

## PART 2 – CONFIDENTIAL FACTS AND ADVICE

**MD2190**

**Title: Wembley (Brent) Housing Zone – Wembley Parade**

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**This information is not for publication until the stated date, because:**

It contains commercially sensitive information the disclosure of which might prejudice the commercial and business interests of GLA Land and Property Limited. It also contains legally privileged information.

**Date** at which Part 2 will cease to be confidential or when confidentiality should be reviewed:

31 March 2020, although specific consideration should be given as to whether the legally privileged advice contained herein should be withheld for a longer period.

**Legal recommendation on the grounds of keeping the information confidential:**

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 contains information relating to confidential assessments of the scheme and unit costs of housing relating to the intervention and proposed Housing Zone funding; the proposed structure and terms of Housing Zone 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 should be considered confidential at this time

**Name:** Michael Mullin

**Date:** 22 November 2017

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

## Confidential decision and/or advice:

### 1. Confidential information

#### *Proposition*

- 1.1 AWP will use the £34.5m loan facility to re-finance a land acquisition loan and provide development finance to bring forward the scheme. The loan will ensure the exposure of Anthology Group Limited's US parent is limited as less equity is required. This has the benefit that Anthology will bring forward this scheme imminently, thereby accelerating housing delivery in the Wembley Housing Zone.

#### *Appraisal*

- 1.2 Lambert Smith Hampton (LSH) undertook project due diligence using a Housing Zones Development Appraisal Toolkit and supplementary information that Anthology Wembley Parade Limited (AWP) provided. LSH conducted high-level benchmarking analysis and in general deemed AWP's appraisal inputs to be appropriate. Additionally, LSH also found AWP's assumptions to be in line with its local market assessment of the value of both market sale and affordable homes.
- 1.3 LSH identified the following key risks to delivering the scheme:
- Significant increase in development costs.
  - Uncertain economic conditions which impact property prices.
  - Off-plan sales rates are not as robust as currently assumed.
- 1.4 Overall, however, LSH did not consider that the development risks associated with the scheme are significant enough to prevent the GLA from providing funding, so long as appropriate security is put in place.
- 1.5 AWP is assuming that it will sell 79% of the private homes off-plan. This rate is high compared to LSH's expectation of between 25% and 50%. AWP intends to mitigate this risk by instructing Savills to market and launch the scheme and to launch an international marketing campaign once units have been marketed locally. While the loan agreement requires that AWP markets all homes in the scheme domestically before marketing them abroad, LSH concluded that a slower absorption rate caused by fewer pre-sales than currently assumed will not affect AWP's ability to repay the loan.
- 1.6 The project cashflow shows a 28-month development programme up to and including practical completion of all private units and the conclusion of the sales programme.

#### *Repayment*

- 1.7 AWP will draw down the Housing Zones loan as profiled in the cash flow analysis as set out in Annex 1. It expects to repay the loan in uneven instalments between August 2019 and November 2019. However, while GLAP expects repayments to be in line with the cashflow, under the Development Facility Agreement, Anthology is only contractually required to repay the principal by the Final Repayment Date: 31 March 2020. This is considered acceptable given the security package that AWP is providing.

#### *Security*

- 1.8 Security for the loan comprises: a first ranking legal charge in respect of the site; a debenture granting fixed and floating security over all of AWP's assets (including all its rights in relation to scheme project documents to which it is a party); a charge over all the shares in the Developer; and collateral warranties with step-in rights from key members of the professional team. GLAP will only permit releases from AWP's deposit bank account if they are in line with the budget and AWP cannot make

any payments to equity either in the form of dividends or repayments of subordinated debt while the loan is outstanding, although this excludes payments of reclaimed VAT which AWP can use to repay VAT payments funded by AWP's parent company.

- 1.9 The security package requires a minimum land value of £14m. The loan agreement requires AWP to appoint a valuer with a duty of care to GLAP to provide a Red-Book Valuation of the site prior to drawing down funding. Savills undertook this valuation in October 2017 and supported a site value of £14m.

