PART 2 – CONFIDENTIAL FACTS AND ADVICE

MD2266	
Title:	**Tottenham Hale (LB Haringey) Housing Zone – Hale Wharf**

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This information is not for publication until the stated date, because: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 **Title**: Senior Associate - Property & Planning Law **Date:**

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

Confidential decision and/or advice:

1. Confidential information

Outputs

1.1 The outline planning permission (OPP) for the site has consented up to 505 homes, together with an obligation to deliver 35% affordable housing. The £14,670,000 recoverable grant investment in the site approved under Director Decision (DD) 2161 recognised this planning position, but equally, recognised that the proposed density of homes on the site may decrease during the process of obtaining detailed planning consent on a phased basis (Hale Wharf is a multi-phased scheme). The GLA therefore agreed a minimum or baseline scheme density with the developer in return for the recoverable grant investment and DD 2161 confirmed this baseline density as 450 homes. DD 2161 also confirmed that clawback of recoverable grant will be triggered in the event the affordable housing on the site falls below a level of 35%. The GLA entered into two Public Funding Agreements (PFA) with Waterside Places Limited (WPL) following the signing of DD 2161 to formalise the recoverable grant investment. Under these PFAs, 450 homes, including 35% affordable housing, are classed as "direct" contractual outputs and as such are caught by the contractual obligations in the PFAs. A further 55 homes, including 35% affordable housing, are classed as "indirect" in recognition of the fact that they are contingent on the process of detailed planning permission. These indirect homes are not linked to contractual obligations in the PFAs. The total direct and indirect housing output of the PFAs is the 505 homes, including 35% affordable housing, as consented by the OPP.

1.2 The £38,183,235 Financial Transaction funding that is the subject of this MD is facilitating the delivery of the housing output detailed above in that it is providing the commercial debt finance for the scheme [1]. Therefore, as with the PFAs, WPL as borrower under the Financial Transaction funding, will have contractual obligations to deliver a minimum of 450 homes, including 35% affordable housing. However, to avoid double counting in Housing Zones (HZ) at a programme level, all of the homes approved under this MD will be classed as "indirect" for the purpose of monitoring programme outputs.

Appraisal

1.3 Lambert Smith Hampton (LSH) undertook project due diligence using a HZ Development Appraisal Toolkit and supplementary information provided by the borrower in September 2017 to inform the due diligence requirements set out in DD 2161. This due diligence involved a benchmarking analysis of costs and revenues and general appraisal assumptions. It found that HZ funding will enable the scheme to be brought forward to deliver homes which otherwise may not be built and that the funding will ensure programme timescales are met. It also highlighted that scheme related enabling works are key to unlocking the delivery of the housing being brought forward on the site and that funding is required to avoid programme delays and non-delivery. Overall, LSH found that benchmarking inputs are acceptable. Continued reliance is placed on this due diligence given (i) it is

[1] One of the blocks in scheme is for private rent and it is anticipated that a specialist investor will be brought on board to fund this element of the scheme.

less than 6 months old and (ii) relates to the same scheme or proposal that is the subject of this approval.

1.4 Notwithstanding the continued reliance placed on LSH's September 2017 due diligence, it was updated in March 2018 to reflect the Financial Transaction funding. This report states that, in the absence of Financial Transaction funding, "WPL would be required to secure funding from other sources, the consequences of which would likely be an increase in interest payments and potential delay in the delivery of the scheme. The GLA loan will reduce this exposure for WPL and will ensure accelerated delivery". It goes on to state, the "funding will enable the scheme to be brought forward to deliver homes which may otherwise not be delivered and the funding will ensure that programme timescales are achieved".

1.5 The LSH work highlights project risks in the form of land assembly, market failure and/or construction cost increases. The original report also highlighted project viability as a risk, citing a funding gap if the costs required to acquire the final leasehold interest within the site are considered.

1.6 WPL is currently in negotiation to acquire the final leasehold interest at Hale Wharf. If it fails to agree terms by private treaty, compulsory purchase is a potential route to acquisition.

