

GREATER LONDON AUTHORITY

REQUEST FOR DIRECTOR DECISION – DD2147

Title: Pocket 2017 Funding Allocation

Executive Summary:

MD2122 (May 2017) delegated approval of £51.4m in funding for Pocket Living to the Executive Directors of Housing & Land and Resources. The approval was subject to the terms of the contract documentation being satisfactory; and also the outcome of due diligence.

This DD summarises the outcome of that due diligence and seeks approval to allocate £25m of new funding from the Mayor's Affordable Housing Innovation Fund to Pocket Living; together with the re-allocation of up to a further £26.4m under an existing funding agreement between the GLA and Pocket Living dated 19 July 2013. This will form a revolving fund of up to £51.4m to finance site acquisitions and related pre-construction costs agreed with the GLA. The funding is due to be repaid by end March 2028.

Pocket Living provides new build homes for discount market sale (typically 80 per cent of local open market values) to London first time buyers. The funding is expected to deliver at least 1,059 additional affordable housing starts by the end of March 2021, on top of the homes that will be delivered under the July 2013 agreement.

Decision:

That the Executive Directors of Housing & Land and of Resources approve:

1. An investment of £51.4m in Pocket Living Ltd for a revolving fund to finance the acquisition of sites and related pre-construction costs so as to deliver at least 1,059 affordable housing starts by March 2021, and in addition to the affordable housing to be delivered under the existing agreement dated 19 July 2013
2. That of the £51.4m investment:
 - i. approximately £3.75m, for the market element of development, be in the form of a commercial loan at an interest rate set out in part 2 of this decision form
 - ii. £4.9m will be a commercial loan of working capital to cover overheads at an interest rate also set out in part 2 of this decision form
3. To formalise the above, that the GLA enters into:
 - i. a new loan funding agreement Pocket Living 2017 Ltd
 - ii. an inter-creditor arrangement between Pocket, HCA and Lloyds Bank
 - iii. a guarantee from Related

AUTHORISING DIRECTOR

I have reviewed the request and am satisfied it is correct and consistent with the Mayor's plans and priorities.

It has my approval.

Name: David Lunts

Signature: 

Name: Martin Clarke

Signature: 

Position: Executive Director Housing and Land

Date: 1.8.17

Position: Executive Director Resources

Date: 1.8.17

PART I – NON-CONFIDENTIAL FACTS AND ADVICE

Decision required – supporting report

1. Introduction and background

- 1.1. MD2122, approved in May 2017, delegated the decision to the Executive Directors of Housing and Land and Resources, in agreement with the Deputy Mayor for Housing and Residential Development, to agree additional investment for Pocket once the contract documentation was in finalised form and following a detailed financial due diligence review.
- 1.2. This Director Decision sets out the financial due diligence undertaken as part of the MD approval (requirements detailed in Finance comments in Part II of the Mayoral Decision), and seeks final approval from the Executive Director of Housing and Land and the Executive Director of Resources for the allocation to Pocket Living 2017 Ltd of £25m funding from the Homes for Londoners: Affordable Homes Programme 2016-2021 and the re-allocation of up to £26.4m of funding from the existing funding agreement between the GLA and Pocket Living (2013) LLP. This will form a revolving fund of £51.4m to finance site acquisitions on a conditional to planning and unconditional basis, and any related pre-construction costs agreed with the GLA. The DD also seeks approval for two separate commercial loans to Pocket.
- 1.3. Pocket is a provider of affordable homes, typically sold at a discount of 20% to the market sale price which is secured in perpetuity through an on-sale covenant. The Mayor has an existing agreement dated 19 July 2013 with Pocket Living (2013) LLP funded originally through the Mayor's Housing Covenant - Homes for Working Londoners Programme to use revolving loan financing of £26.4m as set out in MD1145, MD1174, DD1054, DD1090, DD1365, and DD2020. The original funding agreement enabled Pocket to acquire development sites on a subject to planning basis and deliver 665 affordable starts on site, of which 277 are complete, with an additional 388 units under construction.
- 1.4. The total facility of £51.4m will be treated as a recyclable and recoverable grant to Pocket (except where it will be on commercial terms for non-affordable housing – 1 see 1.6 below) and contractually obligates Pocket to deliver at least 1,059 additional affordable housing starts by the end of March 2021. Under the terms of the new funding agreement, from March 2021, GLA will conduct delivery and performance reviews every two years with Pocket, where the GLA will be able to assess performance based on outputs achieved and an updated business plan and determine whether to wind down the facility or extend it for another two years, with the ultimate repayment longstop date being 31 March 2028.
- 1.5 It is intended to permit the funding to be used in part to fund the acquisition of sites prior to the grant of planning permission. In broadening the scope of the programme to allow unconditional acquisitions and the use of surpluses, the requirement is to enable the business to reach a scale that will go on to achieve a self-sustaining position.
- 1.6 The sites to be acquired by Pocket using the new facility may be used for a mix of affordable housing and other uses (including market housing). Where this is the case, GLA funding will be on fully commercial terms to the extent required to ensure that the GLA is not providing public subsidy in respect of any non-affordable (i.e. market) housing elements. Further details in relation to the funding proposal are set out in Part 2 of this report.
- 1.7 Senior construction financing has now been secured from HCA and Lloyds Bank for the first seven sites. The two senior facility agreements have been substantially finalised and are awaiting signature pending approval of this DD. The GLA will have a legal first charge on sites that it has funded the acquisition of and the charge will only be subordinated to a senior lender once advances have been made by the relevant lenders under the senior facility agreements for development costs on respective sites. Pocket are contractually required to have development finance in place within a reasonable period to ensure there is momentum of delivery.
- 1.8 The contracts for the new funding, comprising: the GLA-Pocket loan agreement, the Intercreditor Agreement, and the guarantee from the borrower to the GLA, have now been completed in accordance with MD2122 and are awaiting execution following approval of this Director's Decision. The key elements of the deal that have been finalised following MD approval are summarised in Part 2 of this Directors Decision.
- 1.9 The financial due diligence has now been completed, details of which can be found in Part 2 of this paper. Based on the requirements outlined in the MD, the review consisted of two main components: i) a review of the numerical

