

PART 2 – CONFIDENTIAL FACTS AND ADVICE

DD2339

Title: Swan New Homes – Strategic Partnership Loan Facility

Information may have to be disclosed in the event of a request under the Freedom of Information Act 2000. In the event of a request for confidential facts and advice, please consult the Information Governance team for advice.

This information is not suitable for publication until the stated date because:

It contains commercially sensitive information the disclosure of which might prejudice the commercial and business interests of the GLA, GLA Land and Property Limited, Swan Housing Association and Swan New Homes. It also contains legally privileged information.

Date at which Part 2 will cease to be sensitive or when this information should be reviewed with a view to publication: 31 July 2024

Legal adviser recommendation on the grounds for not publishing information at this time:

Under section 43 of the Freedom of Information Act information is exempt if its disclosure would, or would be likely to, prejudice the commercial interests of any person (including the GLA). Under section 42 of that Act information is exempt if its disclosure would, or would be likely to, involve the disclosure of information that is legally privileged.

These are both qualified exemptions, meaning that information captured under sections 42 and 43 can only be withheld if the public interest in withholding it outweighs the public interest in releasing it. The information below includes confidential assessment of the Swan Strategic Partnership with the GLA, associated loan facility including the proposed structure and terms of the funding; and confidential information relating to the proposed recipient of the funding. This is all commercially sensitive information, the disclosure of which would, or would be likely to, prejudice the commercial interests of GLAP, and other organisations specified below. While there is a public interest in understanding the circumstances in which public money is provided to other bodies, it is considered that in these circumstances the public interest lies in maintaining the exemption and withholding the information.

If this information is considered for release pursuant to the provisions of the Environmental Information Regulations 2004, this information should be considered exempt information under regulation 12(5)(e) – where disclosure would adversely affect the confidentiality of commercial or industrial information where such confidentiality is provided by law to protect a legitimate economic interest.

The information below also contains legally privileged advice relating to the above, particularly in connection with the contractual arrangements and State Aid. It is also considered that, in the circumstances, the public interest lies in maintaining the exemption and withholding the information.

Legal Adviser - I make the above recommendations that this information is not suitable for publication at this time.

Name: TfL Legal

Date: 7 March 2019

Once this form is fully authorised, it should be circulated with Part 1.

Decision and/or advice:

Clearly set out the decision or sensitive advice which is not suitable for publication.

1 Confidential information

Proposition

- 1.1 Swan New Homes (SNH) will use the £50m GLA Land and Property Limited (GLAP) loan facility to acquire and develop sites in London to assist delivery of their Strategic Partnership with the GLA.

Funding Summary

- 1.2 Swan Housing Association have entered into a strategic partnership with the GLA with a target to deliver 2,000 units of which 60% will be affordable housing, all starting on site before March 2022. Through this, Swan have been allocated £66.64 million of grant funding.
- 1.3 The GLA already has two loan facilities with Swan provided through Housing Zones. These are £50 million for Blackwall Reach (LB Tower Hamlets) and £29.2 million at Cambridge Road (LB Barking and Dagenham). The Cambridge Road facility is due to be repaid in full in 2019. Repayment of this facility will be a condition precedent to any drawdown through this new facility.
- 1.4 Swan estimates that debt funding of £129 million will be required in addition to the grant to deliver the strategic partnership units. Swan approached the GLA to explore how the GLA could further support them using loan finance to achieve delivery of their strategic partnership targets. The GLA has agreed to provide an initial facility of £50 million for a term of five years.
- 1.5 The GLA retains the right at its absolute discretion to extend or increase the facility. However, these terms would be agreed separately and will be subject to a number of factors as well as GLA approval at the time.
- 1.6 The strategic partnership homes will be delivered through SNH, a wholly owned subsidiary of Swan Housing Association. SNH will be the counterparty for the facility. Swan Housing Association will also be a party to the facility agreement and will covenant to purchase the affordable housing and acquire (or procure that a member of the Swan Housing Group acquires) those homes intended for private sale if SNH is unable to sell them on the open market.
- 1.7 SNH will be able to drawdown funding following the approval of strategic partnership schemes by the GLA. The approval of schemes will be subject to:
- (a) The provision of details relating to the scheme such as number of units and affordable housing delivery together with any other information reasonably requested by GLAP;
 - (b) a satisfactory due diligence report from a consultant from the Land fund Panel in respect of the proposed Scheme;
 - (c) a Valuation in respect of the proposed Scheme;
 - (d) adequate security over the relevant Site is available;
 - (e) no Event of Default is continuing;
 - (f) GLAP is satisfied that the completion of all Approved Schemes will be achieved in compliance with the terms of the facility agreement and the relevant Annual Affordable Housing Delivery

