PART 2 – CONFIDENTIAL FACTS AND ADVICE

MD2036
Title: **Tottenham Housing Zone (Phase 1), London Borough of Haringey – Hale Village Tower**

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This information is not for publication until the stated date, because: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 January 2021, 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. Whilst 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: Gemma Jackson **Date:** 23 September 2016

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

Confidential decision and/or advice:

Appraisal

1.1 Project due diligence was undertaken by Lambert Smith Hampton (LSH) using a Housing Zone Development Appraisal Toolkit and supplementary information provided by Anthology. LSH's cost appraisal involved benchmarking costs against other schemes based on their previous experience and Anthology's costs were deemed to be within an appropriate range.

1.2 With regard to values, Anthology's appraisal values are also in line with LSH's local market assessment of the value for both sale and affordable homes.

1.3 The project cashflow shows a 45 month development programme up to and including practical completion of all private units and the conclusion of the sales programme. The Housing Zone loan is structured as two separate loans. The first loan is to fund land acquisition and amounts to £12,000,000, with Anthology contributing the remaining £8,000,000 required to purchase the site alongside the Housing Zone loan. The second loan is to provide development finance and amounts to £43,159,294. This represents a total loan of £55,159,294. Anthology is required to provide satisfactory evidence to GLAP as to the level and availability of additional Anthology equity (which is required to be a further £12,000,000) before the second loan is made available.

1.4 The Housing Zone loan is profiled to be drawn down as per the cashflow analysis attached at Annex 2. The Housing Zone loan together with accrued interest is profiled to be repaid as follows (consistent with the cashflow appended at Annex 2):

- Loan tranche 1 – single repayment of the principal not later than 31 January 2021 with interest payments being made bi-annually starting 6 months after first drawdown of loan funding.

- Loan tranche 2 – uneven repayments between December 2019 and July 2020 with full repayment taking place no later than 31 December 2020 and with interest payments being made bi-annually starting 6 months after first drawdown of loan funding.

1.5 It should be noted however that, although repayments are expected in line with the cashflow, under the Acquisition and Development Finance Agreement Anthology is only contractually required to repay the principal by the Final Repayment Date; namely 31 January 2021 for loan 1 and 31 December 2020 for loan 2. GLA officers consider that this is acceptable on the basis of the security package being offered.

1.6 A creditworthiness assessment of Anthology was undertaken by GLA Group Finance, the result of which was presented to Interest Rate Setting Board (IRSB) held on 21 July 2016 and 16 August 2016. IRSB has applied the resultant credit rating to both loans. Both loans are secured by the same security which comprises: a first ranking legal charge in respect of the site; a debenture granting fixed and floating security over all of Anthology's assets (including all its rights in relation to construction contracts, professional appointments and bank accounts); collateral warranties with step-in rights and a share charge granted by Anthology's parent company. Releases from Anthology's bank accounts will only be permitted if they are in line with the budget and (other than payments of reclaimed VAT which can be used to repay VAT payments funded by Anthology's parent company) no payments can be made to equity (either in the form of dividends or repayments of subordinated debt) while the loan is outstanding. The loan-to-value in relation to loan 1 must not be more than 60%, and the loan to gross development value of loan 2 must not be more than 45%. In respect of collateral, IRSB agreed the following: loan 1 benefits from High collateral while loan 2 benefits from Normal collateral.

1.7 It should be noted that the security package requires a minimum land value of £20,000,000 to achieve the 60% loan to value requirement for loan 1. The valuation (by Savills as at September 2016) does achieve a land value in excess of this figure. This valuation is predicated on the assumption that the 250 home proposal achieves planning consent. This planning consent will not be in place when loan 1 is anticipated to be drawn, i.e. September/October 2016. Planning submission is anticipated to take place by September 2017. In mitigation of this risk, it should be noted that (i) the principle of residential development has been established on the site, (ii) LB Haringey and GLA planners are supportive of the proposed density and (iii) LB Haringey and GLA planners are supportive of the proposed level of affordable housing given the level delivered to date across the Hale Village masterplan area. LSH has commented on the risk of not securing consent for the 250 home scheme and consider it to be "minimal" on the basis that "the site already has consent for 194 units and the scale and affordable housing provision has been agreed in principle with both the GLA and LB Haringey".

1.8 Subject to contract, IRSB has indicatively offered Anthology the following fixed interest rates for the two loans (these rates have been accepted by Anthology):

- Loan tranche 1 – 3.84 per cent.
- Loan tranche 2– 4.74 per cent.

1.9 LSH's Due Diligence incorporates project appraisal, comparable analysis of the proposed development costs and reviews of delivery milestones. Having reviewed LSH's assessment report, officers of GLA Housing and Land approve its findings and deem them to be sufficiently robust to justify investment into the project.