1.7 In terms of market failure, LSH commented in its original work that "[o]verall, we consider the sales values to illustrate a conservative approach to values". This, together with the loan covenants – particularly the loan to gross development value (see below) – provide an element of mitigation in the event of market failure.

1.8 By way of mitigation of potential cost increases, a monitoring surveyor owing a duty of care to GLAP is required under the terms of the funding agreement. This appointment will provide on-going monitoring and early warning of potential cost increases throughout the construction programme with the opportunity to take corrective action as required, for example, re-design, value engineer and/or review tendering procedures to drive efficiencies in the construction supply chain.

1.9 In respect of the funding gap highlighted by LSH in its original work given the need to acquire the final leasehold interest in the site, as confirmed in DD 2161, the GLA accepts the principle that WPL may require additional grant from the 2016-21 programme to make the scheme viable and deliver at least 35% affordable housing. In this respect, there is an agreed viability review mechanism in the signed section 106 agreement for the scheme to evidence any requirement for additional funding.

1.10 A failure to repay the loan was also highlighted as a primary risk for GLAP in Part 1 of this MD. This risk is mitigated by putting appropriate security in place (see below).

Repayment

1.11 WLP draw down and repay the loans as profiled in the cash flow set out in Annex 1. Subject to construction progress on site, the loan is expected to draw down from August 2018, peak in June 2020 and fully repay by October 2021. The cashflow reflects a more optimistic construction programme in respect of timely completion of the development than the dates highlighted for start on site and practical completion in Part 1 of this MD as the dates in Part 1 are milestone dates which trigger potential breach of contract, i.e. an element of time contingency has been built into the contractual dates detailed in Part 1 of this MD.

Security

1.12 Security for the loan comprises a fixed charge over the site together with collateral warranties in respect of the key construction documents. This gives GLAP effective security over both land and work in progress but stops short of the debenture normally used to secure HZ loans [2]. GLAP has agreed with the borrower that a debenture will not be provided for this HZ loan because WPL is a JV that is used to deliver several development projects [3]. The GLA's Interest Rate Setting Board (IRSB) approved the loan on this basis. The loan agreement requires security to be underpinned by a Red Book land valuation and the certification of work in progress by an independent monitoring surveyor owing a duty of care to GLAP.

Financial covenants

1.13 The loan-to-cost ratio must not exceed 80%. 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%).

1.14 The loan to gross development value must not be more than 55%.

Interest rate (creditworthiness and collateral)

1.15 The GLA's IRSB indicatively offered the rate set out below on 20 December 2017 (rates to accurately reflect the EC reference rate at the point of contracting):

1.16 The interest rate offered is 5.33% based on a "Weak" borrower and "High" collateral. The creditworthiness assessment reflects the fact the JV is a without recourse development vehicle with limited assets. The collateral assessment reflects the fact that land and work in progress has sufficient value to remain within prescribed loan covenants.

Value for Money – comparison to other HZ loans

1.17 The £38,183,235 loan facility will support 450 homes which equates to approximately £84,852 per home. The table below shows the proposed loan facility in comparative terms against existing HZ loans [4].

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
Hale Wharf	**WPL**	**£38.2m**	**450**	**£85k**
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

1.18 LSH's work overall concludes "funding will enable the scheme to be brought forward to deliver homes which may otherwise not be delivered and the funding will ensure that programme timescales are achieved". GLA Housing and Land officers approve these findings and deem them significantly robust to justify providing funding for this scheme.

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[2] A debenture also gives the lender a floating charge of the remainder of the borrower's assets.
[3] The floating charge carried with a debenture would catch these other development projects.
[4] The table shows the number of homes at the time each loan agreement was signed.

2 Financial comments

2.1 Project due diligence has been undertaken by Lambert Smith Hampton for DD 2161 in September 2017. Overall, the benchmarking inputs were found to be acceptable. Continued reliance is placed on that due diligence given it is less than 6 months old and relates to the same scheme.

