CABINET

16 March 2021

Title: Be First and Be First Developments (Muller) Ltd Business Plans 2021-26	
Report of the Cabinet Member for Finance, Performance and Core Services	
Open Report with Exempt Appendices (relevant legislation: paragraph 3 of Part I of Schedule 12A of the Local Government Act 1972)	**For Decision**
Wards Affected: All	**Key Decision:** Yes
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Accountable Strategic Director: Claire Symonds, Chief Operating Officer	

Summary

This report seeks Cabinet approval of the 2021-26 Business Plan for Be First and Be First Developments (Muller) Ltd in line with the requirements of their Shareholder Agreement. The Business Plans have been scrutinised by the Shareholder Panel, the advisory body created to monitor and to report to Cabinet on the performance of companies that the Council has a shareholding interest in.

It must be noted that the Business Plans have been developed whilst in the middle of a third nationwide lockdown and it is possible that there are further impacts on the Company's ability to deliver the outcomes outlined in the report which are not yet known. Performance against this plan will be monitored through the Shareholder Panel.

The substantive Business Plans are contained within Appendices 1 and 2, which are in the exempt section of the agenda as they contain commercially confidential information (relevant legislation: paragraph 3 of Part I of Schedule 12A of the Local Government Act 1972) and the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

Recommendation(s)

The Cabinet is recommended to:

(i) Approve the Be First Business Plan 2021-26, as set out at Appendix 1 to the report.

(ii) Approve the Be First Developments (Muller) Ltd Business Plan 2021-22, as set out Appendix 2 to the report;

(iii) Authorise the Chief Operating Officer, in consultation with and on the advice of the Investment Panel, to take all necessary action to enable Be First or Be First Developments (Muller) Ltd to carry out its proposals under the Business Plan and to agree any minor variations to the Business Plans subject to the conditions in these recommendations;

(iv) Approve Be First, Be First Developments (Muller) Ltd or the Council to enter into any procurement related agreement or commitment required to enable the delivery of the Business Plans, subject to compliance with relevant procurement regulation and with State Aid rules;

(v) Agree that if Be First enter into contractual arrangements described in the Business Plans and the report, the Council shall give a guarantee to the contractor under such contract guaranteeing performance of the contract by Be First, subject to Be First being satisfied that the contractor is able to perform the contract and all necessary due diligence being undertaken;

(vi) Authorise the Chief Operating Officer to enter into any such guarantee and any necessary documents to give effect to the contractual arrangements as described, subject to the above conditions and the advice of the Director of Law and Governance;

(vii) Note the dividend strategy as set out within the Be First Business Plan and note that it may be necessary to increase the existing working capital loan facility to support the Be First cash positions as set out within the report;

(viii) Authorise the Chief Operating Officer, in consultation with and on the advice of the Investment Panel, to grant loans and complete all necessary documents and negotiations to complete the projects set out in the Business Plans subject to all necessary due diligence and compliance with State Aid rules, the Public Contracts Regulations 2015 (or any replacement thereof) and the Council's Constitution;

(ix) Delegate authority to the Chief Operating Officer, in consultation with the Shareholder Panel, to approve a long-term strategy for the use of Special Purpose Vehicles (SPVs) and authorise the Director of Law and Governance to complete any documents and legal agreements necessary to give effect to that strategy in future acquisitions; and

(x) Note the progress in developing innovative mixed-use schemes, including 12 Thames Road as referred to in paragraph 3.3 of the report, and authorise the Chief Operating Officer, in consultation with and on the advice of the Investment Panel, to enter into all necessary legal documents to give effect to the schemes.

Reason(s)

To assist the Council with delivering the Inclusive Growth Strategy and delivering a well-run organisation. This proposal is in line with Recommendation 8 of the independent Growth Commission's report published in February 2016 and is therefore aligned to the Council's 'Inclusive Growth' priorities.

1. Introduction and Background

1.1 The approval of the Be First and Be First Developments (Muller) Ltd business plans are reserved to the Council as shareholder under a shareholder agreement entered into with Be First in September 2017. This is an executive function exercised by the Cabinet on behalf of the Council as shareholder. In line with that agreement this Business Plan has been produced for Cabinet approval as outlined in the recommendations.

1.2 The Business Plans were approved by Be First's Board in January 2021; Corporate Strategy Group in February 2021 and have been scrutinised by the Shareholder Panel and recommended for approval to Cabinet on Monday 15th February 2021.

1.3 This report highlights the key objectives to be delivered and the period by which the returns, either financial or social, are expected with the detail behind the assumptions being shown in the Business Plans at Appendix 1 and 2.