accuracy of Pocket's model and the financial health of the company; ii) an assessment of the viability of the company and commercial assumptions of the wider deal.

2 Objectives and expected outcomes

- 2.1 The main objective of the £51.4m loan facility is to support the growth of output of Pocket Living by funding the acquisition of sites and pre-construction costs (such as planning and design) related to the delivery of new affordable housing. The facility therefore in effect provides Pocket with access to affordable housing subsidy on a revolving basis. Pocket will use the facility to acquire sites that consist of:
- Type A: 100% affordable Pocket homes
 - Type B: mixed tenure that also include a minority proportion of full market sale homes
- 2.2 From Type A and Type B sites, Pocket is required to deliver at least 1,059 affordable housing starts by 2021. Both type A and B sites may from time to time include non-residential floorspace as required by planning policy.
- 2.3 The Homes for Londoners Affordable Homes Programme 2016 – 21 set out the Mayor's approach to investing over £3bn to deliver 90,000 affordable starts by March 2021. While the guidance supports three core products (London Affordable Rent, London Living Rent and London Shared Ownership) at tariff grant rates; the programme also supports other forms of genuinely affordable housing. The Programme prospectus states that of the 90,000 new affordable homes, some 65% are expected to be forms of affordable home ownership such as London Living Rent, London Shared Ownership or other forms that the Mayor deems to be genuinely affordable.
- 2.4 The Affordable Homes Programme identifies an Innovation Fund to support, scale and replicate innovation in the delivery of affordable housing. The Pocket proposal has been evaluated and moderated with a score of 20 marks out of 25 and now taken forward through detailed due diligence and contracting.
- 2.5 Pocket is an established platform for the delivery of affordable home ownership in London. Its very high standard of design quality has informed London Plan Housing Design Guide space standards and gained the support of local authorities, some of whom have agreed to sell sites to Pocket on a subject to planning basis. The Pocket product has become part of the affordable housing landscape in London and is popular with prospective purchasers – some 30,000 people have registered their interest in future Pocket homes and schemes tend to complete sales within a month of going on the market.

3 Equality comments

- 3.1 Section 149(1) of the Equality Act 2010 provides that, in the exercise of their functions, public authorities must have due regard to the need to:
- Eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Equality Act 2010;
 - Advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it; and
 - Foster good relations between persons who share a relevant protected characteristic and persons who do not share it.
- 3.2 The obligation in section 149(1) is placed upon a decision maker, and due regard must be had at the time a decision is being considered. The duty is non-delegable and must be exercised with an open mind.
- 3.3 The allocation of the funding is from the Homes for Londoners: Affordable Homes Programme 2016 – 21 Innovation Fund and is aimed at implementing the Mayor's policies set out in the Mayor's London Housing Strategy. In January 2014, the GLA published an Integrated Impact Assessment (IIA), including an equalities impact assessment, of that strategy. The policies related to increasing housing supply, of which this paper relates, were covered by the IIA for the Further Alterations to the London Plan.
- 3.4 The delivery of new and additional homes by Pocket through the Innovation Fund will help to implement Objectives 1, 2, 3 and 4 of the Mayor's Equalities Framework "Equal Life Chances for All" (June 2014) through the creation of new homes, housing products and well-designed housing schemes.

