Classification: Public
Key Decision: No

Gravesham Borough Council

Report to: Council

Date: 18 May 2021

Reporting officer: Sarah Parfitt, Director (Corporate Services)

Subject: Long term loan to Elizabeth Huggins Cottages Charity Housing Association - Update

Purpose and summary of report:

In December 2019 Full Council approved the provision of a loan facility of up to £2m to The Elizabeth Huggins Cottages Charity Housing Association (The Charity). The loan facility was to be used to fund the development of housing at their site at Cross Lane West and provide a long term investment income stream to the council. To date this loan facility has not been utilised.

The Charity has recently identified potential additional funding for the development through Homes England. The Charity has subsequently approached the council to seek amendment to the loan facility structure previously agreed (should their bid for funds be successful), such that it is available to fund all stages of the scheme rather than just the element previously referred to as phase one. The total value of the loan facility requested remains as previously approved at up to £2m.

This report seeks to update Members and make the necessary amendments to the authorities sought from Full Council in December 2019.

Recommendations:

That council:

1. Delegates responsibility to the Director (Corporate Services)(in the role of S151 Officer), in consultation with the Deputy Leader, Lead Member for Housing, Chief Executive and Monitoring Officer to negotiate and agree the final terms of any loan and enter into the necessary associated legal agreements on behalf of the council.

2. Provides approval for the necessary updates to the Treasury Management Strategy Statement to reflect that the Non-Specified Investments time duration for term deposits with unrated counterparties be increased to 50 years, as per the potential loan arrangement with the Charity.

1. Introduction

1.1 The council has a strategic objective to increase housing delivery in the borough, both through its adopted Local Plan and Corporate Plan objectives. The Corporate Plan 2019-23 sets out the council's vision for the delivery of new homes that allow residents and their families to stay and grow in the borough, linked to a commitment to deliver an ambitious and diverse programme of building: increasing the supply of high quality market and affordable housing.

1.2 In 2016 the council signed an Armed Forces Community Covenant which set out a public statement of mutual support between the council, the borough's civilian communities and Armed Forces communities. The Community Covenant is intended to complement the Armed Forces Covenant, which outlines the moral obligation between the Nation, the Government and the Armed Forces, at a more local level. The purpose of the Community Covenant is to encourage support for the Armed Forces Community working and residing in the borough and to recognise and remember the sacrifices made by members of this Armed Forces Community, particularly those who have given the most.

1.3 For a number of years, The Charity has been seeking to identify funding sources to implement redevelopment plans for their site at Cross Lane West, which currently consists of 13 bungalows. The redevelopment plans are intended to modernise the dwellings provided on the site and increase the number of social housing units available.

1.4 On 17 December 2019, Full Council gave delegated authority for named officers to negotiate and agree the final terms of a long term loan of up to £2m to The Charity in relation to what was then referred to as the first phase of the proposed development, alongside authority for the necessary updates to be made to the Treasury Management Strategy Statement and the Capital Programme.

2. Homes England Bid

2.1 The Charity has continued to seek additional funding towards the delivery of the redevelopment scheme, and is currently in the process of putting together a bid for Homes England Funding (Affordable Homes Programme 2021-2026). The Programme provides grant funding to support the capital costs of developing affordable housing for rent, which is understood to be the intended rental model for units to be brought forward on the Cross Lane West site.

2.2 As a result of this potential new funding source, The Charity has approached the council to seek amendment to the loan facility structure previously agreed (should their bid for funds be successful), such that it is available to apply to the entire scheme rather than just phase one. The total value of the loan facility requested remains as previously approved at up to £2m.

2.3 In the main, the legal and financial implications remain as per those presented to Full Council when the original decision was taken in December 2019. These are repeated in the following paragraphs for information, with necessary updates to reflect changes in State Aid/Subsidy and PWLB Lending Terms since that time.