1.4 The Be First Business Plan identifies that Be First have progressed a number of activities outlined within the 2019/20 Business Plan and that it has made tremendous strides in establishing a ground-breaking model of local authority regeneration with over 100 staff delivering at a pace and the organisation now fully established and operational.

1.5 However, 2020 was an exceptionally difficult year. Be First's work was battered by a combination of global, national and industry-specific events set out and summarised in the four key challenges below, many of which will have ramifications for the lifetime of their business plan.

1.6 The ultimate result of the EU Membership Referendum in June 2016 is still causing uncertainty and it remains to be seen what impact it will have on the speed of delivery and trade prices of materials.

1.7 The Grenfell Fire tragedy in June 2017 transformed public awareness of cladding issues, and serious inconsistencies and ambiguities in building regulations and, as a result, fire safety guidelines continue to change as these issues are brought to light and addressed. There is a lack of clear government guidance and fire officer wariness, resulting in delay and additional cost. This issue will not be resolved until clear guidance becomes available, removing the uncertainty.

1.8 The Covid-19 pandemic is having an unprecedented impact, not just across business but upon all our lives, and will affect how we do business for some time to come. Be First and its staff have adapted, working from home where possible, while at the same time progressing on site construction, ensuring our sites are safe for everyone. Be First currently have 12 sites under construction, working safely and with little impact to the current programme however, the pandemic has impacted the Company's ability to deliver the financial return required by LBBD, with most income streams under-performing during 20/21 despite a recovery plan being implemented in April 2020 to mitigate the effect of delays to the programme.

1.9 There is uncertainty over the continuation of New Homes Bonus (NHB), which is a significant contributor to the company's ability to generate the recurring £10.3m required from March 2021 onwards. It remains unclear whether NHB will continue beyond 2022 or be replaced with something similar as the Government has set out its intention to hold a consultation on the future of the New Homes Bonus, with a view to implementing reform in 2022/23. The Provisional Local Government Finance Settlement for 21/22 has indicated that this will result in a financial impact as there is no legacy payment in respect of 2020/21, and there will be no legacy payment in respect of 2021/22 in forthcoming years. Prior to this announcement New Homes Bonus was forecast to deliver just over £43m in income towards the Be First financial target over the next five years. Although Be First has modelled a steady state scenario which outlines the work programme needed to still meet the £10.3 financial return, meeting that challenge and delivering the return as set out in this plan is not without significant risk.

1.10 Taking all these factors into account the Be First 21-26 Business Plan is ambitious. It reports Be First remaining true to its mission to deliver socially inclusive regeneration, setting out an aspiration to ensure the homes are not just exemplar architectural schemes, but also sustainable and flexible, situated in attractive, culturally rich places to live, with access to jobs and good transport and social infrastructure. The regeneration strategy focuses on seven key areas outlining a vision of the social, cultural and economic identity for each which speaks to the history, aspiration and opportunity that could be unlocked by working in collaboration with the local community to deliver projects that achieve a better place, more homes and more jobs, so no-one is left behind.

2. Be First Company performance highlights in 2020/21

2.1 Be First's performance is measured against four key strategic objectives which are: delivery of new homes; place making, socio economic outcomes and financial return. A summary of progress and achievements this year against each one of these is set out below.

2.2 Be First are forecasting completion of 261 homes in 20/21 against a target of 116 with 101 of the extra homes being due to delays from completions in Q4 19/20. The total breakdown of homes being delivered this year are shown table 1.

Table 1: 2020/21 unit completion forecast

	20/21 Business Plan units target	**2020/21 forecast units (As at Q3)**
Wivenhoe	20	20
Grays Court	62	62
Melish & Sugden	19	0
Margaret Bondfield	15	0
SUBTOTAL	**116**	**82**
Weighbridge	N/A	92
Becontree Heath	N/A	87
TOTAL	**116**	**261**

2.3 Be First are committed to delivering a cumulative financial return to the Council of £10.3m by 31 March 2021 and £10.3m per year annually thereafter. This return is achieved by adding up a variety of different income sources such as the operational surplus from their core operations (planning, capital programme delivery, construction) in addition to New Homes Bonus and any commercial income generated from investments proposed and delivered by Be First.