4 Other considerations

Risks and Issues

- 4.1 Housing delivery and property development is an intrinsically risky exercise. A general risk to property development is that significant changes to demand factors in the housing market could negatively impact on Pocket's ability to deliver genuinely affordable homes. Price falls could render schemes financially unviable for providers and increases could move homes out of reach of the target audience.
- 4.2 Sensitivity testing of sales value assumptions within development appraisals will be considered by the GLA at the time of site purchase and the housing market will be monitored on an ongoing basis. Security documentation and repayment arrangements have been put in place as part of the GLA's funding requirements to protect against the risk that a development incurs a loss upon completion.
- 4.3 There has been marked construction price inflation in recent years. Further cost inflation and uncertainties in the availability of construction labour in London (especially post-Brexit) could exacerbate build price rises further.
- 4.4 Sensitivity testing of cost assumptions and inflation within development appraisals will be considered by the GLA at the time of site purchase. Pocket developments to date have included the use of off-site precision manufactured homes and this is expected to increase which should help to insulate projects from the uncertainty of sharp increases from fluctuations in the supply of labour. As mentioned above, security documentation and repayment arrangements have been put in place as part of the GLA's funding requirements to protect against the risk that a development incurs a loss upon completion.
- 4.5 Because Pocket will be able to compete for development sites on an unconditional basis before planning permission is granted and the level of affordable housing is known, it is possible for Pocket to over-pay for land or to acquire land that cannot be delivered for housing.
- 4.6 Pocket will be required to present to GLA a package of due diligence material to support the land offer assumptions including planning risk, site constraints and qualified assumptions on sales values and build costs. The minimum level of affordable housing within a Pocket development is contractually set at 70% and in most cases there will be 100% affordable housing. The risk that a development incurs a loss upon completion are mitigated through security and repayment arrangements including the Facility Agreement and Intercreditor Agreement with senior lenders. Details of these are set out in Part 2 of this report.
- 4.7 During the construction phase of a project, there is a risk that building contractors may face administration or liquidation and be unable to proceed with the delivery of the project. There may be circumstances where this could lead to senior lenders calling a default and placing the GLA's investment at risk, including from other projects that are provided as collateral. This risk has been mitigated as far as possible through the terms of the intercreditor arrangements between the GLA and senior lenders. The GLA will implement robust project management and reporting procedures to ensure the early identification of issues that could trigger events of default under the senior facility.
- 4.8 As part of agreeing to provide this additional funding to Pocket, officers focussed on implementing an appropriate project management and performance monitoring system. The following additional measures have been included in the new loan agreement with Pocket:
 - Consistent and comprehensive recording and reporting of project, programme and financial performance against agreed metrics including forecast and actual outputs, expenditure and income including reconciliation of expenditure
 - As part of any decision to support a site acquisition; a forecast profile of housing outturn and cashflow impact on the revolving facility in the context of the wider delivery of the programme and overall risk assessment
 - Quarterly programme reports with running assessment and risk rating of delivery of acquired sites against a programme forecast model
 - Updated businesses planning to inform bi-annual GLA decision to continue to retain or wind down the facility investment.

5. Financial comments

- 5.1 Detailed financial comments are provided in part 2 of this Director Decision.

