CABINET

21 April 2020

Title: Be First Business Plan 2020-25	
Report of the Cabinet Member for Finance, Growth and Investment	
Open Report with Exempt Appendix 1 (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 2020-25 Business Plan for Be First in line with the requirements of their Shareholder Agreement. This Business Plan has 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 Plan has been developed prior to the recent pandemic and it is not yet possible to determine the extent of the impact this will have on the Company's ability to deliver the outcomes outlined in the report however this will be monitored through the Shareholder Panel.

The substantive Business Plan is contained within Appendix 1 which is 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 2020-2025 at Appendix 1 to the report;

(ii) Authorise the Chief Operating Officer, in consultation with the Investment Panel, to take all necessary action to enable Be First to carry out its proposals under the Business Plan and to agree any minor variations to the business plan subject to the conditions in these recommendations;

(iii) Approve Be First or the Council to enter into any procurement related agreement or commitment required to enable the delivery of the Business Plan subject to compliance with relevant procurement regulation and compliance with State Aid rules;

(iv) Agree that if Be First enter into contractual arrangements described in the Business Plan 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;

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

(vi) Agree to vary the existing loan facility as outlined in the report subject to the existing conditions relating to it; and

(vii) Authorise the Chief Operating Officer, in consultation with the Investment Panel, to grant loans, any other relevant approvals on behalf of the Council which may be relevant or required for the specific project and complete all necessary documents and negotiations to complete the projects set out in the Business Plan, subject to all necessary due diligence and compliance with State Aid law, the Public Contracts Regulations 2015 (or any replacement thereof) and the Council's Constitution.

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 both the 'Growing the Borough' and Inclusive Growth objectives.

1. Introduction and Background

1.1 In line with the Shareholder Agreement for Be First, this Business Plan has been produced for Cabinet approval as outlined in the recommendations.

1.2 The Business Plan was approved by Be First's Board in March 2020; Corporate Strategy Group in February 2020 and has been scrutinised by the Shareholder Panel and recommended for approval to Cabinet on 23 March 2020.

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 Appendix 1.

2. Company performance highlights in 2019/20

2.1 The 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 is now fully established and operational.

2.2 In 2019 Be First have identified several sites for acquisition, undertaken feasibility works and developed proposals which have secured approval. These include proposals to invest in several sites with a view to bringing forward development at key locations including Chadwell Heath. Be First have also been developing a wider acquisition plan for the Council.

2.3 Be First have started on site for 10 regeneration schemes which will deliver much needed new homes for the Borough. The Business Plan notes that 3 schemes which were expected to have started on site by the end of March 20 have been delayed, primarily for reasons relating to cost concerns resulting from increasing fire regulations and significant construction cost inflation.

2.4 Be First are expecting to deliver 67 more homes this year than in the 19/24 plan as the delivery of units at Becontree has been brought forward into this financial year. With the 179 units being completed in 19/20 Be First will have delivered 427 homes since 2017.

2.5 Be First have taken the lead in progressing the Film Studios project forward at pace and demonstrating that they can step in when the private sector is derailed by political and financial uncertainty and the planning application has now been submitted for consideration.

2.6 The plan highlights that Be First has been working with the Council to define and agree a new estate regeneration offer for tenants. This business plan commitment is also reflected in the company's commissioning mandate from the Council.

2.7 Be First are predicting to deliver a surplus by the end of this financial year which is earlier than their contractual commitment to deliver £10.3m by 31st March 2021 but there are still significant risks around the final position which relate to the ability to finalise contracts.

3. Business Plan Commitments 2020-25

3.1 Part of the objective of Be First is accelerate regeneration. The plan provides an outline of the commitments Be First are making to deliver against this objective and which are:

- complete 116 new homes in 20/21 from 4 schemes. They will also commence development of 7 schemes which will deliver 938 homes between now and 24/25 with an average of 73% affordable housing with proposed tenure across the portfolios to ensure no one gets left behind.
- Agree a masterplan for Thames Road to include mixed use residential development to enhance employment offer
- Secure Planning Permission for the film studio and start construction on site
- Develop a vision for Dagenham Dock that focuses on opportunities from the wholesale markets

3.2 In addition to accelerating development Be First are proposing to deliver a number of place shaping commitments including:

- Delivering improvements to the look and feel of Barking Station
- Attracting a major development partner for Barking Town Centre
- Completing a number of strategic masterplans
- Submitting the Local Plan to the inspectorate

3.3 Be First are contractually required to deliver a financial return to the Council of £10.3m by 31st March 2021 and annually thereafter and the plan provides detail on how that objective will be reached. Other than in 2021/22 Be First are not forecasting that they will reach this return based on the current programme of schemes although they are working to develop a pipeline of new schemes such as Turnkey projects and a new stream of pipeline Investment and Acquisition schemes. If the pipeline of new schemes are approved this could deliver in excess of the required return over the next 5 years but would require a significant increase in funding. Be First outline that to if approved the full pipeline would require £2bn of funding over 10 years.

