

CABINET

22 SEPTEMBER 2020

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

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Summary

This report updates Cabinet as shareholder about the first five residential developments being progressed by the Medway Development Company Ltd (MDC). It also proposes the creation of a new subsidiary to enable the company to own land and advises Cabinet about the production of Group Accounts in the future.

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 third update report to the Cabinet as shareholder by MDC, with previous reports received at 10 April 2018 and 24 September 2019 Cabinet meetings.
- 2.2 The MDC Board, comprising of two Council appointed Directors and two non-executive Directors, 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.
- 2.3 The Covid-19 pandemic has slowed some progress, but in the round activity has been maintained on three of the first four consented sites and the Company has continued to operate through remote working and site visits with social distancing measures in place.

3. Update on the first four consented sites within the Business Plan

Waterfront Chatham

- 3.1 Since planning permission was granted on 20 March 2019 for the development of 175 apartments on this, the first MDC site, works have taken place to discharge planning conditions and to undertake archaeology. Hoarding has been added to the site and a marketing design chosen. Piling works are due to start in September.
- 3.2 The computer generated image below shows the significant public realm works that will be delivered as part of this scheme, which also includes commercial space to make the most of riverside.
- 3.4 Despite the impact of social distancing requirements of the pandemic on construction activity work has continued on site. Completion of the five buildings that make up this scheme is now expected from mid-2022.
- 3.5 A cost certainty exercise, by tendering 70% of the build costs, has been carried out to show the scheme remains viable. The option to deliver some rented accommodation is within the gift of the company, to respond to the residential market in 2022.
- 3.6 Advice has been taken by the company from industry experts at Jones Laing Lusselle to indicate the state of the residential and commercial market as a result of the pandemic.



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

Britton Farm

- 3.5 Linked, through a section 106 agreement, to the Waterfront scheme, is the delivery of 44 affordable residential apartments to be built on the former loading bay area of this previous supermarket site. This prominent development will form part of a concerted investment in Gillingham, at this strategic gateway site, close to the High Street. Works to turn the former supermarket store area into new public sector office accommodation are complete, with project management of that provided by the Company. The new tenant KMPT are now in occupation.
- 3.6 A recent approval of the Getting Building Fund of £1.9 million will see the rest of the site benefit too. The first floor of the storage area at the rear of the former store will be converted to an Adult Education provision. There will also be a significant intervention in the public realm area, with removal of the roof on the mall area. It is proposed that these two additional projects and the residential development, which also benefitted from the funding, will be project managed by the Company.
- 3.7 The Britton Farm residential development must be started before occupation of the Waterfront scheme is possible. An agreement in principle from Golding Homes for acquisition of the site has unfortunately not proceeded, but active discussions with other prospective purchasers are in progress with an agreement expected in the next few months.



Fig2. CGI of Britton Farm residential development



Fig3. CGI of the public realm interventions and residential development from Jeffrey Street

Garrison Point

- 3.7 Planning permission for 115 apartments at the former Whiffens Avenue car park was granted by the Planning Committee on 29 May 2019 with 9 shared ownership units aimed at keyworkers on site and 20 units of affordable rented provided at White Road (see below).
- 3.8 A cost certainty exercise for this scheme has also been completed to assure the Board about viability. The name "Garrison Point" has been chosen by the Board to reflect Medway's strong military heritage and the excellent position of the development, with views of the River Medway below. A marketing approach has also been developed.
- 3.9 Progress has also been possible on this site, taking care to follow appropriate Covid-19 precautions and completion is expected in Spring 2022.



Fig4. CGI of Garrison Point residential development

White Road

- 3.10 Linked, through a section 106 planning agreement, is the provision of 20 units of affordable housing built by Tophat, a modular housing provider, on the area of land behind White Road Community Centre. The units which are being built at Tophat's factory in Derbyshire, are due to be delivered to site in September. Social distancing measures required to be taken in the manufacturing process have caused some additional complexity.
- 3.11 The 20 new homes boast high levels of energy efficiency and low running costs. The design and finish of the terrace will be similar to those being built at the Kitchener Barracks site in Chatham. Agreement has been reached to sell the houses to MHS housing on completion which is expected in November 2020.



Fig5. Photo showing the preparatory ground works at the White Road site.



