

CABINET

24 SEPTEMBER 2019

MEDWAY DEVELOPMENT COMPANY LTD UPDATE

Portfolio Holders: Councillor Howard Doe, Deputy Leader and Portfolio Holder for Housing and Community Services
Councillor Adrian Gulvin, Portfolio Holder for Resources

Report from/Author: Perry Holmes, Chief Legal Officer

Summary

This report updates Cabinet as shareholder about the first four residential developments being progressed by the Medway Development Company Ltd (MDC). It also proposes the creation of a private rental subsidiary of MDC.

1. Budget and Policy Framework

- 1.1 The responsibility for managing the Council's land is a matter for Cabinet as is the provision and management of housing.
- 1.2 Medway Council is the sole shareholder of MDC with that role being undertaken by Cabinet.

2. Background

- 2.1 This is the second update report to the Cabinet as shareholder by MDC. Cabinet approved a Business Case submitted at the 5 September 2017 meeting for the creation of a new company to be called Medway Development Company Limited and amended the structure of the company at its 10 April 2018 meeting as part of the first update report it was provided by the Company, to enable it be more tax efficient.
- 2.2 MDC was incorporated on 24 October 2017 and Councillor Howard Doe, Deputy Leader and Councillor Adrian Gulvin, Portfolio Holder for Resources were appointed as directors. Councillor Doe has been appointed as the Chairman. Additional non-executive directors Jonathan Sadler and Barbara Richardson have been recruited externally and have been formally appointed to the MDC Board.

Barbara Richardson is Chief Executive of Windsor and Maidenhead's housing company. She previously worked for Hounslow's housing company. She has many years of housing industry experience and has previously worked at Savills, Berkeley Homes, Orbit and NHBC. Jonathan Sadler was until recently Chief Executive at Chatham Maritime Trust and prior to that worked at the Homes and Community Agency (HCA now Homes England). He was well known to the Council as he was the HCA representative on for Rochester Riverside Project Board.

- 2.3 In January 2018 MDC recruited a Head of Operations, Lewis Small, who has taken forward four initial projects identified in the Business Case presented to Cabinet. That Business Case listed twelve potential sites, with a total investment needed of £120 Million. In May 2019 MDC also appointed a Senior Project Manager to support the delivery phase of the initial projects. The Chief Legal Officer, as the senior officer responsible for the Council's property portfolio has undertaken a client representative role. It is suggested that this is formally approved by Cabinet.
- 2.4 The MDC Board has met regularly to oversee the progress of projects in line with the company's Business Plan which was approved by Cabinet in April 2018 (via a delegation to the Chief Legal Officer, in consultation with the Leader). The Chief Legal Officer has attended as an observer. An updated version of the Business Plan is attached at Exempt Appendix 1 for formal approval.
- 2.5 A process for initial funding of the four projects was agreed and has been overseen by the Leader and Chief Finance Officer under a delegation from Cabinet. Details of the funding provided to date is contained in Exempt Appendix 2.

3. Update on the first four projects within the Business Plan

Chatham Waterfront

- 3.1 Planning permission was granted on 20 March 2019 for the development of 175 apartments on this, the first MDC site, including a significant intervention in the public realm area between the bus station and the River Medway. That is illustrated in the computer generated image below. Commercial space will be created on the ground floor including retail space with a river view. This scheme has the capacity to make a significant positive impact in the middle of Medway's "city centre" and is already generating local interest. It is also expected to act as a catalyst for further development in this central waterfront location.
- 3.2 The Council has a requirement for large schemes like Chatham Waterfront to provide 25% affordable units. 44 apartments which are a mix of shared ownership and affordable rent are being provided, after agreement by the Planning Committee, at Britton Farm (see below).

