Delivery models and case studies identified by the New Delivery Models sub-group

This appendix presents case studies of new delivery models identified by the sub-group. Case studies are presented for information only, and do not constitute legal or financial guidance or advice from the GLA.

1. Brighton Council / Hyde Group Limited Liability Partnership

Structure and arrangements

1.1 In this model, Hyde Group Limited (the HA) and Brighton Council (the LA) will incorporate a new limited liability partnership (LLP) on a 50:50 basis. The LLP will acquire, fund, develop, sell and own (as applicable) discounted rental and Shared Ownership homes.

1.2 Each of the LA and HA (the LLP Members) will provide equity to fund the project, with the funds provided to the LLP as non-interest bearing loans.

1.3 Each LLP Member is expected to receive a commercial rate of return on its equity investment from the profits generated in the LLP as properties are either let or sold. Each LLP Member would benefit from a stable long-term index-linked revenue stream as rental growth is linked to either CPI or RPI (as applicable).

1.4 The Shared Ownership investment also provides the potential for capital growth, through house price inflation linked to staircasing receipts.

1.5 There are also valuable indirect benefits for the LA and its local area including social and economic benefits from the inward investment into the provision of new housing, increased council tax revenues and New Homes Bonus.

1.6 In this model, the LA gains access to the HA's technical and commercial developer skills, and benefits from the HA's supply chain arrangements and volume buying power. Both LLP Members benefit from the pooling of funding and resources, and sharing of risk.

Housing delivery

1.7 The guiding principle behind the proposal is to create a bespoke affordable housing delivery model that is tailored to the specific housing needs that exist within the LA's area.

1.8 The discounted rent model is a bespoke model that is tailored to local incomes. Essentially a Living Rent product is proposed, with average rents equating to less than 60% of local market rents. The rents have been calculated to ensure genuine affordability for low income working households from the LA area.

1.9 The cost of a mortgage, rent and service charge for the proposed Shared Ownership housing is less than the cost of local private market rents for comparable homes, and has been calculated to ensure that the properties are affordable to households earning average local incomes in the LA area.

Procurement

1.10 The LA and HA enter into a members' agreement in order to incorporate the LLP. The members' agreement does not impose obligations on either the HA or LA to provide services to, or to procure works or supplies on behalf of, the LLP. It deals simply with the constitutional arrangements necessary to establish the LLP itself. Consequently, the members' agreement does not constitute a public contract for the purposes of the Public Contract Regulations 2015 and selection of either HA/LA does not require an EU-regulated procurement process.

1.11 The rules set out in the Public Contracts Regulations 2015 apply to specified bodies known as "contracting authorities". The Public Contracts Regulations 2015 set out a list of various bodies within the UK which are specifically designated to be contracting authorities for the purpose of the Regulations. In addition, the Regulations set out further tests through which other bodies which are not specifically listed may also be determined to be contracting authorities and therefore subject to the requirements of the Regulations.

1.12 In these circumstances, given the nature of the proposed schemes and the LA and HA's relationship with the LLP, the LLP is likely to be a contracting authority for the purposes of the Public Contracts Regulations 2015. This conclusion is reached because of the likely levels of control which the LA and HA will have over the LLP and the LLP is not likely to be considered to have a "commercial or industrial character" so as to place it outside the ambit of the Regulations.

1.13 The LLP will call off work for both consultants and contractors using the HA's established multi user frameworks, thereby satisfying the requirements of the Public Contracts Regulations 2015.

1.14 Simple land transfers in which the LA or HA transfer property to the LLP without imposing any obligations to carry out particular works are generally outside the scope of the Public Contracts Regulations 2015. Therefore there are no procurement issues under the Regulations.

2. Newcastle Science Central Limited Liability Partnership

2.1 This involved L&G structuring a new LLP ("NewCo") with the existing partners of Science Central LLP ("OldCo") (Newcastle City Council and Newcastle University) to invest into Newcastle Science Central.

2.2 OJEU was not required in this example because it was a straightforward land and investment deal, whereby the OldCo (which could be any Public Sector Body ("PSB"), for example) sells land to NewCo (e.g. joint-venture (JV) between PSB and Private Sector Investor), comprising the Council, the University and L&G as equal Partners. A framework enables OldCo to transfer future phases to NewCo at valuation. The public sector bodies engage with L&G as an investment partner rather than developer partner, thereby negating the need for OJEU because L&G are not providing any works, goods, or services.