2.4 In last year's Business Plan Be First forecasted they would deliver £10.1m return in 20/21 and a cumulative return from 2017-2021 of £16m but delivery of this income has been impacted by Covid-19 with income being below target in most areas of the business. Due to continued uncertainty, it is not possible to accurately predict the full end of year position although current forecasts indicate the return will be less than forecast. Some elements of the financial return such as New Homes Bonus are already confirmed and have already been received by the Council, but the actual level of commercial income received as well as operational surplus achieved will not be known until the end of Q4. In addition to this the actual level of distributable dividend that will be issued by Be First and counted towards achievement of their target depends on a number of elements which are not yet finalised including:

- Accounting treatment of the 2017/18 losses being finalised.
- 2020/21 Final audited accounts which are not expected until the Summer.
- Tax liability on the P&L which cannot be confirmed until the final actuals are audited.
- Confirmation of the level of retained earnings / working capital potentially required by Be First which could be up to £4m (depending on the final outturn from 20/21). This would be used to support cash flow to enable the maximum dividend to be paid to the Council, in accordance with the dividend strategy set out within the business plan.

2.5 Although it is likely the final return will be less than target due to the difficulties experienced this year, a capital receipt of £5.5m has been created by Be First from the successful delivery of the film studio transaction and will be counted towards the Be First return. Normally, capital receipts would not count towards Be First's revenue target but as the Council will be able to use these to fund transformation it has been agreed that as a one-off this sum will count towards delivery of the target. To ensure the maximum amount of revenue is deliverable in future, the Business Plan outlines the need to develop a longer-term strategy for the creation of Special Purpose Vehicles and a working group has already been established to develop this.

2.6 In addition to the financial and delivery progress Be First has continued to develop a regeneration strategy for the borough, focusing on six 'zones' where transformation is required. The detail of the key actions for next year are set out the business plan but progress has been made in 2020/21 by activities such as supporting the bid for Freeport status (which if achieved will help to transform Dagenham dock) and progress towards finalising the local plan which has been out for public consultation. Be First have made further progress in developing it's Social Value offer and in 2020/21 have facilitated 231 jobs being successfully placed with local people.

3. Be First Business Plan Commitments 2021-26

3.1 The Business Plan identifies that Be First continues to develop and expand to meet the growing business. Since 2017 when Be First was established, it has recruited nearly double the regeneration resources that were TUPE transferred into the Company from 55 full-time equivalent staff in 2017 to 110 FTE in 2020. At point of transfer, the majority of the team was focused on delivery of the Council's capital programme only and a very small number of regeneration schemes. This added level of resource is needed to drive the Council's Regeneration vision for the borough and brings a wealth of new skills and expertise to enable delivery of the vision and strategy set out in the Business Plan.

3.2 Although it has been slow to build a pipeline of schemes through to feasibility, planning and now into delivery stage, the plan outlies that Be First are expecting to complete 207 new homes during 21/22. By 1st April 2021, Be First anticipates having projects on site which are forecast to deliver a total of 2,200 new homes in future years. In total, Be First anticipate completing 5,069 new homes over the next 5 years of which 3,747 (74%) have already received Investment Panel approval.

3.3 The plan outlines how Be First are delivering against the Council's strategic vision with re-development in key locations such as Thames Road. The proposed re-development of 12 Thames Road, formerly a vacant industrial warehouse, which received planning approval in December 2020 is expected to provide an exemplar of how to combine residential accommodation with commercial units, allowing 156 new affordable homes to be delivered without the loss of commercial space by re-providing over 5,000m2 of modern industrial floorspace. By demonstrating to the market that this type of innovative development is both deliverable from a planning as well as commercial perspective is anticipated to act as a catalyst for private developers to bring forward other similar schemes thereby stimulating the wider regeneration of industrial spaces. This scheme is due to start on site at the end of March 2021 and be completed by April 2023.

3.4 To enable Be First to deliver these units the Council will need to borrow approximately £1.61 billion (bn) over the next 5 years, which is a similar amount to the £1.63bn outlined in the previous business plan. As at 31 December 2020 the Council had £700m of debt and this will therefore increase to over £2bn by 2025/26. This is important in relation to the potential change to the Prudential Code noted in section 1.9 above and further work will need to be undertaken over the course of the next financial year to consider the future funding strategy.

3.5 The Business Plan is based on Q2 data and predates the further lockdown in November 2020 and January 2021 and therefore the impact of Covid-19 in terms of scheme delays, which have a consequential impact on income is not reflected. The plan forecasts however that Be First will generate a surplus above target in the next three years but acknowledges that its ability to continue to meet the £10.3m annual target is dependent on there being an increase in either direct borrowing by the Council or by the Council providing a guaranteed return to external funders in addition to overcoming the challenges set out at the top of this report. The plan includes bold assumptions but is accompanied by significant risks and dependencies which are largely not within either the Council or Be First's control and therefore there is no question that continuing to meet the annual target will become increasingly challenging and is not without significant risk.