#### *Financial covenants*

- 1.10 The loan-to-cost ratio must not exceed 79%. For the purposes of this calculation, development costs are defined as the value of land plus the value of work-in-progress (discounted by 10%).
- 1.11 The loan to gross development value of the loan must not be more than 50%.

#### *Interest rate*

- 1.12 **On 11 September 2017, Interest Rate Setting Board (IRSB) indicatively offered AWP an interest rate of 5.25% subject to contract which AWP has accepted.** This rate may be amended to reflect the EC reference rate as at the date the loan agreement is signed.
- 1.13 IRSB agreed to offer this indicative interest rate on the basis that AWP has "Weak" creditworthiness and is providing a "Normal" level of collateral. The creditworthiness assessment reflects that Anthology Group Limited is not providing a parent guarantee to AWP and that AWP has little equity. The assessment of collateral reflects the loan-to-cost covenant of 79%.
- 1.14 IRSB also agreed that AWP could defer interest payments until the end of the scheme. Rather than paying interest biannually, it will begin to pay interest once it generates sales revenues. Interest payments will be added to the principal amount of the debt on a six-monthly basis and AWP will provide additional equity if necessary to ensure it does not breach the loan-to-cost covenant as a result. Additionally, AWP has confirmed it will not withdraw profits from the scheme until it has repaid the deferred interest.

#### *Contractual arrangements*

- 1.15 The counterparty is Anthology Wembley Parade Limited – a development company Anthology Group Limited created for the purposes of acquiring the site and developing and selling the homes.

#### *Value for Money – comparison to other Housing Zones loans*

- 1.16 The £34.5m loan facility will support 195 homes which equates to £177,000 per home. As with the loan to an Anthology entity in relation to the Hale Village Tower scheme (see MD2036), the Wembley Parade scheme is highly geared in terms of GLAP's commitment. That said, while a high amount of gearing creates additional lender risk, this risk is reflected in the indicative interest rate offer. The below table shows the proposed Wembley Parade loan will rank in the mid-range for value for money when compared to other Housing Zones loans.<sup>1</sup>

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<sup>1</sup> The table shows the number of homes at the time each loan agreement was signed.

Contractually committed Housing Zones loans in order of value for money:

Scheme	Counterparty	Loan facility (£)	No. of homes	Investment per home (£)
Blackwall Reach	Swan	£50m (recycled)	1,477	£34k
Britannia Music Site	Durkan	£25m	354	£71k
Cambridge Road	Swan	£29.1m	274	£107k
Wembley Parade	Anthology	£34.5m	195	£177k
Northolt Road	South Harrow / Origin	£25.3m	116	£218k
Hale Village Tower	Anthology	£55.1m	250	£221k

## Conclusion

1.17 LSH's due diligence work included project appraisal, comparable analysis of the proposed development costs and review of delivery milestones. LSH concluded in its report that overall the development risks associated with the scheme are not significant enough to prevent GLAP from providing funding, so long as appropriate security is put in place. It added that the risk that AWP does not repay the loan is not significant. GLA Housing and Land officers approve these findings and deem them significantly robust to justify providing funding for this scheme.

## 2. Financial comments

- 2.1 The interest rate of 5.25% was confirmed by the Treasury team on the 11 September 2017. This rate may be amended to reflect the EC reference rate as at the date the loan agreement is signed.
- 2.2 The costs and values that have been stated by the AWP have been deemed by Lambert Smith and Hampton as being within an acceptable range.
- 2.3 In arriving at the interest rates for this intervention, the IRSB has relied on the following interest rate grid as their margin for risk. Therefore, an organisation/project with Weak Creditworthiness and High Collateralisation attracts a margin for risk of 2.2%. This is a widely-used state aid grid, which is also used by the Homes and Community Agency (HCA).

