Performance and Finance Scrutiny Committee

22 January 2020

Update on Procurement of Joint Venture Partner in Property Development

Report by the Director of Property

Summary

At its 22 May 2019 meeting, the Performance and Finance Select Committee received a paper on the proposal to set up a joint venture trading arrangement to carry out property development on selected Council sites across the county. The Committee supported the venture in principle and requested further information be brought to the Committee as the work progresses in setting up the arrangements. This report provides an up-date on the current position, work in progress and timeline for the venture by outlining the: -

- Governance principles of the company, which proposes the setting up of a Limited Liability Company (LLC) that will enter into a joint venture agreement with a private sector partner (PSP) in a limited liability partnership (LLP);
- the procurement by competitive dialogue (CD) of a PSP in order to enable the Council to further develop the requirements, trading procedures, management and governance principles;
- sites and selection criteria for the joint venture and;
- timing for the procurement, which is expected to take a year to complete.

The focus for scrutiny

The Committee is asked to note this up-date on the procurement of a joint venture partner in property development. Key areas for scrutiny include:

1) that the principles of the County Council are met and maintained by the structure of the proposed joint venture;
2) that the joint venture arrangement is focussed on the maximum benefit being gained from the Council's assets;
3) that the governance arrangements for the joint venture are considered and established appropriately;
4) that the objectives and targets to be achieved by the joint venture have been identified;
5) that the risks of the joint venture have been identified and plans put in place to manage/mitigate these;
6) that site selection criteria are identified and;
7) that the financial implications of the joint venture procurement have been established including the cost of consultants and an indication as to when monetary returns might be anticipated.

Proposal

1. Background and Context

1.1 At its meeting on 22 May 2019 the Performance and Finance Select Committee supported the principle of progressing a public/private joint venture (JV) to carry out property development on selected County Council assets based on maximising returns.

1.2 In its support, the Select Committee requested a further update report, at an appropriate time, ahead of officer decisions being taken and tender documents starting to be drawn up addressing the principles of the proposed partnership, governance arrangements and the sites to be put forward.

1.3 The Cabinet Member for Finance took a Key Decision in June 2019 to set up a trading vehicle and competitively procure a private sector enterprise that could partner with the County Council in the corporate arrangement, which was endorsed by the PropCo Panel.

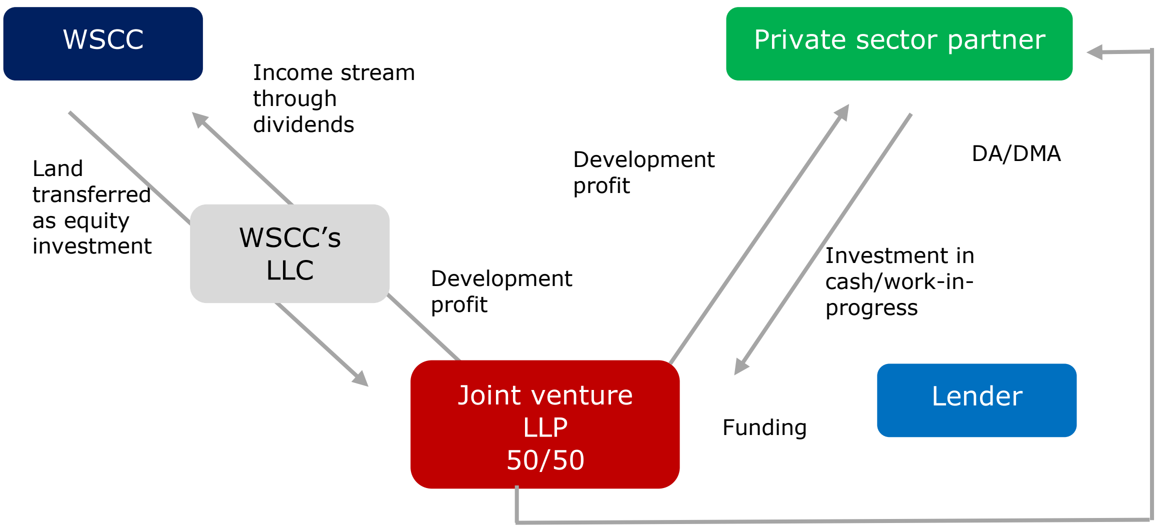
2. Proposal

2.1 **Outline;** in considering the structure and governance/procurement process, further analysis work was initially undertaken by the new professional advisers to assess the different delivery models potentially available to ensure that we were going down the right path; the corporate JV model, as originally proposed, continues to be recommended as the only structure capable of achieving the County Council's core objectives in terms of: -