3. Legal Implications

3.1 Ability to make a loan

3.1.1 The council has the power to make a loan for the purpose of providing financial assistance to a registered housing provider for privately let housing accommodation under Section 24 and Section 25 of the Local Government Act 1988. The Charity is a social housing provider registered with the Regulator for Social Housing.

3.1.2 Chapter 1, Section 12 of the Local Government Act 2003 provides the council with the power to invest for any purpose relevant to its functions under any enactment, or for the purposes of the prudent management of its finances.

3.1.3 The council has the power to borrow under Chapter 1, Section 1 of the Local Government Act 2003 for any purpose relevant to its functions under any under any enactment, or for the purposes of the prudent management of its financial affairs.

3.1.4 The council is therefore able to borrow and make an investment under Section 12 of the Local Government Act 2003 or a loan under Section 24 of the Local Government Act 1988 for the purposes of the provision of social housing.

3.1.5 The council has the general power to borrow and to make loans under the General Power of Competence in Section 1 of the Localism Act 2011, which enables local authorities to do anything an individual can do as long as this is not ultra vires. This provision supplements the powers set out above.

3.2 State Aid/Subsidy

3.2.1 Whilst EU State Aid law was revoked from 1 January 2021, the council does need to ensure that it complies with the Subsidy Control Regime set in place under the Trade and Co-operation Agreement with the European Union.

3.2.2 In advancing a loan to the Charity, the council must ensure that any loans/investment is made in a commercial manner to prevent an economic advantage being created for the Charity by the council (i.e. the Charity receiving more generous terms/interest rates than it otherwise would if it sought the loan from the private market).

3.2.3 To ensure compliance with Subsidy Control Regime considerations, any loan advanced by the council will be on a commercial basis and based on a full financial appraisal that demonstrates the viability of the scheme and the Charity's ability to meet the loan repayments.

3.3 Financial Conduct Authority (FCA) Authorisation

3.3.1 It has been confirmed by the FCA that the council would not be required to be registered with the FCA to enable the loan facility to be made. The council would be considered compliant under PEGR 2.9 of the FCA Handbook, allowing the forward lending of funds and the application of a risk premium associated with such lending. https://www.handbook.fca.org.uk/handbook/PERG/2/9.html

4. Financial Implications, Risk and Due Diligence

4.1 As part of its due diligence, the council has reviewed the activity of other local authorities that have already made loans on a similar basis, speaking to officers at one local authority to better understand the implications and the arrangements under which any such loan facility may be made available.

4.2 In addition to this, the council will also discuss the loan facility and agree the appropriate accounting treatment with its external auditors, Grant Thornton.

4.3 Treasury Management

4.3.1 The Capital Strategy outlines the principles followed by Gravesham Borough Council in its approach to capital investment over the long-term implications. The provision of the loan facility to the Charity fulfils the capital investment priorities of the council through the delivery of long-term economic benefits to the borough for both regeneration and community benefit, as well as generating a limited beneficial financial return to the council that can be directed to support services and maintain its ongoing financial sustainability.

4.3.2 The council has been making use of its cashflow balances as a means of supporting the sustainability of its longer term financial position. It is therefore intended that any loan provided to the Charity will be through long term borrowing undertaken by the council at the prevailing rate applicable on that day. Officers continue to track the borrowing rates from The Public Works Loan Board (PWLB), as well as alternative sources of borrowing that the council could consider at the point of advancing the loan to the Charity, including the Municipal Bonds Agency (MBA). All other avenues, however, carry significant additional requirements in relation to credit worthiness checks and administration, and as the loan would be backed by the addition of a premium, underpinned by ongoing rental income from the new properties, PWLB borrowing may prove to be the most viable funding source for this initiative.

4.3.3 There is sufficient capacity within the existing Operational Borrowing Limit and Authorised Borrowing Limit to support this loan.

4.4 Structure of loan facility

4.4.1 The loan amount will be up to £2m with a repayment term of 50 years to enable the Charity to bring forward the development and provide additional social housing in Gravesham. Provisions will be included in the loan agreement to ensure that any monies advanced are used solely to provide social housing and there is compliance with this requirement throughout the term of the loan.