Target (i.e. the delivery of 60% affordable housing across those approved schemes which have started on site) is achievable; and

- (g) GLAP receiving confirmation that SNH has sufficient funds to complete the relevant scheme.

- 1.8 Interest will be charged at 5.5%, calculated and paid biannually. Receipts from sales must be paid into a "Deposit Account", which will be charged in favour of GLAP. SNH will be able to recycle funds within the term of the loan where receipts are received in excess of the on lent funding and the full amount of the loan will be repayable at the end of the term in March 2024.

Key Commercial Terms	
Total Commitment	£50,000,000
Fixed Rate of Interest	5.5%
Final Repayment Date	March 2024
Minimum SNH Equity per Scheme	20%
Interest Period	Interest shall be paid on the final day of each Interest Period. Interest periods are 6 monthly ending on 31 March and 30 September.
Financial Covenants: LTC LTV (GDV)	60 per cent 45 per cent

Risk Mitigation

- 1.9 The following key risks have been identified:

Risk	Impact	Mitigation
Commercial		
Counterparty Exposure. Total exposure to Swan New Homes will reach £100 million.	Medium - loan default.	- Repayment of Cambridge Road facility as a CP to initial drawdown. - Consideration of GLAPs existing commitments and repayments further to the agreement of any additional funding. - Noted that the counterparty, although a development SPV, is part of Swan Housing Group – with a parent RP rated A- by S&P. - Noted that Swan HA are also receiving £66.64m grant funding for the strategic partnership units. - Additional mitigations would need to be considered by the Interest Rate Setting Board and the Land Fund Investment Committee if further funding is requested by Swan.
Failure to repay the loan	Low – delay/loan default	- Financial covenants agreed through the contract. - Borrower for this transaction is Swan New Homes, a wholly owned subsidiary of Swan Housing Association – (S&P's rating of A-). - Covenant from Swan Housing Association to purchase the affordable housing units as well as the private sale units which have not sold within 6 months of practical completion. - Additionally, SNH must provide evidence satisfactory to GLAP, that it has sufficient funding to complete all current approved schemes as a CP to each funding claim and also

		confirm there have been no adverse changes to its financial position.
Planning and/or Technical		
Failure to deliver agreed outputs and percentages of affordable housing	Low – delay/ loan default	• SNH has to submit schemes to the GLA for approval, providing details regarding the number of affordable housing units to be delivered. • The loan agreement contains a clause regarding the overriding purpose of the loan which is to assist in the delivery of 2,000 units of which 60% is affordable housing. Under this clause, if the GLA is not satisfied that the borrower will deliver these outputs it can, at its absolute discretion request repayment of drawn funding within 24 months.
Insufficient security package	Low – Site is not developed	• The primary security package for the project will comprise a First Legal Charge over the Site for which funding is to be claimed. • The GLA also has a floating charge over all SNH assets as well as a covenant from Swan Housing Association to purchase the affordable housing. • Through the approval process for each scheme (prior to any claim by SNH) GLAP officers will review the site, and valuation provided to ensure that the scheme is deliverable and offers satisfactory security.
Creditworthiness	Low – delay/ loan default	• The Borrower for this transaction is SNH which is a wholly owned subsidiary of Swan Housing Association. Swan Housing Association currently holds a S&P's credit rating of A-. • As part of the on-going loan management process a creditworthiness assessment of all GLAP loans are continuously monitored. • Additionally, prior to each and every claim, SNH must confirm that there have been no material adverse changes in its assets, business or financial condition since the date of its last annual accounts.