2.2 The loan facility of £38.2m will facilitate a minimum of 450 homes of which 35% are to be affordable.

2.3 The security on the loan consists of a fixed charge over the site with collateral warranties in respect of key construction documents – not as effective as the debenture normally used to secure HZ loans (see section 1.12).

2.4 The interest rate indicatively offered is 5.33% based on a 'weak' borrower and 'high' collateral. The actual rate will reflect the EC reference rate at the point of contract.

2.5 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%

2.6 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.

2.7 For the lender's cost of funds, we use the cost of GLAP borrowing funds from the DCLG. The rate may fluctuate with movements in the EC reference rate, as 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.

2.8 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.

2.9 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:

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

2.11 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

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 Facility Agreement are GLAP and the Developer (Waterside Places Ltd). The funding advanced by GLAP to the Developer is to fund certain development costs of dwellings which will be disposed of to be used as private rental accommodation or which will be sold on the open market on a development at the site known as Hale Wharf, Ferry Lane, London, N17. Development of the market dwellings is being funded on the basis that not less than 450 Dwellings will be built on the Site with a minimum of 35% being affordable housing dwellings.

3.3 The Developer is obliged to provide a quarterly report to GLAP containing updated information about the project and its progress. The Developer will also provide annual and management accounts to GLAP.

3.4 The quarterly report will, amongst other things, provide details of progress against Milestones and an updated Cashflow showing actual income and expenses to date and forecasted income and expenses. The quarterly report will, also include computations as to compliance with the financial covenants in the agreement which are as follows:

3.4.1 the ratio of the loan to the aggregate of £4,103,930 (being the initial site value assuming no works) plus 90% of the development costs does not at any time exceed 80%; and

3.4.2 the ratio of the loan to the gross development value (being the value of the site assuming practical completion has occurred) does not exceed 55%.

3.5 The Facility Agreement contains a number of events of default. These include (but are not limited to):

a) failure to pay any amount due under a Finance Document, subject to a 3 business day grace period where non-payment is as a result of administrative or technical error;

b) a milestone failure which is not the subject of a milestone extension event;

c) the Developer fails to perform and/or observe any obligation or restriction on it under any finance document or scheme project document (to which it is a party) which would have a material adverse effect.

3.6 Where an event of default occurs and is continuing the GLA may among other things, require the Developer to prepare a plan to remedy the breach, suspend or alter the timing for payment of Funding and enforce security.

3.7 GLAP will advance loan monies to the Borrower to fund the costs of developing the scheme up to 80% of the total scheme costs. A claim for funding 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.

3.8 Interest shall accrue at the fixed rate of 5.33 per cent per annum. Interest will accrue and then be capitalised quarterly.

3.9 Amounts drawn, together with accrued interest, shall be repaid:

3.9.1 in an amount equal to 75% of the receipts from each disposal of Block A Dwellings or Phase 2 Market Dwellings

3.9.2 where such disposal is by way of sale, on the date of completion of that sale; and

3.9.3 in respect of any other payment, within 2 Business Days of its due date.

3.9.4 to the extent that any amounts remain outstanding on the Final Repayment Date, on the Final Repayment Date; or alternatively at any time if it becomes illegal for GLALP to continue to perform its obligations or enjoy its rights under this Agreement.

3.10 GLAP will have a first ranking legal charge over the site and collateral warranties in respect of the key construction documents

3.11 There are a number of conditions precedent to be provided by the Developer before any funding is advanced pursuant to the Facility Agreement which include corporate formalities, a scheme budget, a construction timetable for Phase 1, a valuation and the latest available audited financial statements of the Developer. Further conditions precedent include:

3.12 a certificate of title in respect of the site (we have reviewed the certificate of title and reported any issues to you); and

3.13 security being granted over the site and collateral warranties provided in respect of key contractors and professionals.

State Aid

3.14 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.

3.15 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:

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

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

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

3.16 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.

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

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

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

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

3.17.4 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.

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

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

3.18.2 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

3.18.3 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).

3.19 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.

3.20 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 2.9 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.

3.21 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-party, 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.