3.6 As part of Be First's top 9 priorities for 2021-22, there is a commitment to take a holistic view to align design, development management, planning and resident offers to ensure a deliverable scheme for all. The borough has set itself some ambitious targets in relation to addressing the structural inequalities which hold back too many of our residents from fulfilling their potential and the scale of the challenge means that a cross-sector, local and national effort is required to deliver change.

3.7 However, Be First are moving forward with delivering a housing programme which will provide 75% affordable housing over the life of the business plan. The provision of high quality, secure and affordable housing is a crucial part of the foundations required for people to thrive. Therefore, providing housing on scale will make a contribution to delivering these targets.

3.8 Alongside this progress has been made on the drafting of the new Local Plan for the borough. This plan will set out the strategic planning framework for the borough, setting out where the new homes will be delivered alongside other infrastructure.

4. Be First Developments (Muller) Ltd Business Plan 2021/22

4.1 The Council acquired the Muller site in July 2020 via a project specific SPV - Be First Developments (Muller) Ltd. The SPV is managed by a fully independent Board consisting of members of the Be First Board but in line with its Shareholder Agreement is required to ensure Cabinet approval of its annual Business Plan.

4.2 The Muller site was purchased to promote delivery of a revised mixed-use allocation for the Chadwell Heath area, supported via a new Masterplan which was being created with a view to accelerate strategic regeneration in the wider area. The expectation is the site will be held for up to three years before it is sold with the benefit of the revised allocation and the land value uplift returned to the Council.

4.3 The report outlines that the governance arrangements and operational arrangements in terms of the short-term lettings is taking place, and interim users are generating a near expected level of revenue. The update sets out a clear list of priorities for the site moving forward through 2021/22 and a further, more detailed updated will be provided in subsequent plans as the detailed design work is progressed.

5. Consultation

5.1 The Be First and Be First Developments (Muller) Ltd, Business Plans have undergone the following consultations -

- Approved by the Be First & Be First Developments (Muller) Ltd Boards in January 2021;
- Endorsed by Corporate Strategy Group in February 2021;
- Endorsed by the Shareholder Panel on 5 February 2021.

6. Financial Implications

Implications completed by: David Dickinson, Investment Fund Manager

6.1 The Be First Business Plan (BFBP) is based on data as at 30 September 2020 and this predates any subsequent Investment Panel and Cabinet agreements but also predates issues that may result from additional Covid-19 lockdowns and caused by Brexit. To date the impact of Covid has been managed well but has still negatively impact the BFBP as schemes were delayed and there has been an increase in build costs.

6.2 An additional consideration that may impact the BFBP is a CIPFA consultation on the Prudential Code. This consultation is looking at:

- Any commercial investment undertaken should be consistent with statutory provisions, proportionate to service and revenue budgets and consistent with effective treasury management practice.

- Requirements to assess the affordability of commercial activity within local authorities' capital strategies. CIPFA will also publish, early this year, further guidance on good practice for development of capital strategies.

- The addition of sustainability and ensuring that the capital expenditure is consistent with a local authority's corporate objectives (such as diversity and innovation) to the objectives in the Prudential Code.

- Introduction of new prudential indicators on affordability. External debt to net service expenditure (NSE) ratio, and commercial income to net service expenditure.

- The introduction of the liability benchmark to promote good practice and understanding of local authority's debt management in relation to capital investment.

While the majority of the consultation will have no or very limited impact on the BFBP, prudential indicators on affordability could put a limit on the level of borrowing by a local authority. While this should not impact the schemes already agreed it may have an impact on the funding of future schemes.

6.3 As outlined in the BFBP, the future of New Homes Bonus (NHB) is unclear and potentially may end. Currently it has not been included from 2023/24 and therefore this risk has been mitigated to a degree in the BFBP.

6.4 At the time of adding these financial implications, it is too early to tell what the financial impact will be but close monitoring by Be First and the Council is essential to identify any issues and adjust the BFBP accordingly.

6.5 Be First Return to the Council and Increased Borrowing Requirements

6.5.1 The BFBP for 2021 to 2026 outlines an ambitious programme of development and regeneration of the Council, with a significant increase in the borrowing required. The BFBP shows that Be First will generate target surplus of £11.9m for 2021/22, £10.2m for 2022/23 and potentially £38.8m for 2023/24. The BFBP therefore forecasts Be First’s ability to deliver at or near its target of £10.3m to the Council for the next three years. As the target return has not changed from the £10.3m, the forecast of additional return provides a margin, should there be pressures on the return.