- Flexibility to bring new sites in/remove them at later stages;
- creating a long-term relationship with the resultant benefits (particularly around scalability, consistency of quality and availability of supply chains) and;
- the flexible ability to secure revenue streams as well as capital receipts.

It is emphasised that the corporate JV is the only legal structure capable of bringing in new and presently unknown sites in the future to provide flexibility.

2.2 **The basic structure**; the structure below has formed the successful operational model used by other similar council joint ventures and is proposed to be employed here: -



2.3 **The precise JV structure and governance details;** these can only be further developed during the Competitive Dialogue procurement process as the details need to be informed by the market requirements. It should be noted that the broad form of the anticipated model, as outlined above, is an established one already successfully working at other councils. This will involve the County Council setting up a wholly-owned subsidiary which will be a Limited Liability Company (LLC). For legal and governance reasons the Council's LLC would enter into the joint venture as an equal partner with the private sector partner (PSP). The County Council's independent specialist advisers have noted that it is a legal requirement to operate some of the key policy objectives (particularly such as having the ability to place new sites into the partnership in the future) through such a separate trading identity, also this is considered important to provide perceived distance between the development activities and the County Council.

The joint venture to carry out the developments would be established as a limited liability partnership (LLP), which is a flexible and tax efficient structure, that is well suited to the development of joint ventures and the generation of funds to support the County Council's revenue budgets.

2.4 **Structure and financing key points: -**

- In a typical scheme, the LLP partners (i.e. the County Council and the procured commercial enterprise) will agree a funding profile, which will establish the most appropriate split of equity to third party debt (such third-party debt being provided by a senior lender and such a provider could be the County Council itself lending at commercial interest rates);
- Equity investment from the County Council will come from its land value, which will be invested in a tax efficient manner into the LLP via the LLC;
- Although yet to be decided, the investment of land could be arranged as a 'loan note' to release early money to the County Council;
- The PSP will then invest equity by way of the value assessed in the cost of work-in-progress needed to design and build a development (this amount will be overseen/agreed by independent valuation advisers acting for the County Council);
- The investments (i.e. land from the County Council and the value of work-in-progress equity from the commercial partner) may not be equal, which means one party may need to put in further cash to achieve the required parity. For example, if the land value were more than required for the County Council's required equity investment, an initial land payment back to the Council is often made through partnership agreement for the difference, although;
- Conversely, if the land were less than required for the County Council's required equity investment, the County Council may have to invest further, which could be via a loan.

Development profits that are not mutually agreed to be retained in the LLP, such as to be used for further development investments and feasibilities, will be available for distribution. The Council's LLC should then be able to declare dividends to the County Council. The way that this money then flows to the County Council will need to be agreed, but could return in the form of being allowable into a ‘revenue’ budget as opposed to a ‘capital receipt’ as is usual for a straightforward land sale return. This distinction is an important opportunity for the Council arising only from carrying out the development work. The process in detail will be informed by extensive professional financial and tax advice to ensure the optimum operational efficiency.

2.5 **Governance key points: -**

- The LLP will be managed by a management board, i.e. the LLP board of directors, which will have equal director representation from the County Council and the PSP, this usually comprises two or three (three more likely) from each;
- These County Council Officer Board members will need to be identified early in the tendering process;
- Certain key decisions will be reserved to these LLP members by the Council’s LLC e.g. approval of business plans or scheme plans;
- As for the LLP, the Council’s LLC will also have a board of directors, typically two or three in number, usually comprised of officers and potentially a non-executive director. The Council’s LLC will ultimately be answerable to the County Council;
- It is usual for direct elected member involvement to be kept to a minimum and such involvement is restricted to a non-decision-making role of vision, oversight and standards monitoring, which could, for instance, be carried out by the Propco Panel. This is to avoid conflict of interest situations;
- At the LLP level, the LLP partnership agreement will contain the governance details and deal with important areas such as the reserved matters and deadlock and;
- In terms of financial accounting, both the Council’s LLC and the JV LLP will need to produce their own accounts to legal company standards. The County Council will then consolidate its share of the JV within the year end accounts.