Fig6. CGI of the modular housing for the White Road residential scheme

Mountbatten House

- 3.12 One of the reasons the Council acquired the Pentagon Centre in April 2019, was to enable it to secure possession also of the sub-lease for Mountbatten House. That has not been possible by negotiation with the current tenant and therefore Cabinet has approved a compulsory purchase of the site [decision number 75/2019 refers]. To support the compulsory purchase, good progress has been made by the Company to obtain planning permission for a residential led scheme of approximately 160 units. Architects Lyalls have been appointed after a design competition and have recently presented to Members initial proposals for the scheme with approximately 100 units proposed in the current Mountbatten House and 60 in an adjacent new extension. The new extension will include 16 shared ownership units aimed at key workers and 24 new units proposed to be produced offsite at the under-used Council car park site at Upper Mount, Chatham, subject to Cabinet approval.
- 3.13 The timeline for submission of a planning application is October 2020. If successful, the compulsory purchase process can then be concluded.

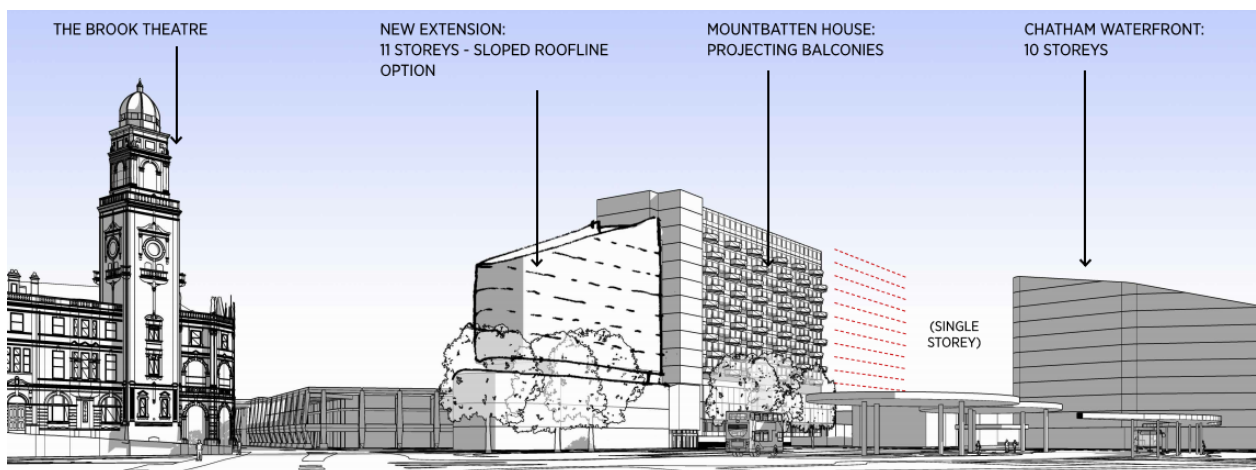


Fig7. Early massing image of the residential led scheme at Mountbatten House.

4. Advice and Analysis

- 4.1 The MDC Board met on 6 August 2020 and 27 August 2020 to review the Business Plan and progress against it. The Board noted good progress has been made against the first five development sites and discussed the impact of the Covid-19 pandemic on the Company's development programme. It suggested amendments that could be made to units to enable home working and reflected on property prices in the area.
- 4.2 As the developments have moved to a delivery phase it is important for Cabinet, as shareholder, also to review progress against the Business Plan. It 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.

- 4.3 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.
- 4.4 The Business Case for creating a housing company 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. Versions of which entity (the Council or the Company) holds the freehold of the sites developed have been considered. The Company have taken advice on the point from Jones Laing Lasselie and from the Council's Legal team. On balance and to avoid a more complex real estate picture for prospective purchasers or tenants, the Board recommends that Cabinet agrees to allow the Company to own freehold to the sites.
- 4.5 The simplest mechanism is to create another subsidiary to the Company to hold the land. The advice is that this should be a non-Teckal subsidiary to enable more efficient decision making for example on unit sales. The Company would continue to have a Teckal relationship with the Council, through the main Board, enabling the direct award of work, such as the Britton Farm projects to the Company, without a procurement process required. Proposed new Articles of Association for the subsidiary are set out in Appendix 1 to the report.
- 4.6 In a competitive market it is right that the Company should keep sales and letting transactions as simple and efficient as possible. The Company should be fleet of foot and flexible to react to changes in the market and focussed on sales once the units are constructed. This is the main rationale for the additional non-Teckal subsidiary. The Company would also hold assets which could off-set liabilities it holds for example in the early stages of on projects. This would enable an exit strategy, if required, on a given project with the sale of the asset.
- 4.7 Projections for capital receipts based on the market sale of built units show that MDC is on course to exceed the projections in the original 2017 Business Case, with capital receipts of £7.1m over the next 3 years and up to £17.1m over the next 5 years. Those projections would differ if private rented schemes were pursued on any of the sites, reducing capital receipts but providing a revenue return. Land sale receipts for the Waterfront and Whiffens sites will be received by the Council from the Company. This will need to be reflected in the Council's Medium Term Financial Strategy.