Creditworthiness		Collateralisation	
	High	Normal	Low
Strong (AAA-A)	0.6%	0.75%	1%
Good (BBB)	0.75%	1%	2.2%
Satisfactory (BB)	1%	2.2%	4%
Weak (B)	2.2%	4%	6.5%
Unsatisfactory (CCC and below)	4%	6.5%	10%

- 2.4 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**

- 2.4.1 For lender's cost of funds, the State Aid Matrix or the PWLB (our default source of finance) rates are used, whichever is the greater.
- 2.4.2 For margin for risk, the Interest Rate Communication risk matrix is used, which has been specifically issued by the EC to comply with state aid; we have taken a professional view that it is indeed a reasonable framework (in the expectation of building up a diversified portfolio); as the portfolio evolves, we will keep this position under review, including from time to time commissioning external research, but would not expect to go below these suggested spreads.

2.4.3 The IRSB has decided that in relation to costs they will set this at the level of GLAP's legal fees.

- 2.5 For the lender's cost of funds, we use the cost of GLAP borrowing funds from the DCLG. The rate is currently 1.64% and this rate may fluctuate with movements in the EC reference rate, which is currently 1.04%. DCLG charges GLAP 60 basis points on top of this, taking GLAP to be a counterparty of Strong Creditworthiness and High Collateralisation. Interest rates are fixed at point of borrowing in relation to DCLG and GLAP Housing Zones Financial Transactions.
- 2.6 The Chief Investment Officer or Assistant Director Group Finance certifies that the pricing principles above have been complied with and (following consultation with Legal Services) that the other terms and conditions of the loan are structured in a prudent commercial manner, in line with our MoU with DCLG.
- 2.7 Given that we judge our rate to be calculated in a commercial manner, and that we anticipate our contracts will contain the normal provisions found in commercial loans, we are satisfied we are meeting the requirements of the MEIP:
- 2.7.1 GLAP lends "on terms and conditions which would be acceptable to a notional private lender operating under a normal market economy situation".
- 2.8 As an overlay, where we are dealing with companies with actively traded bonds, we would compare our rates to look for large discrepancies and seek to understand these.

### **3. Legal comments**

#### *Contracting Party/Security/Exit Routes*

- 3.1 External lawyers have prepared and advised on the draft Public Funding Agreement and other contractual documents. Below is a summary of the agreement.
- 3.2 The parties to the agreement are GLA Land and Property Ltd and Anthology Wembley Parade Ltd.
- 3.3 GLAP will have a legal charge over the Site pursuant to the debenture, fixed and floating charges over all of the Developer's other assets (including its rights in relation to the Scheme Project Documents to which it is party) and a charge of all the shares in the Developer. In addition, collateral warranties will be provided from key members of the professional team, and either the main contractor engaged by the Developer and key sub-contractors or each trade contractor engaged by the Developer directly with design responsibility, as and when they are appointed, and these collateral warranties will include step in rights. There is also a deed of subordination which subordinates all intra group debt made available to the Developer to GLALP's debt although funding provided by the Developer's parent to meet VAT costs may be repaid by the Developer to the parent when the VAT is reclaimed from HMRC.
- 3.4 An event of default occurs under certain circumstances. If this happens, GLALP has the right to enforce its security. These include (but are not limited to):
- a. a Milestone failure occurs or is in the opinion of the Monitoring Surveyor likely to occur which is not the direct result of a Milestone Extension Event;
  - b. failure to pay any amount due under a Finance Document, subject to a 2 Business Day grace period where non-payment is as a result of technical delay in the transmission of funds;
  - c. failure to perform a provision of the agreement, save that no event of default will occur where such failure to perform is capable of remedy and a plan for remedy is submitted by the Developer to GLALP within 20 Business Days of GLALP giving notice of the default or the developer becoming aware of the failure to comply and then such default is remedied in

accordance with the plan submitted within 20 Business Days or such longer time as GLALP agree;

- d. an event or circumstance occurs in relation to the Developer that might in the opinion of GLALP have a Material Adverse Effect; and
- e. cross default with other financial indebtedness.