3.4 The Business Plan largely assumes almost all financial surpluses are continuing to be driven by work commissioned by LBBD. The plan outlines an aspiration to secure external funding for at least one new investment scheme and an aspiration for their development framework to be utilised by other authorities.

3.5 In addition to a surplus from delivery of their core operations the Be First return includes income from New Homes Bonus. This plan assumes that New Homes Bonus will bring in £37m of income over the next 5 years however there is uncertainty over this income stream long-term and the Government has announced plans to consult on new proposals. Be First have proposed mitigations which suggest that the lost income could be off-set by further development and assumes that for every £2m pa lost to NHB Be First would need to develop 170 units requiring £60m in development funding to sustain the current financial projections. These mitigations will need to be considered further in the coming year.

4. Consultation

4.1 The Business Plan has undergone the following consultations

- Approved by the Be First Board in March 2020
- Endorsed subject by Corporate Strategy Group in February 2020
- Endorsed by the Shareholder Panel on 23rd March 2020

5. Financial Implications

Implications completed by: David Dickinson, Investment Fund Manager

5.1 Be First Financial Return to the Council and Increased Borrowing Requirements

5.1.1 The Be First Business Plan (BFBP) is based on data as at 31 December 2019 and this predates any subsequent Investment Panel and Cabinet agreements but also predates issues that may result from the Covid-19. It is likely that the impact of Covid-19 will negatively impact the BFBP as schemes will likely be delayed as some of the construction will cease for the foreseeable future and there is the potential for demand for new builds to reduce. At the time of adding these financial implications, it is to 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.

5.1.2 The BFBP for 2020 to 2025 outlines an ambitious programme of development and regeneration of the Council, with a significant in borrowing. The BFBP shows that Be First will generate target surplus of £10.1m for 2020/21, £9.9m for 2021/22 and £10.2m for 2022/23. The BFBP therefore confirms Be First's ability to deliver at or near its target of £10.3m to the Council for the next three years but that ability to continue to meet the £10.3m target is dependent on there being an increase in either direct borrowing by the Council or through the Council providing a guaranteed return to external funders.

5.1.3 To enable Be First to achieve these returns, the Council will need to spend £543.2m, which is a significant amount over three years. Most of the £543.2m 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.

5.1.4 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 2023/24 onwards or if additional expenditure is required to fund additional commercial schemes or the Turnkey schemes.

5.1.5 The Business Plan does not cover, in any great detail, other income streams outside of Development and Construction Fees and New Homes bonus 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.

5.1.6 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 additional borrowing of £346.2m. Be First have briefly outlined an option to fund this from financial institutions but greater details will be required before external funding of these schemes should be considered. The risks and issue around external funding are outlined in section 5.5 below.

5.1.7 The forecast return includes New Homes Bonus (NHB) which, in 2020/21, is forecast to be £1.8m due from the expected growth in supply of new homes within the borough. The BFBP outlines potential risks around NHB, as this source of funding may be withdrawn. The BFBP calculates that for every £2m lost to NHB, Be First would need to develop 170 units requiring £60m in development funding to sustain the current financial projections. As this increase in borrowing is currently not budgeted for this would require an increase in interest budget of £1.5m, based on £60m at 2.5% interest.

5.1.8 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.

5.1.9 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.

5.1.10 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.

5.2 Loan Facility

5.2.1 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 with the first repayment no earlier than 31 March 2020.

5.3 Be First Contribution to the Investment Strategy

5.3.1 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.

5.4 BFBP Funding

5.4.1 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.

5.4.2 The BFBP requires an increase in net development costs of £24.8m for the existing IAS schemes but also an additional £223.8m for pipeline schemes and £342.4m for

Turnkey schemes, for a total of £591.0m over the next 5 years. This will require a significant increase in additional long term borrowing by the Council to fund this as this increased borrowing has not been budgeted for. The delays in some of the schemes becoming operational will also have a negative impact on the borrowing costs as income from the schemes will be delayed and therefore there will be delays in receiving the interest income.

5.4.3 Each £100m of additional borrowing will require an interest budget of £2.5m based on borrowing costs of 2.5% and this will be a cost per year until schemes become operational. Once schemes are operational, then the interest income received from the scheme being operational can be used to fund further borrowing. Based on the net development costs provided within the BFBP and the date when the various schemes will become operational, to fund the additional £591.0m will require approximately £5m of additional funding by the Council to meet the increased borrowing costs.

5.4.4 New proposals for funding put forward by Be First will need to be either self-financing or a replacement of any schemes that are currently budgeted for but potentially are not progressed with or are delayed. 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.