6.5.2 Currently the BFBP does forecast £5.8m for 2024/25 and £2.7m for 2025/26, although this is without NHB, which could still be a source of income for the Council if it continues or a similar scheme is agreed. The main driver behind the drop in return from Be First from 2024/25 onwards is that the operational profit from development fees reduces. To increase the operational profit, additional sources of income are required, or additional schemes need to be agreed by the Council, which will result in an increase in borrowing.

6.5.3 To enable Be First to achieve these returns, the Council will need to spend £797m, which is a significant amount over five years but does include £242m of potential spend. Approximately £200m of the £797m has been secured by the Council at relatively low, fixed rates of borrowing of around 2%. Securing borrowing at these rates has allowed a number of costs pressure that have come through during the year, including increasing costs to meet new fire regulations requirements, construction cost inflation and delays in getting schemes operational to be absorbed, without the need to increase the interest budget.

6.5.4 Development and Construction income, which delivers the majority of Be First's financial return is driven predominantly by fees from the Councils Investment and Acquisitions Strategy (IAS). The Council is currently responsible for funding the IAS and therefore this income is reliant on the Council providing funding. This funding requirement must be factored into Be First's future strategy as there will be a limit to the level of funding the Council can provide, especially from 2024/25 onwards or if additional expenditure is required to fund additional commercial schemes or the Turnkey schemes.

6.5.5 The Business Plan does not cover, in any great detail, other income streams outside of Development and Construction Fees and it is essential that Be First identifies additional income streams to reduce the pressure on the Council. If this does not happen then there will be a continuous requirement for the Council to continue to increase its borrowing to levels.

6.5.6 The Be First financial return to the Council does consider investing in Turnkey schemes to support their financial returns as Be First's financial return will come under pressure from 2024/25 onwards as the current schemes are built and become operational and Be First no longer receive development and construction management fees. The Turnkey schemes will require borrowing of £351m, with potentially a further £241m for further schemes.

6.5.7 Development and Construction fees are directly linked to development spend and can be increased through bringing forward schemes that were originally scheduled for later on in the Business Plan, through new pipeline schemes being added but also as a result of an increase in development costs due to cost inflation and build cost increases. All of these lead to an increase the amount the Council needs to borrow and, in turn, the borrowing costs. It is therefore essential for Be First to work closely with the Council to ensure that the schemes acceleration is affordable, both in terms of funding but also in terms of Be First achieving their £10.3m target.

6.5.8 A concern within the BFBP is the delay in a number of the schemes. During 2019/20 no units became operational as the Becontree Heath (87 units) site was closed in March due to Covid-19 and Weighbridge (92 units) is now forecast to complete in Q1 2020/21. Wivenhoe was also due to be completed in 2019/20 but its completion has also been pushed back to 2020/21.

6.5.9 The impact of these delays means that the income to the Council from Reside, both from interest from the loans and from the net return, is delayed. This puts pressure on the Council's interest budget and the IAS target return. Going forward, it is essential that schemes are completed on time and as close to budget as possible and that new schemes are only started when there is sufficient interest budget to fund them.

6.6 **Loan Facility**

6.6.1 A loan facility agreement of up to £4.2m working capital was provided to Be First in 2017/18. This loan will not be repayable until Be First are fully self-financing.

6.7 **Be First Contribution to the IAS**

6.7.1 Be First will help to accelerate the delivery of the Council-led development schemes which will be integral to the Council's ability to achieve its £5.1m investment strategy returns by 2020/21. The £5.1 investment return is in addition to Be First's target return of £10.3m and is predominantly generated when each scheme is operational and managed within Reside. Delays in schemes becoming operational and or where net returns are reduced will negatively impact on the ability for the Council to achieve the target return. As no new schemes became operational in 2019/20, the IAS will struggle to meet its income target.

6.8 **BFBP Funding**

6.8.1 The borrowing requirement outlined in the BFBP comprises most of the schemes agreed in the IAS but excludes some of the large schemes that have already been built, such as Abbey Road 2, Weavers and the Street Purchases schemes. The size of the borrowing is significant and careful treasury management is required to manage the interest cost of carry during the construction phase.

6.8.2 The BFBP potentially requires an increase in net development costs of £200m for the existing IAS schemes but also an additional £320m for pipeline schemes, £185m for commercial schemes and £246m for Turnkey schemes, for a total additional funding of £950m over the next 5 years. This results in the funding requirement increasing from £2.69bn to £3.64bn, although £2.1bn of this are potential schemes that have not been agreed or taken to gateway panels.

6.8.3 Although interest will be capitalised during the development period, delays in some of the schemes becoming operational will also have a negative impact on the net borrowing costs as income from the schemes will be delayed and therefore there will be delays in receiving the interest income.