5. Corporate Governance

- 5.1 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 five projects including company overheads is set out in Exempt Appendix 2.
 - Decisions to amend the way the Company operates have been referred back to the Council as shareholder, with the Cabinet asked to agree such changes, in accordance with the decisions reserved to the shareholder.

6. Group Accounts

- 6.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) Accounting Code of Practice (the Code) sets out a requirement for a local authority to prepare Group Accounts where the authority has interests in subsidiaries, associates and/or joint ventures, subject to consideration of materiality and level of control. A subsidiary is defined as an entity where the authority is exposed to (or has rights to) variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. As MDC is a LATCo that is owned by Medway Council (Single Shareholder) it falls into this category.
- 6.2 Up to the current financial year, the Council has not had to prepare Group Accounts on the basis of materiality, but there are likely to be large assets held within the balance sheet of MDC in 2020 - 2021, this means that Group Accounts will be required that will relate to all subsidiaries. In order to prepare for this, the Council is required to review, whether or not consolidation is required on an annual basis. In order for consolidation to be possible, the entities to be consolidated are required to have the following in place:

- Ensure their accounting policies are aligned with those of the Council
- Have the same financial year end date as the Council (or a maximum of 3 months difference if not).
- Be able to produce and publish draft and audited financial information in timescales that enable the Council to produce consolidated accounts within the timeframes required under the Accounts and Audit Regulations 2015, the dates being 31 May and 31 July following the year and date respectively.
- Ideally the entities accounts should be prepared under International Financial Reporting Standards (IFRS) rather than UK GAAP as this will again align with those the Council reports under and mean less work when converting the entities accounts into a format that can be consolidated into those of the Council.

6.3 MDC Board were advised of the requirements for it to align its Accounting Policies with Medway Council at its 27 August Board Meeting.

7. Risk management

Risk	Description	Action to avoid or mitigate risk
Sales risk or market failure due to the Covid-19 pandemic	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. JLL have considered the Covid-19 impacts and advised the company.
Delays to construction due to Covid-19 social distancing measures	Delay in recovering the investment made by the shareholder	The initial construction phases (which is the stage the first three projects are at) are less impacted by the

		Covid-19 restrictions. Contractors are required to ensure that Covid-19 measures are taken on site but that progress is made.
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 a subsidiary being a fully commercial entity preventing 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 subsidiaries.
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.

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 The sale of land to the Company will be at best market consideration. Loans to the company would be at commercial rates.

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 including amendments to the Articles of Association.

10. Recommendations

- 10.1 Cabinet notes the updates to progress against the Business Plan as set out in Exempt Appendix 1 to the report.
- 10.2 Cabinet notes the investment made by Medway Development Company Ltd to date as set out in Exempt Appendix 2 to the report.
- 10.3 Cabinet approves the establishment and the Articles of Association of a new subsidiary of Medway Development Company Ltd to allow it to own land and transact with purchasers or tenants, as detailed in section 4 of the report and Appendix 1 to the report.
- 10.4 Cabinet agrees to delegate authority to the Chief Legal Officer, in consultation with the Portfolio Holder for Resources, to make the necessary amendments at Companies House to effect the changes agreed at recommendation 10.3 above.
- 10.5 Cabinet agrees to commission Medway Development Company Ltd to project manage the Getting Building Fund projects at Britton Farm, Gillingham.
- 10.6 Cabinet agrees to part of the Upper Mount car park, Chatham being re-developed as the affordable off-site provision for Mountbatten House, with the retention of the lower level car park spaces for continued public use, subject to planning permission being granted, as detailed in paragraphs 3.10 and 3.11 of the report.
- 10.7 Cabinet agrees to delegate authority to the Chief Legal Officer as Corporate Client for Medway Development Company Ltd to ensure that Medway Development Company Ltd accounts are produced for consolidation in the Council's accounts from this financial year (2020-2021).

11. Suggested Reasons for Decision

- 11.1 To continue the regeneration of Chatham as Medway's "city centre" with the provision of high quality riverside housing, public realm and an improved retail offer and to continue the regeneration of Gillingham High Street area, to create new Adult Education provision, new housing and to enhance the local streetscene.

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Appendices

Appendix 1 – proposed new Articles of Association

Exempt Appendix 1 – MDC updated Business Plan and Timeline of Developments

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

Background Papers

None