1.10 In comparing this intervention with GLAP's first two Housing Zone Financial Transaction loans, it should be noted that the project is more highly geared in terms of GLAP's commitment. It has a higher debt:equity ratio in favour of debt finance compared with previous Housing Zone loans. The funding is for this reason going to deliver fewer homes. The first two Housing Zone loans (Britannia Music Site within the LB Redbridge Housing Zone and Cambridge Road within the LB Barking and Dagenham Housing zone) required approximately £71,000 and £107,000 of investment per home respectively. This compares with a figure of approximately £223,000 per home for the Hale Village Tower site. The higher level of gearing for the Tower site equates to a greater degree of lender risk. This is in turn reflected in a higher margin return in terms of the interest rate charged and the absolute return in monetary value as a result of this higher interest rate.

1.11 Due to the uncertainties as a result of Brexit, Anthology's US parent is unwilling to provide further funding to progress the Hale Village Tower site beyond the £20m equity being released alongside proposed Housing Zone debt. An alternative to Housing Zone finance would be for the developer to seek bank finance if commercial terms cannot be agreed with GLAP. Against this, it should be noted that GLAP's £200,000,000 Housing Zone loan facility from DCLG is significantly undersubscribed and DCLG has been formally approached with a request to defer drawing the agreed £50,000,000 for 2016/17 until 2018/19 given the anticipated take-up of loan funding at the time of writing. This approach to DCLG has been necessary in light of the fact that a number of loans allocated or approved under the Housing Zones MDs for Phase 1 (covering the first 20 Housing Zones under two separate MDs – 1457 and 1545) are now abortive. At the time timing of writing these abortive loans amount to over £74m. The Hale Village Tower site therefore represents an opportunity to fund a stalled development site by providing commercial loan finance and at the same time utilising DCLG funding.

1.12 Housing Zone funding improves the risk profile of the scheme and the appetite for Anthology to purchase and develop the site by providing certainty of funding. The developer could potentially procure development finance from mainstream funders but given the current cautiousness of funders in the aftermath of the result of the referendum on the United Kingdom's membership of the European Union, this source of finance is uncertain and could result in the site becoming stalled. Housing Zone funding ensures that the site will be unlocked and delivered in accordance with the timescales set out in the body of this report, which is an accelerated timescale compared with a position where no such funding is made available.

Contractual Arrangements

1.12 The counterparty is Anthology Development 4 Limited. This is a development company set up for the purpose of acquiring the site and developing and selling the homes.

2. Finance Comments

2.1 This MD proposes a two tranche loan totalling £55,159,294 to be resourced from the Housing Zones DCLG funding. The first tranche is for £12m or 60% of the open market value of the land. The interest rate for this loan is suggested by the Interest Rate Setting Board to be 3.84%. The second tranche is for £43,159,294 for the construction of the tower will be for 70% of the construction cost, but in assessing 70% of these costs, we discount them to 90%. This means that we are lending 63% of the construction costs. The interest rate for this loan is suggested by the Interest Rate Setting Board to be 4.74%.

2.2 In arriving at the interest rate for Anthology, 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%

2.3 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 cost of funds, the State Aid Matrix or the PWLB (our default source of finance) rates are used, whichever is the greater.

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

2.4 For the lender's cost of funds, we use the cost of GLAP borrowing funds from the DCLG. This rate is currently 1.64%, this rate may fluctuate with movements in the EC reference rate, which is currently 1.04%. DCLG charges GLAP 0.6% on top of this, taking GLAP to be a counterparty of Strong Creditworthiness and High Collateralisation. Interest rates are fixed a point of borrowing in relation to DCLG and GLAP Housing Zone Financial Transactions.

2.5 IRSB has decided to make an initial offer to Anothology, subject to Mayoral approval of 3.84% (2.2% + 1.64%) for High collateral loan 1 and a rate of 4.74% (3.10% + 1.64%) for High/Normal (((2.2% + 4%)/2) + 1.64%) collateral on loan 2.

2.6 If the Mayor, after the recommendation of the Interest Rates Setting Board, approves the rates proposed in this report, the rate will be set for the duration of the loan.

2.7 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.

2.8 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:

- GLAP lends "on terms and conditions which would be acceptable to a *notional private lender* operating under a normal market economy situation".

2.9 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. We are also developing relationships with other lenders in the same space in order to compare notes.

2.10 Given that the American backers have capped the amount of equity they are willing to commit to the project, the project requires debt finance and this loan will be unlocking and accelerating development on this site.

2.11 In not approving this loan, there is an increased risk that Housing Zone funds may have to be returned to the DCLG as unallocated.

2.12 As mentioned in the body of the report, there is 42% social housing across Hale Village. The Hale Village Tower site also proposes the delivery of 38 affordable homes on the Hale Village Tower site. This compares with a position under the current outline consent which delivers no affordable housing.

2.13 Of the £200m lent to the GLA from DCLG we have currently committed to lending £54.195m; £25m to Durkan and £29.195 to Swan New Homes.

3. Legal Comments

Contracting Party/Security/Exit Routes

3.1 External lawyers have prepared and advised upon the draft Acquisition and Development Facility Agreement on behalf of the GLA. Below is a summary of the Agreement, although at the date of writing it is not yet in final form; any final changes are proposed to be subject to approval by the Executive Director of Housing and Land in consultation with the Deputy Mayor for Housing & Residential Development.

3.2 The parties to the agreement are GLAP and Anthology Development 4 Limited. GLAP will have the security referred to at paragraph 1.6 above.