#### *Scheme Funding*

- 3.5 There are a number of conditions precedent to be provided by the Developer before any Funding is advanced.
- 3.6 GLALP's obligations under the Facility Agreement are subject to the satisfaction of certain initial conditions precedent, including corporate formalities, agreed form debenture, share charge and subordination agreement, a draft of the scheme budget and the Valuation (all of which must be satisfactory to GLALP).
- 3.7 There are additional conditions precedent which must be satisfied prior to the Initial Drawdown, including share certificates and duly executed stock transfer forms for the Developer; the release of the existing security relating to the current financing; the delivery of a Certificate of Title; evidence that the Developer continues to have sufficient funding to complete the Scheme; a copy of the Scheme Details; a construction timetable including the Milestones (including the installation of the frame, cladding and Practical Completion); establishment of the Project Account and the Deposit Account; the grant of planning permission including approval of siting, design, access and use, landscaping and materials for the whole of the Scheme and completion of the related Section 106 Agreement; evidence of compliance with the financial covenants and of there being no cost overruns that have not been funded by the Developer; and the appointments of each professional. Additionally, there must be evidence satisfactory to GLALP as to the level and availability of contributions from the Developer and that the existing facility with Barclays Bank Plc has been fully discharged.
- 3.8 Further conditions precedent must be satisfied prior to each Subsequent Drawdown. Some of these are the same as the conditions precedent to the Initial Drawdown, such as evidence that the Developer continues to have sufficient funding to complete the Scheme and evidence of compliance with the financial covenants and of there being no cost overruns that have not been funded by the Developer.
- 3.9 The Developer will also be required to satisfy certain conditions subsequent within six months of the date of the first Subsequent Drawdown. The Developer will be required to provide, insofar as they have been entered into, all remaining collateral warranties and appointments of each member of the professional team, contractors and key sub-contractors, to the extent they have not been provided. Where such professional or contractor is required to maintain professional indemnity insurance, the Developer will be also be required to provide a copy of the relevant professional indemnity insurance certificate or confirmation of such insurance.

#### *State Aid*

- 3.10 It is GLAP's intention that the terms and conditions and the interest rate for this proposed loan to the counter-parties are in line with those available on the open market. On that basis GLAP proposes to rely upon the Market Economy Investor Principle (MEIP), 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. Providing the principle is properly complied with then no state aid arises as no advantage is conferred on the loan recipient.

- 3.11 The onus when relying on MEIP is for the public authority to justify (and if required prove) that its loan has complied with MEIP requirements. These include:
- i. That the terms/conditions of the loan and interest rate are market terms for the particular circumstances of each transaction;
  - ii. That a notional market lender would have lent to the particular loan recipient (e.g. they were creditworthy); and
  - iii. That the terms of the loan properly reflect the security being offered.
- 3.12 External lawyers have advised the GLA as to whether the methodology for calculating a market interest rate set out in the EU 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 MEIP 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.
- 3.13 Circumstances where unlawful state aid may still arise when using the proposed methodology include:
- i. No market lender would have lent to the loan recipient (e.g. bad credit score or insolvency concerns);
  - ii. Not applying the methodology as a notional market lender would (e.g. accepting poor security but scoring it as strong security);
  - iii. Not commercially assessing and/or applying the credit scoring; or
  - iv. 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.
- 3.14 External lawyers have advised that the following steps should be followed by the GLA to help mitigate against these risks:
- i. Ensure that the credit rating is current and from an independent respected organisation;
  - ii. 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
  - iii. 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).
- 3.15 GLA officers have confirmed that the above mitigating measures have been followed and external lawyers have been instructed to prepare and negotiate the funding contracts and security documentation for GLAP, including the incorporation of any provisions required to ensure compliance with state aid rules.
- 3.16 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 MEIP/state aid requirements. Their advice is that a loan with a fixed interest rate is acceptable under MEIP providing it complies with the requirements set out in paragraph 3.10/3.11 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.
- 3.17 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 the counter-parties, 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.