.5% in comparison to stamp duty on property assets at 5%. The lower stamp duty will reduce the subsequent purchasers cost resulting in a modest improvement in the council's overall return.
- 6.3 It is proposed to set up a new SPV and lend the SPV 100% of the purchase costs, planning promotion, site assembly and disposal costs. Accordingly, the total loan will exceed the purchase cost but will be less than the eventual exit price.
- 6.4 Advice has been provided by Savills and Strutt and Parker in relation to the assumed purchase and exit price. It is important to emphasise that, as outlined in the risk assessment, there is the potential for the exit price of the site to be lower than the value provided. This is a risk that can be mitigated but the final value will only be confirmed once the site has been sold.
- 6.5 Additional advice has been sought from PWC on the loan rate and they have confirmed that in the initial stages of the project no allowance against tax will be permitted by HMRC for the loan costs associated with the purchase.
- 6.6 Advice has been sought from Avison Young (formerly GVA) on the appropriate loan cost to ensure that the lending from LBBB to the SPV complies with State Aid regulations. Nevertheless, for the purposes of calculating the potential profit and eventual revenue receipt to the council the cost of the loan is largely irrelevant in so far as its cost cannot be offset against the gross profit in order to reduce the tax liability. Instead tax will have to be paid on the gross profit before any interest cost deduction. However, if shares in Asset Co is sold and the receipt is returned to Hold Co via a dividend payment this should be exempt from corporation tax as it is treated as an SSE. Therefore, the tax treatment of the interest charges will not effect the overall receipt to LBBB. Additionally, the increased loan rate over and above the rate at which money is borrowed will enable an early repatriation of revenue to the council, i.e. it is able to achieve an annualised return of its potential revenue receipt at the point of disposal planned to be in three years' time.
- 6.7 For this reason the proposal provides a useful mechanism for the council to borrow to increase its short-term revenue generation at the same time as securing wider regeneration benefits in the borough.

7. Legal Implications

Implications completed by Dr Paul Feild, Senior Governance Solicitor

- 7.1 This report proposes the freehold acquisition of the site known the former Muller Factory from current owners Lionpride Ltd. The process recommended is set out in this report as Option One that is to say that such assets should be acquired via a special purpose vehicle being a 100% Council owned holding company. The purchase will be financed through a loan. It is understood to be conditional on the

site being purchased with vacant possession and all buildings on the site will be demolished by the vendor prior to completion of the acquisition. Key legal considerations will be: -

- The purchase of the freehold;
- the establishment and ownership of the companies and the governance of them
- The legal powers to enable the transaction;
- The nature of the transaction;
- The need to minimise the Council's exposure to risk and unforeseen liabilities particularly with regard to the size of the site, its current and future investment value, planning, development and environmental risks;
- Existing interest of power substation;
- Grant funding conditions;
- Letting the site as an open storage facility;
- Taxation implications

- 7.2 A report on title has been prepared by external legal advisors Gowlings LLP together with advice on the structure of the deal and establishment of the companies proposed. The purchase will be at market value of the freehold interest. The purpose for which land is acquired is relevant to the powers to be relied upon. The report has identified the site as an investment opportunity that enables the Council through BFR to set the scene for the site to provide the best development opportunities for the area. Detailed feasibility assessments will be carried out to determine the most suitable development strategy.
- 7.3 On the understanding the acquisition is in pursuit of the Councils Investment and Acquisition Policy then the Council has the power to acquire land by virtue of Section 120 of the Local Government Act 1972 and to carry out the proposed scheme by the general power of competence given by section 1 of the Localism Act 2011 (GPC). Under the GPC power the Council can do anything that individuals generally may do provided that there is no prohibition against it elsewhere. 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 (to any extent) overlaps with the general power of competence. 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.
- 7.4 There is in the alternative a power to acquire land under s. 227 of the Town and Country Planning Act 1990. This enables the Council to acquire land for any purpose for which it could compulsory purchase where that the acquisition will facilitate the carrying out of development, re-development or improvement; or the land is required for a purpose which it is necessary to achieve in the interests of the proper planning of an area. It may be better to acquire using the S.1 power and later use s.227 for reasons explained below in para 6.10.
- 7.5 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 various proposed agreements, 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. If there is an

intention to trade the Localism Act 2011 requires that it be facilitated by use of a company.