Counterparty

- 1.10 The borrower for this transaction is Swan New Homes, a wholly owned subsidiary of Swan Housing Association who currently hold a Standard and Poor's credit rating of A- which was last updated in 2018. A creditworthiness assessment of the borrower was undertaken by the Transactions Team and GLA Group Finance. The creditworthiness of the Borrower on this basis was agreed to be 'satisfactory' which was agreed at Interest Rate Setting Board (IRSB) on 11th December 2018 and the Land Fund Investment Committee (LFIC) on the 29th January 2019.

Security Package

- 1.11 Security for GLAP takes the form of:
- 1.11.1 A first ranking charge over the land of Approved Schemes;
 - 1.11.2 Collateral warranties from key members of the professional team, contractors and sub-contractors, as and when they are appointed, which include step-in rights;
 - 1.11.3 A debenture including fixed and floating charges over all SNH assets (including its rights in relation to building contracts and development documents and over the deposit account); and
 - 1.11.4 A covenant from Swan Housing Association to purchase all of the affordable housing units as well as private sale units (possibly through a group member) which have not sold 6 months following completion;
- 1.12 A valuation will be provided by the borrower for each site, prior to the approval of each site as an Approved Scheme under the terms of the contract.
- 1.13 Following due diligence, the following financial covenants have been agreed:
- 1.13.1 Loan to Cost of 60%
 - 1.13.2 Loan to value (GDV) of 45%.
- 1.14 On this basis the collateral position was agreed to be normal to low.

Project Delivery – Roles and Responsibilities

- 1.15 SNH are responsible for sourcing sites to deliver their strategic partnership targets. They will purchase the sites which will remain in their ownership throughout the development period.
- 1.16 GLAP will have a first ranking charge over the sites and step in rights to all key contracts and warranties in the event of default.
- 1.17 Swan Housing Association covenant to purchase the affordable housing units as well as private units (potentially through a group member) which have not sold within 6 months of practical completion of the scheme.

Funding

- 1.18 This decision seeks approval to provide an interest-bearing loan of £50m from existing uncommitted funding (see MD2396), to be fully repaid by March 2024.
- 1.19 As at the date of this paper committed funding under MD2396 extends to £41.636 million. There are sufficient funds available under MD2396 to cover this loan.

Interest Rate

- 1.20 This director's decision proposes a loan facility of £50m to be resourced from the budget approved through MD2396, to assist SNH with the acquisition of sites and development costs for homes developed through Swan's strategic partnership with the GLA.
- 1.21 In arriving at the interest rate for SNH, Interest Rate Setting Board (IRSB) and LFIC have relied on the following interest rate grid for their margin for risk. An organisation/project with Satisfactory creditworthiness and normal to low collateralisation attracts a risk margin of 3.1% (220 basis

points). This is the adopted grid for the Greater London Authority and is very similar to the widely used state aid grid.

Creditworthiness	Collateralisation (basis points)		
	High	Normal	Low
Strong (AAA-A)	60	75	100
Good (BBB)	75	100	220
Satisfactory (BB)	100	220	400
Weak (B)	220	400	650
Very weak (B-)	400	650	825
Unsatisfactory (CCC & below)	650	825	1000

1.22 In common with all commercial lenders, GLAP sets its rates according to the following principle:

Offered Rate = Lender's cost of funds + margin for risk + costs

For lender's costs of funds whichever is greater between the European Commission Reference Rate and the Public Works Loan Board (PWLb) rate, the GLA's default source of finance, is used, plus 0.6%.