5.4.5 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.

5.5 **External Borrowing**

5.5.1 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.

5.5.2 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 is a much less competitive rate and allows funding to be considered from a number of different banks and pension funds.

5.5.3 The BFBP includes a reference to the 30-year gilt rate of 1.28% and therefore the equivalent borrowing costs from institutional investors would be approximately 2.4% to 2.8%. These rates are higher than the average cost of borrowing that the Council has managed to achieve over the past three years and would also include a cost during the construction phase, which is currently not taken into account when Council borrowing is utilised.

5.5.4 Borrowing costs during the construction phase is one of the main barriers for the Council in funding more schemes early, as during construction there is no income but just an expense from the cost of borrowing. It is possible, with borrowing financial institutions, to capitalise the cost of borrowing (adding this to the total build costs), as well as to defer funding (receive funding over a number of periods). All of these options should be considered.

5.5.5 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.

5.5.6 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.

5.5.7 Careful profiling of the development programme to allow for there to be sufficient interest budget to fund future schemes, as well as meeting key targets of completion dates and costs, can prove to be a much more prudent and less onerous than trying to accelerate the programme through the use of more complicated funding sources.

5.6 **Risks**

5.6.1 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.

5.6.2 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.

5.6.3 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.

6. Legal Implications

Implications completed by: Ian Chisnell, Major Projects Solicitor

6.1 The Council has a number of relevant powers concerning the formation of trading companies, borrowing and investment activities.

Relevant Statutory Powers

6.2 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. The GPC enables the Cabinet to agree the loan facility and to delegate to appropriate officers' approval of the final terms and entering into a loan facility agreement (for capital to fund development).

6.3 The Company will be advised on its procurement and other matters by an external firm of solicitors, currently Gowling WLG.

6.4 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 for profit only 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, for example with a view to promoting regeneration is likely to fall within the power to invest.

6.5 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.

Other Legal and Commercial Considerations

6.6 The Council's fiduciary duties could be briefly summarised as it acting as a trustee of tax 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 rate and council taxpayers.

6.7 Cabinet in making the decision concerning the facility for Be First Development Limited/Be First should give due consideration to the risks and benefits of approving the recommendations. In practice Cabinet will want to consider whether the Council will achieve an appropriate return for its risk and that the Council has minimised the risk and potential cost to it if Be First Development became insolvent and/or defaulted on its loan(s). The Chief Operating Officer should also consider this in approving the terms of the relevant legal agreements.

6.8 Consideration should also be given to whether the Council's funding in this arrangement is proportionate and properly balanced against the anticipated benefit (taking into account) the wider interests of its local business rate and tax payers. On a practical basis this means that the Cabinet Members should consider whether the monies they are requested to approve for lending to Be First company could be better used by the Council for the wider interests of its local tax payers.

6.9 The Ministry of Housing Communities and Local Government (MHCLG) has issued statutory guidance on what qualifies as 'an investment'. CIPFA has also updated its guidance in relation to local authority loans and investments.

6.10 In exercising the delegation of authority to agree the terms of the Facility Agreement the Chief Operating Officer should be satisfied that there is provision within the Council's budget/MTFS to fund the facility/borrowing costs associated with it and to ensure that it complies with the Council's relevant investment strategy.

6.11 In terms of procurement, if Be First procure on behalf of the Council they must follow the Council's Constitution and adhere to the Public Contracts Regulations 2015.

6.12 If it is agreed that Be First enter into contracts to undertake works as contracting party then they must follow their own procurement rules and as they are a contracting authority under those regulation they must also adhere to the Public Contracts Regulations 2015. It should be noted that the Regulations require that all procurement of whatever value must be open and transparent.

6.13 The Council will have to agree a service agreement with Be First for them to act on the Council's behalf.

State Aid Implications

6.14 As a public body, the Council cannot provide state resources or other forms of support on a selective basis to any organisations or body in a manner that could potentially distort competition and trade in the European Union. The Council is aware of its duty not to breach state aid law and in this regard, will seek reassurance from Be First and professional advice from external professionals that the terms of the overall Facility Agreement (including its terms, finance rate and security offered) satisfy the Market Economy Investor Principle. The Facility Agreement and loans made under it are required to be state aid compliant and legal due diligence will be carried out to confirm this to the Chief Operating Officer before entering into any agreements or permitting draw-downs.

6.15 Consideration will need to be given as to the way any third-party developer is sought.

Governance Implications

6.16 The approval of the Be First business plan is 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.

7. Other Implications

7.1 **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

7.2 **Staffing Issues** – Some elements of the plan will require the Company to employ a greater number of staff.

7.3 **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.

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

7.5 **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 2020-2025 (exempt document)