- 7.6 If the intention would be to acquire the land and dispose after a minimal period of time then the site would constitute a trading asset and such a transaction could be likely to be considered a trade, even if it was a single occasion if it carried as described by Her Majesty's Revenue and Customs (HMRC) with a 'badge of trade'. These are identified as being:
- o profit seeking motive;
 - o the number of transactions;
 - o the nature of the asset;
 - o existence of similar trading transactions or interests
 - o changes to the asset;
 - o the way the sale was carried out;
 - o source of finance;
 - o interval of time between purchase and sale;
 - o method of acquisition.
- 7.7 It therefore follows that if a site is identified in a report and the recommendation is to acquire for the purposes of resale on a short basis with relatively little or no value being added then the realisation of a surplus on disposal may be treated as trading and subject to tax.
- 7.8 A local authority has the power to trade subject to it being carried out by a company (S.4 Localism Act 2011). This means land so acquired for disposal as a trade would need to be acquired by a local authority company. As the intention of the preferred option one is to use a holding company vehicle, this issue is addressed. In due course it may be liable for corporation tax for any profits made. There may be other tax implications such as SDLT and VAT for which specialist advice will be needed.
- 7.9 Investment Aspects - In exercising the power of general competence and in making any investment decisions (to the extent that any aspect of this transaction is considered to involve investment decisions), the Council must have regard to the functions for the purpose of which it is exercising the power, must act reasonably and also have regard to the following: -
- o Compliance with the Statutory Guidance on Local Government Investments (the Statutory Guidance);
 - o Fulfilling its fiduciary duty to taxpayers;
 - o Obtaining best consideration for any disposal;
 - o Compliance with Section 24 of the Local Government Act 1988 in relation to giving financial assistance to any person (which either benefits from a general consent or requires express consent by the Secretary of State);
 - o Compliance with any other relevant considerations such as state aid and procurement.
- 7.10 While there are a number of options for funding. The loan will be competitive subject to conditions. This will in turn be lent to the holding company for the purpose of the land acquisition. The necessary loan agreement will need to be made with security on the assets held by the holding company by the use of fixed and floating charges.

- 7.11 Development/Land Risks and Considerations - Apart from the requirement to purchase the land at no more than the market value there will be the imperative to ensure that all land, development and environmental risks are identified and managed through feasibility studies to ensure the preferred development option is deliverable before significant pre-development expenditure, and mitigation strategies are put in place. At the time of writing the sub-station matter is yet to be completed, though final cost aside should be able to be resolved by agreement(s). Potential risk arising include, but are not limited to, any third-party rights or restrictions or incumbrances which may frustrate or prevent the Council's regeneration objectives and development of the land. In terms of environmental risks, caution must be exercised in that a post-industrial site may raise risks of land contamination and if so, any remedial action and the costs of such remediation would need to be factored into the feasibility and viability considerations. Specifically, there should be early due diligence before contractually committing to the transaction to ensuring that the site is suitable for the construction of dwellings and is without risk of historical contamination, or in the alternative that any contamination is capable of being remedied and costs are both factored into the acquisition price and do not compromise the viability of any residential development.
- 7.12 Other Claims - There may be a prospect that the development could be subject to claims and other incumbrances such as easements and claims for same such as right to light. To a degree the effect of such incumbrances will be dependent upon the masterplan and how the sites fit in. However, as a local authority the Council can appropriate the land in question planning purposes pursuant to s. 227 of the Town and Country Planning Act 1990. In doing so the Council can utilise the power given by s.203 of the Housing and Planning Act 2016 override any private rights subject to compensation payments. This power would normally be exercised after planning permission had been obtained, thus there would be time to negotiate the extinguishment of incumbrances beforehand which will enable swifter resolution.
- 7.13 The title investigation by Gowlings LLP at desktop level while rightly setting caveats flags up:
- a) Plausible contaminant linkages and past contaminative usages identified at the property, and as such potential liabilities have been identified under contaminated land legislation.
 - b) There is a history of landfill activity at or in the vicinity to the property which may include environmental risks associated with the material therein, and/or may cause ground instability issues.
 - c) There is a potential flood risk identified at the property due to the location of it. A more comprehensive flood risk analysis is suggested.
- 7.14 A full environmental survey, development appraisals and sound understanding will be a necessity if the Council seek to pursue mixed use or residential development on the site.
- 7.15 State Aid - As local government is an emanation of the state, the Council must comply with European Law regarding State Aid. This means that local authorities

cannot subsidise commercial undertakings or confer upon them an unfair economic advantage. This report does not identify any specific aspect of the proposed acquisition, which is other than a commercial transaction, thus this arrangement satisfies the requirement it is on market terms. Furthermore, in the event that there are harmful residues present on the site, there are certain grants to remediate contaminated land for housing are excluded from the State Aid Regime.

- 7.16 Human Rights – As the scheme as described does not seek the use of compulsory purchase powers or displacement of any residents there does not appear to be critical risks associated with a Human Rights Act challenge, nevertheless matters should be kept under review in case such considerations should arise.
- 7.17 The post-acquisition use of the site contemplates the potential of an open storage use, let to commercial operators on a fixed term lease with measures would be taken to ensure that the security of tenure under the Landlord and Tenant Act 1954 would be regulated to ensure that full possession by the Council could be secured at the appropriate time. If any staff are employed full time as a result of this arrangement, TUPE may also apply.
- 7.18 In terms of taxation implications the Council has sought advice from PWC. They advise that Stamp Duty Land Tax (SLT) will be payable calculated to be 5% of the purchase price, though at a later stage on disposal of the asset the cost of the tax payable will be added to the purchase price for the purpose of calculating trading profit.

8. Other Implications

- 8.1 Risk Management – The land purchase risk has been mitigated via the independent Red Book valuation.
- 8.2 Contractual Issues – Gowlings have advised on the structure of the deal to mitigate the risks to the council.
- 8.3 Property / Asset Issues – BFR will manage the short term letting process to maximise the income for the asset during the hold period via an appointed property agent. BFR will also project manage the masterplan preparation and application process, with the use of consultants, to secure the most appropriate land value uplift for the site's reallocation.

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

List of Appendices:

Appendix 1: Site Location plans

Appendix 2: Proposed Acquisition Business Plan (exempt document)