2.3 Investment occurs via L&G's initial equity buy-in into the JV through lease-based funding for the first office building. Partners then provide additional development capital as required in the form of preferred equity into the JV at a fixed, rolled-up, coupon (with recourse only to NewCo). This provides the LLP's development capex. The first office building is funded by L&G "at cost" (i.e. with no developer's margin) and then leased on a 40 year 'income strip' lease (i.e. ownership reverts to the Council at lease end). The Council is expecting to generate a profit rent from this, as well as the revenue stemming from Newcastle Science Central being an Enterprise Zone. L&G has also agreed to take market risk and fund the second building, of c.100,000 sq. ft. net internal area (NIA), speculatively as and when lettings reach a pre-set hurdle on the first building.

2.4 Having created public realm / serviced plots etc., some of the site will then be sold back down by NewCo to individual Partners, or combinations of Partners, again at market value. For example, the University will wish to solely own and fund some buildings, and the Build to Rent element is likely to be a JV between L&G and the Council. This is all managed via an agreed decision-making process, and governed by a joint Board.

2.5 In this model, best consideration is demonstrated by i) the value L&G pays the Council and the University to "buy-in" to the JV (i.e. the value of the LLP's land holding); and ii) the yield on L&G's leaseback investment. Both of these have been determined by an independent third party surveyor with a Duty of Care to the Council and the University to ensure parity.

3. Affordable housing, key worker housing or supported/specialist housing funding model

3.1 This model involves an institution funding a development in full and then leasing the properties to an "investment grade" covenant – effectively either a Local Authority or major Housing Association (the PSB) – for 20 years or more.

3.2 The value of this covenant and certainty of income stream to a pension fund enables a dramatic reduction in the investor's required return, unlocking a much-lower income yield, and thus rent.

3.3 Modelling this approach in one London Borough, a scheme with 144 units generates £30,655 of rent per week at 80% of market (e.g. 2-bed at £224 per week), equating to gross rent of £1,594,060 per annum. The scheme's build cost would be £23,415,000. If the investor requires an initial yield of 2.75%, that equates to the institution receiving £687,698 in rent from the Borough. Deducting 30% of rent for management, maintenance, and building up a sinking fund, the difference between the rent net of those deductions and the rent payable to the investor equals **£428,144** per annum, which is either kept as revenue by the PSB, or enables rents to residents to be reduced further.

3.4 This model assumes rent rising in line with RPI, given that local rents / income to the PSB typically rises at a similar rate, but this could also be CPI or a fixed amount. For leases over 35 years in this model, the institution could return the properties to the PSB at lease end. This would mean that capital growth is returned to the public sector and all future income is kept by the PSB.

3.5 The PSB can either manage the units itself or use the 30% of rental income to incentivise a third party to manage the units.

4. London Cancer Hub

Background

4.1 The Institute of Cancer Research (ICR), the Royal Marsden Hospital (TRM) and the former Sutton Hospital occupied a 20 hectare site in Belmont, Sutton - now called the London Cancer Hub - until parts of it were sold to the London Borough of Sutton (LBS). The former Sutton Hospital, which is part of the Epsom & St Helier University Hospitals NHS Trust (ESH), has now been largely de-commissioned. This has made 7.4 hectares of land available for re-development.

4.2 Sutton Council launched its Opportunity Sutton programme in 2012 to provide a focus for economic development in the borough. One of the key projects in the programme is the London Cancer Hub, which has evolved since 2013 with a partnership between Sutton Council and the ICR and supported by the Royal Marsden, the Epsom & St Helier NHS Trust, and the Greater London Authority. In 2016, the London Cancer Hub was accepted into the One Public Estate programme run by the Cabinet Office and Local Government Association.

4.3 The vision for the LCH is to create a global centre for cancer innovation, providing state-of-the-art facilities and a world-leading life-science district specialising in cancer research, treatment, drug discovery education and enterprise. This will involve redevelopment of the site over a 20-year period to provide up to 100,000 square metres of commercial space for research laboratories, offices, shops, leisure and other uses that support the creation of a fully fledged innovative district.

Land Acquired by the Council

4.4 Proposals for the site include the construction of a new secondary school that will have a strong focus on Science, Technology, Engineering and Maths (STEM) with practical links with the ICR. Land for the school site (1.6 hectares) was acquired from the ESH in March 2015 (for £8m). Discussions regarding acquisition of land for the school consequently proceeded ahead of preparation of a Development Framework (Masterplan) for the site. The strength of collaboration on the Partnership Board for the London Cancer Hub was significant in helping the process of acquiring the land for the proposed school.