6. Legal comments

- 6.1 Section 30 of the Greater London Authority Act 1999 ('GLA Act') gives the Mayor a general power to do anything which he considers will further one or more of the principal purposes of the GLA. The principal purposes, as set out in section 30(2) of the GLA Act are:
- (1) promoting economic development and wealth creation in Greater London;
 - (2) promoting social development in Greater London; and
 - (3) promoting the improvement of the environment in Greater London
- 6.2 In determining whether or how to exercise the power conferred by section 30(1) of the GLA Act, the Mayor must:
- (i) have regard to the effect that his decision will have on the health of persons in Greater London, health inequalities between persons living in Greater London, the achievement of sustainable development in the United Kingdom and climate change and its consequences (sections 30(3-5)) of the GLA Act;
 - (ii) pay due regard to the principle that there should be equality of opportunity for all people (section 33 of the GLA Act); and
 - (iii) have due regard to the Public Sector Equality Duty; namely the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by the Equality Act 2010, and to advance equality of opportunity between persons who share a relevant protected characteristic (race, disability, gender, age, sexual orientation, religion or belief, pregnancy and maternity and gender reassignment) and persons who do not share it and foster good relations between persons who share a relevant protected characteristic and persons who do not share it (section 149 of the Equality Act 2010).
- 6.3 Given the above (including section 3 of this report), Section 34 of the GLA Act which allows the Mayor to do anything which is calculated to facilitate or is conducive or incidental to the exercise of any of his functions (including his functions under section 30) and the Mayor's powers (under Section 38 of the GLA Act) to delegate to any GLA member of staff functions of the GLA that are exercisable by him, the foregoing sections of this report indicate that the Mayor has the power to agree to the decisions set out above.
- 6.4 Prior to entering into any funding agreement with Pocket in respect of the funding proposal set out in this report, appropriate legal advice must be sought by the GLA as to the detailed terms of the funding, state aid and appropriate security for lending.
- 6.5 Consideration will also need to be given as to whether the proposed GLA funding is, by virtue of section 34A of the GLA Act and the Greater London Authority (Specified Activities Order) 2013/973, a specified, commercial activity that must be dealt with by GLA Land and Property Limited ("GLAP"). If it is, GLAP will be required to enter into the relevant funding agreement, committing the GLA funding.
- 6.6 Once the Pocket entity which is proposed to be the counter-party to the GLA funding agreement has been constituted, GLA officers will need to carry out "know your customer" checks to verify the party with which it is contracting in accordance with the GLA's latest policies. These checks should be completed before any commitment to fund is made.
- 6.7 Further legal comments are set out in Part 2 of this report.

7. Planned delivery approach and next steps

- 7.1 Once this Decision has been formally approved, the facility agreement between the GLA and Pocket will shortly be executed. In addition, an Intercreditor Agreement between the GLA, Lloyds Banking Group and the Homes and Communities Agency will also be executed. Pocket will then be in a position to draw on the new combined facility to acquire land for developments in accordance with the facility agreement.
- 7.2 GLA officers will provide performance and contract management on a monthly, quarterly and bi annual basis. Bi-annual performance and business plan reviews will be undertaken in line with the milestones set out below.

	Delivery milestone	Trigger for review	Potential winddown date
Review 1	31 st March 2021	28 th February 2021	31 st March 2023
Review 2	31 st March 2023	28 th February 2023	31 st March 2025
Review 3	31 st March 2025	28 th February 2025	31 st March 2027
Review 4	31 st March 2027	28 th February 2027	n/a
Longstop date due for repayment			31 st March 2028

Public access to information

Information in this form (Part 1) is subject to the Freedom of Information Act 2000 (FOI Act) and will be made available on the GLA website within one working day of approval.

If immediate publication risks compromising the implementation of the decision (for example, to complete a procurement process), it can be deferred until a specific date. Deferral periods should be kept to the shortest length strictly necessary.

Note: This form (Part 1) will either be published within one working day after approval or on the defer date.

Part 1 Deferral:

Is the publication of Part 1 of this approval to be deferred? NO

If YES, for what reason:

Until what date: (a date is required if deferring)

Part 2 Confidentiality: Only the facts or advice considered to be exempt from disclosure under the FOI Act should be in the separate Part 2 form, together with the legal rationale for non-publication.

Is there a part 2 form – YES

ORIGINATING OFFICER DECLARATION:

Drafting officer to
confirm the
following (✓)

Drafting officer:

Wren Laing has drafted this report in accordance with GLA procedures and confirms that:

✓

Assistant Director/Head of Service:

Nick Taylor has reviewed the documentation and is satisfied for it to be referred to the Sponsoring Director for approval.

✓

Financial and Legal advice:

The Finance and Legal teams have commented on this proposal, and this decision reflects their comments.

✓

Corporate Investment Board:

The Corporate Investment Board reviewed this proposal on 31 July 2017.

EXECUTIVE DIRECTOR, RESOURCES:

I confirm that financial and legal implications have been appropriately considered in the preparation of this report.

Signature

M. D. Allge

Date

1. 8. 17