- 3.3 Procurement of a main contractor was approved at Procurement Board and AMCM have been appointed to provide Construction Management services. The MDC Board have advised the Council to use a “construction management” approach to this project and Britton Farm to enable procurement efficiencies at each stage and to provide greater programme and quality control. This will ensure the construction remains tightly governed on these flagship developments.
- 3.4 The timeline for the Chatham Waterfront development is “start on site” Summer 2019, with archaeology commenced in July and hoarding up from 19 August. Completion is expected in Winter 2021.



Fig1. A CGI of Chatham Waterfront residential development with the public realm works proposed.

Britton Farm

- 3.5 44 affordable residential apartments will be built on the former loading bay area of this previous supermarket site. It is hoped this prominent development will form part of a concerted investment in Gillingham, at this strategic gateway site, close to the High Street. The appointment of G Harpers as main contractor was approved at Procurement Board.
- 3.6 The timeframe for this development is start on site Autumn 2019 and completion late 2020. Agreement in principle has been reached with Golding Homes to purchase the units when complete.



Fig2. CGI of Britton Farm residential development

Whiffens Avenue

- 3.7 Planning permission for 115 apartments at this historic location was granted by the Planning Committee on 29 May 2019 with 9 shared ownership units on site and 20 units of affordable rented provided at White Road (see below).
- 3.8 The proximity of this scheme to a scheduled ancient monument, Fort Amherst, has meant significant liaison with Heritage England. The design is illustrated in the CGI in Fig3 below. Clearance of the escarpment leading up to Fort Amherst will take place (illustrated by the CGI in Fig4 below) as part of this project, together with public realm improvements in Town Hall Gardens.
- 3.9 The timeline for this scheme is commencement on site Autumn 2019 and completion Summer 2021. The Council was able to obtain £732,000 of Accelerated Construction funding from Homes England as part of this project. This reflects the use of modern methods of construction to increase build pace by up to 40%.



Fig3. CGI of Whiffens Avenue residential development



Fig4. CGI of Whiffens Avenue residential development showing proposed clearance of the escarpment behind.

White Road

- 3.10 20 units of affordable housing will be built by TopHat, a modular housing provider, appointed after a competitive process, on the area of land behind White Road Community Centre. The units will be constructed off-site and delivered to site as modules. They boast high levels of energy efficiency and low running costs. The design and finish of the terrace of 20 houses will be similar to those being built at the Kitchener Barracks site in Chatham. Agreement in principle has been reached to sell the houses to MHS housing on completion.
- 3.11 The timeline for this scheme is commencement on site Summer 2019, with enabling works being completed during the holiday period and completion Winter 2019.



Fig5. CGI of the modular housing for the White Road residential scheme.

4. Pipeline of Further Projects

- 4.1 There were 12 sites identified in the initial Business Case. An update on the current pipeline of further projects is set out in three documents. These are Appendix 1 which updates Cabinet about the progress against the first 12 sites it commissioned MDC to consider and the 2 additional sites that were subsequently added. Exempt Appendices 3a and 3b deal with the priority of pipeline work and some additional sites that are being considered. These are at an early stage and will be shared with Cabinet in due course, should MDC advise that they ought to be pursued.
- 4.2 One of the initial MDC commissioned projects, Hook Meadow Community Hub and residential scheme, did not reach the required profitability threshold that the MDC Board has set itself and approval is sought to remove the scheme from MDC Ltd's programme. The Council may wish to consider developing the site itself, as an "enabling scheme", however this would require approval of a new business case by Cabinet.
- 4.3 For one of the development projects, Sir John Hawkins car park, which is split into two sites, it is now proposed that consideration is given to the smaller part of the site being used for multi-storey car parking. If Cabinet were to consider this option, it would require a new business case to be presented to Cabinet for approval.