4.5 The further land required for commercial development for the London Cancer Hub is to be acquired from the ESH in two tranches and will total 5.8 hectares when completed. Acquisition of the first tranche of 2.22 hectares was completed in March 2017 (for £14m). It is anticipated that acquisition of the remainder will be completed by December 2017.

NHS Disposal Process

4.6 Disposal of sites owned by the NHS is governed by the NHS Estatecode. The key requirements of the code for an NHS organisation are:

- Prepare an Outline Business Case for approval by its Board and by NHS Improvement (previously by the NHS Trust Development Authority)
- On receipt of both approvals, declare the land surplus and publish availability of the land for 45 days on a property database called ePIMS, which is maintained by the Cabinet Office, seeking expressions of interest in acquiring

the land. (Only the NHS and other public bodies are allowed to express an interest during this initial phase)

- Assess the expressions of interest, and if there are satisfactory submissions, identify as Preferred Purchaser the organisation that best meets the evaluation criteria and can best demonstrate a requirement for the land that furthers the purposes of that organisation.
- Negotiate terms and dispose. (NHS organisations can acquire at book value, but other public sector organisations have to pay market value).

4.7 In both completed acquisitions, the LBS was the only organisation that submitted an expression of interest and in both cases it was able to demonstrate that the intended use was in line with its corporate objectives and was also able to demonstrate it had the financial resources for the acquisition.

Best Consideration

4.8 There is a tension between the ESH's requirement to achieve best consideration and the Council's need to demonstrate best value. It was therefore necessary to provide, as far as possible, certainty on the key issues that drive the valuation of land. For this site, the key drivers were:

- Planning policies, use and development density
- Site conditions and constraints
- Title restrictions
- Environmental and ground conditions

4.9 The Borough's Local Development Framework allocated the site for residential/health use and, from the start, there was an agreement that the land price would be based on residential use valuation. The ESH consequently commissioned the design of a residential scheme for the site to establish the quantum of development possible and also held pre-application discussions with the Planning Department to inform development that could be acceptable for the site.

4.10 Both organisations agreed to jointly commission the District Valuation Service to undertake the valuation of the site which was to form the basis for agreeing price. Both organisations were consequently able to comment and challenge the valuation inputs. As part of the NHS Estatecode, the ESH was required to commission an independent valuation which was carried out by Savills and validated the DVS's valuation. Both parties were therefore able to satisfy themselves on the price paid for the site.

Financial model

4.11 The initial proposals for the land acquisition sought to do this through an LLP on an equal and joint basis between the Council and the ICR. The Council would borrow through PWLB to fund the full value of the purchase and then lend it on to the LLP (at a higher rate to comply with state aid rules). The LLP would hold the land on its balance sheet adding and rolling up the ongoing debt financing costs, offset by appreciation in land values, before then selling it on to the selected developer. The Council secured agreement with its external auditors, Grant Thornton, that for accounting purposes it would not need to provide minimum revenue provision (MRP) for repayment of the capital sum as this was an investment property clearly held to sell on in the near future and the full capital value will be realised at that point, hence this was an interest only loan.

4.12 Sutton has other commercial property acquisitions (that have annual rental income) that the auditors have been content to advise doesn't require MRP as they are held for investment purposes.

4.13 In the final transaction, the LLP model could not be used due to specialist state aid advice that, in this case, a 30% equity injection would be required upfront. LLP parties could not agree this, therefore the Council has acquired the land directly, but the principles above still apply.

Key Enablers

4.14 The following factors were key to the relatively smooth process of acquiring the two tranches of land:

- Clarity of vision and organisational commitment - all organisations forming the partnership are committed to delivering the London Cancer Hub vision and it is demonstrably a clear priority. The Partnership Board is attended by the Chief Executives and the Leader of the Council.
- Programme management & collaborative approach - underpinning the Partnership Board is a programme management structure that has a number of cross-organisation technical groups to drive various aspects of the project. This has ensured accountability and a shared understanding of matters that had to be resolved.
- Time - the ESH has pressures to achieve its disposals before the final year-end, just as the Council also required early certainty about securing the land required for the school and the rest of the LCH.
- Client management - strong client management skills have been evident in the way that consultants have been procured and managed by both the ESH and LBS.
- Communication and Advocacy - there is a communications plan with close cooperation between all the communications teams in the partnership organisations. The vision of the LCH has been strongly and positively communicated by leaders in the partnership organisations at special events and through their networks. This has led to the project achieving a high profile with the Mayor of London and within central government.