6.8.4 Each £100m of additional borrowing will require an interest budget of £2.0m based on average borrowing costs of 2.0%. Once schemes are operational, then the interest income received from the scheme being operational can be used to fund further borrowing and provide an income stream to the Council. It is important to outline that the Council does not have unlimited borrowing powers and each scheme proposed will need to provide a return and fit within the funding budget.

6.8.5 It is therefore essential that Be First work closely with the Council to ensure that future investment proposals fit within the current funding available and are built, at the right time and within agreed budgets, to ensure that the Council's plans are met within agreed timescale but that are also Value for Money.

6.9 **External Borrowing**

6.9.1 Currently the Council has funded most of the IAS, with only the original Reside 1, William Street and Eastern Thames View, being funded by financial institutions. The Council has used long term fixed rate borrowing, from the Public Works Loan Board (PWLB) and European Investment Bank to fund the schemes.

6.9.2 The BFBP has included the potential for funding from financial institutions. The ability to borrow long term from financial institutions has always existed but the rates are usually around 1.1% to 1.5% above the rate the UK government borrows at (GILTS). Since 2012 the PWLB rate has been the GILTS rate plus a margin of 0.8%, which has made the PWLB rate much cheaper than financial institutions. In October 2019, the government increased the margin the PWLB charges on GILTS to 1.8%, which was a much less competitive rate and allows funding to be considered from a number of different banks and pension funds. Subsequently the margin charged for PWLB borrowing has reduced back to 1.0% above gilts, which makes the PWLB the cheapest available to the Council.

6.9.3 Other borrowing options from financial institutions could include borrowing that is not fixed but is inflation linked, this is often accessed through a lease and leaseback approach. This approach can prove to be useful where there is sufficient margin from the rental income, such as with the recent Aparthotel and Travelodge hotels. However, where margins are small and where there can be pressure to not increase rents by inflation every year, such as with social housing, a disconnect between the increase, through inflation, of the borrowing costs to the funder and the income received from rents. If margins are small, this can turn to a shortfall in income that will need to be covered by the Council.

6.9.4 The risks and requirements of using financial institutions have only briefly been covered as part of the financial implications and it is essential that any proposal includes a detailed outline of the risks and obligations and also scenario testing for different situations.

6.10 **Risks**

6.10.1 There are a number of risks that have the potential to impact on Be First financial performance including risks attached to capital programme delivery; supply chain costs; and general economic performance and activity including the potential impact of Brexit and Covid-19. These are assessed as part of the BFBP and mitigations and monitoring arrangements in place, with the risk register constantly being updated. Corporate risks are monitored through the Shareholder Panel.

6.10.2 Given the increased scale of the borrowing, the interest rate risk (i.e. the risk that interest rates will be higher than currently forecast) will be significant. An interest rate margin has been included to produce the interest budget but there is still the risk that borrowing rates could increase, which would make a number of the more marginal scheme unviable. To mitigate this, where schemes have progressed through Gateway 4 and are in the process of being built, the Council will seek to lock in the borrowing requirement, but it will only do so when rates are relatively low.

6.10.3 In considering the BFBP, it is incumbent on the Council to ensure the activity of Be First is strategically aligned with the Council and Reside priorities to deliver long term outcomes for the borough. These include understanding the quality of schemes as well as the delivery of financial returns. To do this the Council has put in place governance arrangements through the Investment Panel and associated gateway processes.

7. Legal Implications

Implications completed by: Dr Paul Feild Senior Governance Lawyer

7.1 Cabinet is requested to approve the Business Plan for Be First, for the five-year period 2021-2026. The Council is a 100% shareholder of Be First, which was set up by the Council to accelerate delivery of regeneration in the area. The relationship between the Council and Be First is regulated through a shareholder agreement dated 29 September 2017, albeit this is not a legal requirement. Shareholder agreements make provision to ensure accountability to the Shareholder and form part of both the governance of the companies and the contractual documents setting out the course of business, accounting for dividends, and reserved activities over which only the shareholder has control. Via its shareholder controls (exercised through Cabinet and Shareholder Panel) the Council can set the strategic direction for Be First and monitor its performance of the companies. It is a condition of the agreement that an update on the business plan is presented to the Council on an annual basis, albeit the Business Plan for Be First is prepared for a rolling given year period.