5. Advice and Analysis

- 5.1 The MDC Board met on 8 August 2019 to review the updated Business Plan which is presented to Cabinet for approval. It noted good progress has been made against the first four development sites. As the developments move to a delivery phase it is important for Cabinet to review progress against the Business Plan. It is also timely for MDC to take account of wider residential and commercial market factors, broader economic considerations, as well as the local picture to ensure a responsive approach.
- 5.2 Financial viability assessments have been carried out at three stages in the development of the schemes. These have been approved by the MDC Board. They have then been scrutinised and approved by the Chief Finance Officer and the Leader prior to the release of any funding, in line with the Cabinet delegation (paragraph 6.25 (second bullet point) of the Employee Delegation Scheme refers). This ensures that investment decisions are being tested rigorously before approval. The MDC Board has agreed the prioritising of next pipeline sites as set out in Exempt Appendix 3b for consideration and approval by Cabinet.
- 5.3 The Business Case approved by Cabinet in September 2017, was predicated on the construction of residential units for sale, either as market sales, to customers, or affordable units, to registered social

landlords. The MDC Board has maintained an open mind about the option for the company to, in addition, construct residential units for the private rental market. The market sale model is simple. It does not involve any long term borrowing. It involves the sale of units by the Council through MDC. Capital investment is then recovered in a short time frame plus any surplus. If sales are affected this has a direct impact on the recovery of the Council's investment in the short term.

- 5.4 The MDC Board have taken advice on the private rented sector. There is a demand for good quality private rented property in Medway. If the national Help to Buy scheme is terminated by the Government, as some commentators are speculating, there may also be an increased interest in shared ownership schemes. The creation of a subsidiary that is fully commercial rather than a "teckal" company (which provides the majority of its business back to the parent and is subject to a greater level of control) would allow MDC to respond to anticipated changes in the housing market. Were there to be an economic recession that affected sales of private market or affordable units, this could enable a change of approach that would open up the way for more private rented or shared ownership units to be offered in Medway. Alternatively MDC could consider, on a scheme like Chatham Waterfront, which is split into distinct buildings, offering blocks as private rented or shared ownership accommodation to diversify its portfolio. Two indicative financial appraisals of how a private rented sector scheme could operate for a refurbished building or a new build are set out in Exempt Appendix 4 to be compared with an indicative financial appraisal for a market sale scheme for the refurbished building.
- 5.5 In order to give the company maximum flexibility and after consideration, it is proposed to create a subsidiary to enable the company to rent units in the private rental sector or to offer shared ownership units. This is something that the Cabinet as shareholder must approve. Any actual proposals to for a private rented or shared ownership scheme will first have to be agreed by the MDC Board and funding will follow the same approval route as for market sale developments. This is in accordance with the matters reserved to the shareholder at Appendix 2.
- 5.6 Projections for capital receipts based on the market sale of built units show that MDC is on course to exceed the projections in the Business Case with capital receipts of £7.1m over the next 3 years and up to £17.1m over the next 5 years. These figures would alter if private rented schemes were pursued on any of the sites, reducing capital receipts but providing a revenue return.

6. Corporate Governance

- 6.1 The Cabinet can be assured of the appropriate measures of corporate governance being taken by the company from the following:

- The Chief Legal Officer has observed all MDC Board meetings and liaised regularly with the Head of Operations on the various developments being progressed.
- MDC has appointed external auditors who have completed the first filing of accounts.
- All MDC Board meetings have been quorate and all significant company decisions have been approved by the MDC Board.
- Decisions by the MDC Board not to proceed with projects, such as the Hook Meadow scheme have been referred back to Cabinet for approval.
- Procurement processes which mirror those used by the Council have been followed by the company with support and advice have from the Category Management team at the Council.
- Legal advice has been provided by the Council's Legal team on contractual matters.
- All spend has been reported for scrutiny and approval by the MDC Board and signed off by the Chairman. Details of the spend to date on the first four projects including company overheads is set out in Exempt Appendix 2.