4.4.2 There is a variety of loan types that the council could secure. The financial appraisals undertaken to date have used a maturity loan type where repayment of interest amounts are undertaken during the repayment term, with the final payment date requiring the principal sum (and all remaining interest) to be paid. The final loan type and structure will be determined during the final due diligence checks and prior to the agreement for the loan to be made.

4.4.3 The loan may be subject to an arrangement fee which will be determined by the council.

4.4.4 Repayment of the loan will be considered as a capital receipt to the council, with this these being used to support future capital projects of the council.

4.5 Rate of Interest Charged

4.5.1 Calculation of the interest rate payable for the loan will take account of the prevailing interest rate at which the council is able to secure the loan, with an additional premium charged to take account of the assessed risk of default. Any provision of a loan facility to a third party carries a level of risk; in this instance the principal risk to the council is borrower risk, through the borrower defaulting on the loan and causing an unexpected cost to the council and the public purse. The financial appraisals undertaken to date have factored in a risk premium to alleviate any potential impact on public funds.

4.5.2 To maintain compliance with Subsidy Control Regime rules, it will be necessary for the Council to apply a premium to the loan in addition to the substantive rate that the Council itself is able to secure on the borrowing; this is to ensure that the onward lending is in line with commercial rates. Based on the fact that the onward lending would be tied to the delivery of residential units generating the required level of income to repay the loan over 50 years, the council would seek to place a charge on the scheme until such time as the loan has been satisfied.

4.6 Risk of Default

4.6.1 To mitigate the risk of default, due diligence checks will continue to be conducted on The Charity as well as there being an assessment of the financial viability of the scheme being proposed. Due diligence checks carried out to date, such as analysis of The Charity's financial performance for the past five financial periods, occupation rates and governance arrangements, have given no cause for concern at this time. These checks will be completed again prior to any final decision to issuing the loan.

4.6.2 A financial appraisal of the scheme proposal has been carried out over the full term of any potential loan period. Currently this indicates that the project is viable over the 50 year loan period. The appraisal indicates the potential revenue stream for the period of the loan to be in the region of £10.6m. The model reflects provisions for expected expenditure associated with the day-to-day management, maintenance and repairs to the units, which are expected to be in the region of £3.8m. The projection of surplus funds for the Charity will be circa £6.8m, of which £3.1m and £2m will be used to meet the Interest and Capital Loan repayments. This will provide the Charity with a cash surplus on the scheme of £1.7m over the 50 year period.

4.6.3 This modelling is based upon a prevailing rate of borrowing from the Public Works Loans Board of 2.09% but will be subject to change. Increases in the borrowing rate will potentially reduce the amount of loan that the Council is able to advance (meaning that more of the scheme cost would need to be sourced from grant contributions), and therefore a maximum loan facility of £2m will be provided.

4.6.4 It is the intention of the council to hold the full loan amount initially and release funds to meet expenditure on bringing the scheme forward upon evidence of a certificate of works confirming works are completed to a satisfactory standard.

4.6.5 The council intends to secure the loan on the land and property owned by the Charity in the form of a Legal Charge.

4.7 Accounting for the loan

4.7.1 The loan taken by the council will be recognised as external borrowing and will be classed as “unfunded” in terms of the council’s Capital Financing Requirement (CFR). This will result in an increase in the council’s CFR.

4.7.2 MRP will be chargeable in line with the policy that is set out in the council’s Treasury Management Strategy Statement and it is payable on the opening CFR balance. Therefore on the basis that the CFR has increased there will be an additional annual MRP charge to be met by the General Fund. If the loan were £2m, the MRP charge would be £40,000 per annum (based on the maximum of 50 years). Although based on a slightly different profile (increasingly annually rather than straight-line), this will be matched over the course of the 50 year period by the capital repayments made by the Charity.