Relevant Statutory Powers

7.2 The Council has a number of relevant powers regarding its establishment of trading companies, borrowing and investment activities. Section 1 of the Localism Act 2011, the general power of competence (“GPC”) empowers local authorities to do anything that an individual can lawfully do provided that the activity is not expressly prohibited by other legislation. Activities authorised by the GPC can include investment, trading or charging decisions which may be undertaken through commercial (corporate) vehicles with the primary aim of benefiting the authority, its financial management, its area or its local communities. The power is wide and provided that the specific activity is not expressly restricted or proscribed by other legislative provisions, it will be within the parameters of the GPC power. However, Section 4 of the Localism Act 2011 adds a proviso that if the GPC power is exercised for an activity which may be deemed ‘for a commercial purpose’ that is more than incidental to other functions or purposes of the Council, such activity must do so through a company. Therefore, there may be circumstances where commercial activity carried out by the Council’s companies may necessitate that a company limited by shares is utilised and may require further approvals by Cabinet whether the projects have been identified in the proposed Business Plans or not.

7.3 Section 12 of the Local Government Act 2003 (“Power to Invest”) enables a local authority to invest for any purpose relevant to its functions under any enactment, or for the purposes of the prudent management of its financial affairs. Consequently, borrowing to invest primarily or only for profit would not be deemed directly relevant to fulfilling the authority’s functions and will not, therefore, be authorised under this power. However, investment in development, land or property with a view to promoting regeneration will fall within the power to invest.

7.4 Section 1 of the Local Government Act 2003 ("Power to Borrow") provides local authorities with the power to borrow for any purpose relevant to their functions under any enactment or for the purpose of the prudent management of its financial affairs. The Power to Borrow has similar constraints to the investment power under the 2003 Act. Borrowing primarily to achieve a return is unlikely to be deemed connected to the functions of the Council or to be prudent financial management. Caution should be exercised in making decisions to ensure that any investments or loans financed with borrowing further the functions of the Council and are consistent with the prudent management of the Council's financial affairs and associated prudential guidance. In instances, where there may be commercial reasons for borrowing or investment further scrutiny and approval by Cabinet will be necessary as to whether the proposed activity is within the powers to invest and borrow, the CIPFA Prudential Code and relevant statutory guidance will be necessary (among other matters).

Other Legal and Commercial Considerations

7.5 The Council's fiduciary duties can be summarised as the Council acting as a trustee in respect of taxes collected and public sector income on behalf of its rate and taxpayers. The Council in effect holds money but does not own it; it spends money on behalf of its business rates and local taxpayers.

7.6 In making approving the business plan, Cabinet should consider the risks and benefits of approving the recommendations, i.e. whether a prudent investor, shareholder or borrower would undertake the activity or risks proposed; whether the Council will achieve appropriate outcomes and return for the risk it is taking, and that the risks and potential costs involved in approving the planned business activity have been appropriately mitigated in the event of the company (or any subsidiaries) becoming insolvent and/or defaulting on outstanding loan(s). It should be borne in mind that in instances where loan book activity references in the report and business plans is funded by PWLB borrowing, a default by the borrower/s (whether the Council's entities or other third parties) could leave the Council exposed to repaying loans and interest notwithstanding default by its borrowers. The Chief Operating Officer should also consider these risks in approving the terms of any relevant legal agreements.

Funding and Borrowing

7.7 Section 15 of the Local Government Act 2003 requires that the Council have regard to statutory guidance in relation to exercising its borrowing and investment powers. The relevant Statutory Guidance on Local Government Investments (3rd Edition, issued on 1 April 2018). In accordance with the Guidance (paragraphs 33 and 34), A local authority may choose to make loans to local enterprises, local charities, wholly owned companies and joint ventures as part of a wider strategy for local economic growth even though those loans may not all be seen as prudent if adopting a narrow definition of prioritising security and liquidity provided that the overall Investment Strategy demonstrates that:

- The total financial exposure to such loans is proportionate;
- An expected 'credit loss model' has been adopted to measure the credit risk of

the overall loan portfolio;

- Appropriate credit controls are in place to recover overdue re-payments; and
- The Council has formally agreed the total level of loans by type and the total loan book is within self-assessed limits.

7.8 It is noted that matters associated with credit / risk management and borrowing / lending activity are expected to be addressed in the next iteration of the Council's Investment Strategy.

7.9 Individual schemes and projects will have potential implications under the Public Contracts Regulations 2015 and state aid rules, which will need to be complied with by the Council or the company undertaking such activity for the Council. The Council should put in place appropriate assurance protocols for checks and balances to ensure that its companies are compliant.