7. Risk management

Risk	Description	Action to avoid or mitigate risk
Sales risk or market failure	There is another recession in the UK which causes a drop in residential values, affecting the returns expected to the Council. A no deal Brexit impacts on the supply of construction goods or materials.	The Business Case which Cabinet considered included increased costs and decreased sales values. The Business Plan enables a phased approach to delivery. There remains latent demand for new properties in Medway. The private rental subsidiary allows flexibility of offer.
Tenants exercise their right to buy of MDC rental properties	Financial risk to the Council as a potential lender, lack of investment return and increased borrowing costs.	The company structure will include the private rental subsidiary being a fully commercial entity obviating the possibility of right to buy
Overall loss of tax efficiencies and cost savings by operating a private rental subsidiary	Corporation tax is payable by commercial entities on their activity	Tax advice has been taken by the Company and the Council. A revenue return to the Council is possible from the commercial loans made to the private rental subsidiary

Impact on capital receipts anticipated	A diversified model would mean some units generating a revenue income rather than a one off capital receipt	Financial viability assessments will be carried out for each project offering a comparison of the financial return to the Council.
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8. Financial Implications

- 8.1 The borrowing incurred to date from the £120 million agreed by Cabinet and Council, required to fund the company's initial five year programme, is set out in Exempt Appendix 2.
- 8.2 Cabinet delegated authority to the Chief Finance Officer, in consultation with the Leader, to agree the business case for each site and to release funding for the development of each site subject to financial due diligence and the availability of capital funding in three distinct stages.
- 8.3 Loans to the private rental sector subsidiary would be at commercial rates and could involve a revenue return to the Council via MDC. Exempt Appendix 4a illustrates indicative levels of revenue return to the Council under a private rented sector model compared to the capital returns possible on one potential scheme set out in Exempt Appendix 4b.

9. Legal Implications

- 9.1 The legal implications for the Council are set out in the body of the report. Any loans to MDC must be at commercial borrowing rates to avoid state aid.
- 9.2 The Cabinet as Shareholder needs to be satisfied that its investment is being appropriately used and that the projections suggested in the original Business Case it approved, are now reflected in the updated Business Plan and are on course for delivery.
- 9.3 The Council as Shareholder has reserved to itself the approval of changes to the corporate structure of MDC. The creation of a private rental sector or shared ownership subsidiary, that is fully commercial, must be agreed by Cabinet.

10. Recommendations

- 10.1 Cabinet considers and approves the updated Business Plan as set out in Exempt Appendix 1 to the report.
- 10.2 Cabinet notes the report and the investment made by Medway Development Company Ltd (MDC) to date as set out in Exempt Appendix 2.

- 10.3 Cabinet approves the creation of a fully commercial subsidiary of MDC to allow the construction and rental of private rented or shared ownership properties.
- 10.4 Cabinet approves the suggested pipeline of next projects for MDC and the prioritisation of Mountbatten House, as set out in Exempt Appendix 3.
- 10.5 Cabinet approves the cessation by MDC of work on the Hook Meadow Community Hub and residential scheme and instructs officers to submit a business case to a future Cabinet meeting for approval to progress the scheme as a Council capital project.
- 10.6 Cabinet approves the cessation by MDC of work on the smaller part of the Sir John Hawkins car park and instructs officers to submit a business case to a future Cabinet meeting for approval to progress the scheme as a Council capital project..
- 10.7 Cabinet approves the designation of the Chief Legal Officer as client representative for MDC.

11. Suggested Reasons for Decisions

- 11.1 To continue the regeneration of Chatham as Medway's "city centre" with the provision of high quality housing, public realm and retail units.

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Appendices

Appendix 1 – Progress against the initial pipeline sites

Appendix 2 Matters reserved to the shareholder

Exempt Appendix 1 – MDC updated Business Plan

Exempt Appendix 2 – Details of funding to date for the first four MDC projects

Exempt Appendix 3 – Details of the pipeline of future MDC projects (two documents 3a (update) and 3b (priority))

Exempt Appendix 4 – Two indicative financial appraisals, one for private rented (4a) and one for market sale (4b)

Background papers

None