For margin for risk, the above table is used based on an assessment of collateral and credit worthiness. This table is in line with the Interest Rate Communication risk matrix which has been issued by the European Commission on the method for setting a proxy market interest rate for the purpose of assessing state aid compliance.

Costs are agreed with the borrower. They usually comprise, but are not limited to, GLAP's legal costs and may also include fees for valuations and due diligence.

1.23 For the lenders cost of funds, for SNH we have used the PWLB Maturity Rate at 27.02.19 for 5 to 5 and a half years minus 20 basis points to achieve the PWLB certainty rate. This gives a rate of 1.70% which is currently higher than the EC reference rate at 1.09%.

1.24 The GLA has made an offer to Swan, subject to approval, of 5.5%. This is made on the basis of the cost of funds outlined in the table below and a risk premium predicated on a satisfactory creditworthiness position and normal to low collateral position. As the borrower is paying legal fees as well as other arrangement costs so no additional cost premium has been added to this. This calculation is summarised below:

	Assumption	Basis points
Cost of Funds	PWLB certainty Rate	170 (190-20)
Fixed Rate Change	PWLB certainty Rate Change from Offer	-
Premium on cost of debt	Set rate	60
Risk margin	Satisfactory Creditworthiness/Normal to Low Collateral	310
Cost Premium	Costs paid for by counterparty	0
	Total Rate	540 (5.40%)

1.25 In offering a rate of 5.5% the GLA has factored in the additional risk with the facility with no current information regarding the sites as well as mitigating the risk of a small change in PWLB rate and fluctuation to the EC Reference rate.

1.26 If the rate proposed in this report is approved, the rate will be set at a fixed rate for the duration of the loan.

2 Financial Comments

- 2.1 The Assistant Director Group Finance certifies that the pricing principles above have been complied with and (having obtained external legal advice on the terms of the facility agreement) that the other terms and conditions of the loan are structured in a prudent commercial manner.
- 2.2 Given that we judge our rate to be calculated in a commercial manner, and that we anticipate our contract will contain the normal provisions found in commercial loans, we are satisfied we are meeting the requirements of the Market Economy Operator Test:
- 2.2.1 GLAP lends “on terms and conditions which would be acceptable to a notional private lender operating under a normal market economy situation”.
- 2.3 Further financial comments for this Part 2 are set out in sections 1.1 to 1.8 and 1.10 to 1.25 of the paper.

3 Legal comments

- 3.1 External lawyers have prepared and advised upon the draft facility agreement for the Strategic Partnership Facility Agreement. Below is a summary of the facility agreement.

Contracting Party/Security/Exit Routes

- 3.2 On behalf of GLAP, external lawyers have prepared and advised upon the draft Development Facility Agreement and the forms of security documentation. Below is a summary of the Development Facility Agreement.
- 3.3 The parties to the agreement are GLAP, SNH and Swan Housing Association Limited. GLAP will have the security referred to at paragraph 1.11 above. In addition, if SNH proposes to draw down GLAP funding to acquire the shares in a special purpose vehicle (SPV) which owns the site of an Approved Scheme, rather than purchasing the land directly, GLAP will be granted a debenture in respect of the SPV and the SPV will accede to the Development Facility Agreement (as well as providing a legal charge over the relevant site).
- 3.4 It should be noted that SNH is a Swan Housing Group company. In practical terms, SNH could be affected financially if Swan Housing Association became insolvent and this would also be an event of default under the Development Facility Agreement. In addition, the ongoing support of SNH is to some extent dependent on the equity and intragroup funding support from Swan Housing Association.
- 3.5 There will be a Subordination Deed, which subordinates all intragroup debt made available to SNH (or any SPV, as referred to in paragraph 3.3 above) by Swan Housing Association to GLAP’s debt.
- 3.6 SNH is obliged to provide a quarterly report to GLAP containing updated information about any approved schemes and their progress. Each quarterly report will, amongst other things, include computations as to compliance with the financial covenants in the agreement which are as follows:
- Loan to Cost: The ratio of the advanced funding in respect of a particular approved scheme to 90% of the development costs for that approved scheme incurred at that time does not at any time exceed 60%; and

- Loan to Gross Development Value: The ratio of the advanced funding in respect of a particular approved scheme to the gross development value (being the market value of the site calculated in accordance with the most recent valuation) does not exceed 45%.