Procurement Implications

7.10 Be First's business arrangements were structured to ensure that it can provide services to the Council without being subject to the compliance with the European procurement rules. That position has changed in that since February 2020 the UK has left the EU and the transitory measures ended on 31 December 2020. However, some of the principles are also within in the UK's Public Contract Regulations 2015 (PCR). Thus, the so-called 'Teckal' exemption is also set out in Regulation 12 of the PCR. CIPFA advise that compliance requires that a local authority (the Council) must control all the shares in a company (Be First), and also exercise effective control over the company's affairs in a manner similar to its own directorates and, finally, that there is no direct private capital participation. Regulation 12 (3) of the PCR sets out the meaning of "control" as exercising a "*decisive influence over both strategic objectives and significant decisions of the controlled legal person*."

7.11 To benefit from the Teckal exemption, the PCR require that at least 80% of Be First's business turnover must be for its public sector owners. Be First is able to undertake 20% trading with third parties in a manner which is still compliant with its 'Teckal' arrangements with the Council. The turnover is calculated based on three years of turnover – therefore allows for some smoothing over these years. It must be borne in mind that as a Teckal company Be First is an emanation of a public body, therefore, a contracting authority. As the financial position to date demonstrates, Be First primarily act as development / construction manager for contracts in respect of which the Council is employer. Therefore, in procuring works, services or other supplies from third parties, the company must tender in a manner compliant with procurement legislation. Whilst the Council has and is delegating to Be First procurement of contracts which facilitate the delivery of the Business Plan, it should be noted that as the parent body and often contracting party, the Council would also bear the risk of any non-compliance. Therefore, it is recommended that the Council in its shareholder capacity should undertake appropriate assurance measures from time to time to ensure overall compliance with procurement law and good practice by Be First.

State Aid Implications – Post Brexit

7.12 State aid too continues to be a consideration. As local government is an emanation of the state, the Council must comply with UK Law regarding State Aid. This means that local authorities cannot subsidise commercial undertakings or confer upon them an unfair economic advantage. While the UK has left the European Union (EU), issues regarding state aid have not ceased. For example, the UK membership of the World Trade Organisations agreement on trade also has requirements regarding State Aid albeit somewhat less prescriptive than the EU. The agreement with the EU now talks in terms of "Level Playing Field" and "Subsidies" rather than state aid which if anything clouds the issue until we get published Government Guidance. However, the general principle applies in that support on a selective basis to any organisations or undertaking in a manner that could potentially distort competition and trade is challengeable and unlawful. This principle is binding in law on the Council This means that the Business Plans must be compliant in design and execution. The Council is aware of its duty not to breach state aid law and in this regard, will continue to monitor and seek reassurance from the companies that their activities and support from the Council (including its terms, finance rate and security offered) satisfies the Market Economy Investor Principle and any loans and facilities are state aid compliant. Legal due diligence will be carried out to confirm this to the Chief Operating Officer before entering into any agreements or permitting drawdowns. Finally, even if the residue of the EU rules were not effective, the Council has a fiduciary duty to look after its assets to the Government, Non-Domestic ratepayers and Council taxpayers and that also means that funds must be management in a prudent and sound business-like way.

Governance Implications

7.13 The approval of the Be First business plan is reserved to the Council as shareholder under the Shareholder Agreement. This is an executive function exercised by the Cabinet on behalf of the Council as shareholder. Under Part 3, Chapter 1, paragraph 1.2 of the Council's Constitution, the Cabinet can in turn delegate its functions to an officer or authorise the officer to take decisions in respect of specific schemes forming part of the Business Plan, subject to established parameters, such as the need to consult other officers or Cabinet Members prior to making a final decision. It is noted that the Chief Operating Officer has such delegations (e.g. in respect of investment decisions) under the Constitution or expressly given by Cabinet on specific plans or schemes.

8. Other Implications

8.1 **Contractual Issues** - Development of Business Plans is a contractual commitment for all of the Companies and is designed to set the framework by which the strategic direction of each Company is considered and approved or endorsed by the Council as either a major or minor Shareholder.

8.2 The plan sets out an intention to develop a strategy for maximising revenue opportunities through the wider use of SPVs. This strategy will likely require the creation of multiple project/acquisition specific SPVs governed by formal contractual agreements between the Council and each SPV.

8.3 **Corporate Policy and Customer Impact** – The outcomes noted within the Business Plan are expected to have a positive impact on residents, either by supporting the Council's aim to become self-sustainable as well as improving service outcomes and educational attainment for residents and children.

8.4 **Health Issues** - The proposed Business Plans will have a positive impact on the local community in terms of improvements the environment, place and housing.

8.5 **Property / Asset Issues –** Any changes to the delivery of regeneration schemes will impact the financial assumptions set out within the Reside Business Plan

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

List of appendices:

- Appendix 1: Be First Business Plan 2021-2026 (exempt document)
- Appendix 2: Be First Developments (Muller) Ltd Business Plan 2021-2022 (exempt document)