4.7.3 Under Accounting Standard IFRS 9 (Financial Instruments), the loan will be classified as being valued at amortised cost within the council’s balance sheet. On an annual basis, the council will need to calculate an expected credit loss arising from this loan. Any significant increase in the expected credit loss will result in a charge to the council’s surplus/deficit on the Provision of Services in the Comprehensive Income and Expenditure Statement within the Financial Statements.

4.7.4 Monitoring of loan and repayments against the loan will be undertaken by Financial Services, in liaison with Legal Services and Planning Services as required. The status of the loan will be reported as part of the existing Treasury Management monitoring arrangements to senior management and members, through the Finance & Audit Committee. The loan facility will be considered by Internal Audit in development of their risk-based audit plan and will therefore be subject to Internal Audit review. The council's External Auditor will also consider the loan facility and the accounting treatment of this in their annual audit of the accounts.

4.8 Conditions for Loan Advancement

4.8.1 As agreed by Cabinet in 2019, the advancement of the loan facility to the Elizabeth Huggins Cottages Charity will be subject to the following conditions being met (with delegated authority to the Director (Corporate Services), in consultation with the Deputy Leader, Lead Member for Housing, Chief Executive and Monitoring Officer to ensure that such conditions are met before any advance is made);

- A maximum amount of £2m being advanced, with this being adjusted downwards only should interest rate rises in the cost of borrowing mean that the scheme generates insufficient financial returns in order to repay that level of borrowing, and subject to an up to date financial viability appraisal being undertaken.
- That no advance be made by the Council until the Elizabeth Huggins Cottages Charity have demonstrated a tendered construction contract for the relevant phase of the redevelopment scheme, with any shortfall in funding (above the up to £2m loan, or eventual loan from the council, whichever is the lower) being demonstrated as fundable by the Charity either from its own resources or external grant funding contributions.
- That advances of the loan are made in accordance with a certificate of works confirming works have been undertaken and to the required building standards.
- That the Charity allows for the placing of a charge on the land and property assets associated with the development, by the council, as a first charge on those assets, until such time as the loan has been repaid in full.
- Confirmation is received that the approved planning permission is safeguarded as having been implemented, and any variations to that permission are approved prior to development commencing.

IMPLICATIONS	APPENDIX 1
Legal	As set out in Section Three of the main body of the report.
Finance and Value for Money	As set out in Section Four of the main body of the report.
Risk Assessment	As set out in Section Four of the main body of the report. This report considers a loan of up to £2m to The Charity for bringing forward residential development on their site. There is a risk that the Charity will not have sufficient collateral to allow the continued development of the site to its full potential.
Data Protection Impact Assessment	*A data protection impact assessment (DPIA) should be carried out at the start of any major project involving the use of personal data or if you are making a significant change to an existing process.*
	a. Does the project/change being recommended through this paper involve the processing of personal data or special category data or criminal offence data? No
	b. If yes to question a, have you completed and attached a DPIA including Data Protection Officer advice? N/A
	c. If no to question b, please seek advice from your nominated DPIA assessor or the Information Governance Team at gdpr@medway.gov.uk. N/A
Equality Impact Assessment	a. Does the decision being made or recommended through this paper have potential to cause adverse impact or discriminate against different groups in the community? If yes, please explain answer. No
	b. Does the decision being made or recommended through this paper make a positive contribution to promoting equality? If yes, please explain answer. N/A
	In submitting this report, the Chief Officer doing so is confirming that they have given due regard to the equality impacts of the decision being considered, as noted in the table above
Corporate Plan	The information set out within this report contributes to the following Corporate Plan Objectives: - #1 People – Quality Living - #3 Progress – Entrepreneurial Authority
Climate Change	There are no specific climate change implications resulting from this report

Crime and Disorder	There are no specific crime and disorder implications resulting from this report.
Digital and website implications	There are no specific digital or website implications resulting from this report.
Safeguarding children and vulnerable adults	There are no specific safeguarding children and vulnerable adult’s implications resulting from this report.