3.7 An event of default occurs under certain circumstances. If this happens, GLAP has the right to enforce its security. These include (but are not limited to): a milestone failure; failure to pay any amount due under a finance document, subject to a two business day grace period where non-payment is as a result of technical delay in the transmission of funds; failure to perform a provision of the agreement and such failure is not remedied to the satisfaction of GLAP within 15 business days of SNH becoming aware of the failure or GLAP notifying SNH of the failure; an event or circumstance occurs in relation to SNH or Swan Housing Association that could have a Material Adverse Effect; a Finance Document not being, or ceasing to be, effective or not having the priority expressed in it; and cross default in excess of £250,000 with other financial indebtedness.

Scheme Funding

3.8 The loan is to be made available by GLAP to SNH of up to a Total Commitment of £50m in order to help fund the construction of at least 2,000 homes of which 60% are affordable housing dwellings, each of which is to have achieved Start on Site by 31 March 2022 (the “Overriding Purpose”). As mentioned in the table at paragraph 1.9 above, if GLAP is not satisfied that SNH will deliver these outputs it can, at its discretion, request repayment of drawn funding within 24 months. The process for approving a scheme for funding under the Development Facility Agreement is described at paragraph 1.7 above.

3.9 There are a number of conditions precedent to be provided by SNH or Swan Housing Association before any funding is advanced, which include corporate formalities, the debenture, and the initial business plan.

3.10 Further conditions precedent must be satisfied prior to any drawdown of the loan, including confirmation that nothing has occurred which is reasonably likely to jeopardise the Overriding Purpose, a certificate of title for the relevant site, evidence that the Developer will have sufficient funding to complete the scheme, a valuation acceptable to GLAP, repayment of the Cambridge Road facility agreement dated 31 March 2016 between GLAP and SNH in full, and the relevant security.

3.11 SNH will be required to open an Operating Account and a Deposit Account. The proceeds of each claim for funding in relation to the loan will be paid into the Operating Account. Unless there is an Event of Default, SNH will have sole control of this account and may make withdrawals for any purpose.

3.12 There will also be a Deposit Account into which SNH will pay all sales proceeds (net of certain costs and expenses). GLAP will have sole signing rights in relation to the Deposit Account or, if sole signing rights cannot be granted, joint signing rights with SNH on terms that require GLAP’s authority for the operation of the account. Sums standing to the credit of the Deposit Account may be applied to repay GLAP’s funding, or to meet ongoing development costs as “recycled funding” with GLAP’s authorisation. If the sales proceeds (net of certain costs and expenses) for a particular approved scheme are paid into the Deposit Account and exceed the outstanding balance of the advanced funding relating to that scheme (the “Required Balance”), SNH may request that the excess over the Required Balance is transferred to the Operating Account and, provided that no Event of Default will occur as a result, GLAP must comply with the request. Any such amount may be used by SNH for making gift aid payments or repaying any shareholder debt. If the balance in the Deposit Account subsequently falls below the Required Balance, SNH is required to procure that further sums are contributed to the Deposit Account by way of equity or debt from Swan Housing Association to bring the amount up to the Required Balance.

- 3.13 Interest shall accrue at the fixed rate of 5.5 per cent per annum. Interest will be payable in arrears on the final day of each six month interest period ending on a quarter date.
- 3.14 The loan must be repaid by 31 March 2024 or such other date as GLAP agrees. SNH may on giving not less than 15 business days' prior written notice prepay all or any part of the funding. Any partial reduction of the facility shall be at a minimum amount of £2,000,000 and in multiples of £2,000,000.