3.3 Anthology is obliged to provide a quarterly report to GLAP containing updated information about the scheme and its progress. The quarterly report will, amongst other things, include computations as to compliance with the financial covenants in the agreement which are as follows:

- Loan 1: the ratio of the advanced funding less any amount in the Deposit Account to the market value of the site does not at any time exceed 60%;
- Loan 2: the ratio of the advanced funding less any amount in the Deposit Account to 90% of the Development Costs incurred at that time does not at any time exceed 70%; and
- Loan 2: the ratio of the loan less any amount in the Deposit Account to the gross development value (being the value of the site assuming practical completion has occurred) does not exceed 45%.

3.4 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): failure to perform a provision of the agreement and such failure is not remedied to the satisfaction of GLAP within 10 business days of Anthology becoming aware of the failure or GLAP notifying Anthology of the failure; an event or circumstance occurs in relation to Anthology that might in the reasonable opinion of GLAP have a Material Adverse Effect; and cross default with other financial indebtedness.

3.5 It should be noted that before an event of default arises for failure to deliver the 250 homes (the "Outputs"), Anthology will have the opportunity under the terms of the loan agreement to agree revised outputs with GLAP.

Scheme Funding

3.6 The loan advanced by GLAP to Anthology is to fund certain development costs of a development at the site known as Hale Village Tower, Tottenham. The development is proposed to comprise 212 market sale dwellings and 38 affordable dwellings. The current expectation is that the development will be delivered by Q3 2020, although this date will not be finalised until after site acquisition but prior to drawdown of the development finance element of the Housing Zone loan. Both loans much be repaid in full no later than 31 January 2021. .

3.7 There are a number of conditions precedent to be provided by Anthology before any funding is advanced, which include corporate formalities, a draft of the scheme budget, a valuation, evidence required by GLAP for "know your customer" requirements and the security documentation (a Debenture incorporating a legal charge over the site and over the Project and Deposit Accounts, a Charge over Shares and a Subordination Agreement).

3.8 Further conditions precedent are required to be satisfied before loan 1 can be drawn down (including a Certificate of Title in respect of the site) and again before loan 2 can be drawn down (including a construction timetable, planning approval satisfactory to GLAP, an updated Certificate of Title, a copy of the development agreement and collateral warranties in favour of GLAP, evidence of the availability of Anthology's equity contribution and evidence that the Project

Account and Deposit Account have been set up and that the bank has been notified of the charging of Anthology's interest in favour of GLAP).

3.9 GLAP will advance loan monies to Anthology to fund the costs of acquiring the site (loan 1) and developing the scheme (loan 2). A claim for funding must be submitted no later than 10 business days prior to the proposed drawdown date and must be accompanied by written evidence that such costs have been incurred together with confirmation from the monitoring surveyor that it has verified and approved the claim. Subject to the claim being valid, GLAP will pay the funding into the Project Account. Unless a material event of default is continuing, Anthology may then make withdrawals from the Project Account to pay any development costs referred to in the scheme budget or otherwise consistent with the funding arrangements. Anthology will have sole signing rights to the Project Account.

3.10 There will also be a Deposit Account into which Anthology must pay net disposal proceeds. GLAP will have sole signing rights in relation to the Deposit Account. Sums standing to the credit of the Deposit Account can (at Anthology's option) be applied either to repay the Housing Zone loans or be transferred into the Project Account as "recycled funding" if Anthology submits a valid claim to use such recycled funding towards the development costs of the scheme. The scheme cashflow currently envisages £11,500,000 of net disposal proceeds being used as recycled funding. GLAP is to authorise release of the recycled funding within 5 business days of a valid claim.

3.11 Interest shall accrue at the fixed rates of 3.84 per cent per annum for loan 1 and 4.74 per cent per annum for loan 2 with interest payments being made bi-annually starting 6 months after first drawdown of loan funding.

3.12 Amounts drawn shall be repaid by the Final Repayment Date; namely 31 January 2021 for loan 1 and 31 December 2020 for loan 2.

State Aid

3.13 It is GLAP's intention that the terms and conditions and the interest rate for this proposed loan to Anthology 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.

3.14 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:

3.14.1 That the terms/conditions of the loan and interest rate are market terms for the particular circumstances of each transaction;

3.14.2 That a notional market lender would have lent to the particular loan recipient (e.g. they were creditworthy); and

3.14.3 That the terms of the loan properly reflect the security being offered.

3.15 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 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.

3.16 Circumstances where unlawful state aid may still arise when using the proposed methodology include:

3.16.1 No market lender would have lent to the loan recipient (e.g. bad credit score or insolvency concerns);

3.16.2 Not applying the methodology as a notional market lender would (e.g. accepting poor security but scoring it as strong security);

3.16.3 Not commercially assessing and/or applying the credit scoring; or

3.16.4 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.

3.17 External lawyers have advised that the following steps should be followed by the GLA to help mitigate against these risks:

3.17.1 Ensure that the credit rating is current and from an independent respected organisation;

3.17.2 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

3.17.3 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).

3.18 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.

3.19 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 3.13 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.

3.20 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 Anthology, 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.