State Aid

- 3.15 It is GLAP's intention that the terms and conditions and the interest rate for the proposed loan to SNH is in line with those available on the open market. On that basis GLAP proposes to rely upon the Market Economy Operator Test (MEOT), which permits public bodies to lend to enterprises/economic undertakings on terms and conditions which would be acceptable to a notional private lender operating under a normal market economy situation. Provided the principle is properly complied with then no state aid arises as no advantage is conferred on the loan recipient.
- 3.16 The onus when relying on MEOT is for the public authority to justify (and if required prove) that its loan has complied with MEOT requirements. These include:
- 3.16.1 That the terms/conditions of the loan and interest rate are market terms for the particular circumstances of each transaction;
 - 3.16.2 That a notional market lender would have lent to the particular loan recipient (e.g. they were creditworthy); and
 - 3.16.3 That the terms of the loan properly reflect the security being offered.
- 3.17 External lawyers have advised the GLA as to whether the methodology for calculating a market interest rate set out in the EC Commission's Communication in relation to setting reference and discount rates (2008/C 14/02) (the Interest Rate Communication) is acceptable in respect of state aid compliance. Their advice is that this methodology is widely used by public authorities in circumstances where they are making a market loan under MEOT but, in doing so, they are adopting a risk-based approach; by applying the methodology it is probable that in most circumstances the loans would be state aid compliant, though there is still a risk that not all will be.
- 3.18 Circumstances where unlawful state aid may still arise when using the proposed methodology include:
- 3.18.1 No market lender would have lent to the loan recipient (e.g. bad credit score or insolvency concerns);
 - 3.18.2 Not applying the methodology as a notional market lender would (e.g. accepting poor security but scoring it as strong security);
 - 3.18.3 Not commercially assessing and/or applying the credit scoring; or
 - 3.18.4 In effect treating the application of the methodology as a process, rather than a tool to determine the correct market rate for the particular circumstances of each loan.
- 3.19 External lawyers have advised that the following steps should be followed by the GLA to help mitigate against these risks:
- 3.19.1 Ensure that the credit rating is current and from an independent respected organisation;
 - 3.19.2 Properly consider any security being provided (including what is the market value of the assets being secured and order of priority of its security); and
 - 3.19.3 Undertake a more detailed review of difficult cases, particularly if there are concerns that a notional market lender would never lend (e.g. insolvency concerns about the borrower).

- 3.20 GLA officers have confirmed that the above mitigating measures have been followed and external lawyers have been instructed to prepare and negotiate the funding contract and security documentation for GLAP, including the incorporation of any provisions required to ensure compliance with state aid rules.
- 3.21 External lawyers have also advised on the ability of GLAP to adopt a fixed interest rate for its loans and whether this complies with the MEOT/state aid requirements. Their advice is that a loan with a fixed interest rate is acceptable under MEOT providing it complies with the requirements set out in paragraph 3.16 above. To rely upon this GLAP would require evidence that at the time the loan was granted a notional market lender would have offered the relevant fixed interest rate to that borrower in identical circumstances.
- 3.22 It should be noted that the Interest Rate Communication itself requires a variable interest rate. External lawyers have therefore advised that where a fixed rate loan is to be offered, the GLA would also require evidence from a suitably qualified commercial/financial adviser that a rate calculated using the Interest Rate Communication would also be offered in identical circumstances by a notional market lender for a fixed interest rate loan (or advise on the higher margin which a notional market lender would require). Such evidence would have to take into account the creditworthiness of the borrower, security offered and the identical circumstances of the proposed arrangement. External lawyers have advised that advice from an independent external financial adviser would provide the strongest evidence. However, GLA officers have confirmed that, in relation to the proposed loan to SNH, this evidence has been provided by suitably qualified internal advisers. In so doing the GLA is accepting the risk that if the loan is ever challenged on state aid grounds, such internal sign-off may not be viewed as sufficient objective evidence that the fixed interest rate is a market rate.