2.6 The model outlined above in governance and trading principles is now well recognised in the market, which most importantly will give confidence to potential PSP bidders that are interested in or already working with local authorities. This model has been successfully adopted by Hertfordshire County Council, Brentwood Borough Council and others.

2.7 **Procurement of JV Partner**:

- The recommended procurement route for the selection of the PSP is through a competitive dialogue (CD) process;
- the CD procedure is most appropriate where the contracting authority broadly knows what its needs are, but does not have a specific set of requirements setting out the means by which those needs can be fulfilled;
- although in this case the County Council does have a clear development strategy and a desire for its LLC to enter a JV partnership, it does not have a pre-determined view of how best to achieve its aims and objectives, therefore;
- the County Council plans to further develop its strategy, the details of governance (within the planned companies), the criteria for new sites being selected to develop and identify the most efficient way of

meeting its aims and objectives towards creating an effective long-term relationship with a PSP that is tested and informed through the CD process.

An important aspect of the dialogue process will be testing how the potential partners might meet the County Council's objectives. One of the key advantages of CD, over other procurement routes, especially the Competitive Procedure with Negotiation (CPN), is that the final tenders can be clarified, specified and optimised. This cannot be done in CPN, which is a critical shortcoming and would prevent the County Council from ensuring it obtains the best solution for its needs.

A well-managed CD process also makes little difference to the overall procurement timetable and will enable the Council to fully benefit from the market's knowledge and expertise in this area and to optimise the commercial outcomes. The appointed advisers all have recent experience in procuring similar JV partners for councils planning similar arrangements.

A brief summary of how the proposed CD procurement operates is set out below: -

- Interested parties can submit an expression of interest in response to the OJEU Notice;
- the County Council then carries out a short-listing exercise (using a Selection Questionnaire) and only those bidders who meet the Council's selection criteria will be invited to dialogue;
- a minimum of three suppliers must be invited to dialogue (unless fewer candidates have applied and these are sufficient to ensure genuine competition, that is, at least two);
- the County Council then enters a dialogue with the bidders to develop one or more suitable solutions to meet its needs. There is no set format that the dialogue must follow, it usually consists of a series of meetings with each tenderer where each meeting focuses on different aspects of the procurement covering (1) financial (2) technical and (3) legal;
- during the dialogue process the County Council is able to reduce the number of bidders (i.e. 'down-select');
- when one or more appropriate solution(s) have been identified the 'dialogue' phase concludes and the final tenders are invited and;
- the Council assesses the tenders and selects the best tender based on the pre-specified and transparent award criteria (known as the 'most economically advantageous tender' MEAT). It then clarifies any outstanding aspects of the bid and finalises terms in order to achieve contract close.

3.0 Resources

3.1 **The County Council's Team of Advisers**: To support the procurement work a new consultancy team has been competitively selected and recently appointed. The team comprises: -

- **Carter Jonas** – strategic property consultancy, valuation and leading the procurement;

- **Sharpe Pritchard** – legal advisers, contract, all legal implications, structuring the companies, legal procurement advice and general strategic legal input;
- **Gardiner & Theobald** – cost and project management (as sub-contractor to the multi-discipline consultants Faithful + Gould), strategic advice in the construction and development industry for delivery;
- **31ten** – financial background and structuring the flow of funds in and out of the development structure and;
- **PSTax** – is already one of the County Council's appointed financial advisers and will provide specialist input on taxation areas.

3.2 **The Sites proposed for development**

- The initial set of sites will be tested and examined in cost/benefit analyses with potential partners during the competitive dialogue process, but to progress sites only later go under an 'option' or 'land' agreement to progress at the time of contract signature in an award to the selected JV partner (i.e. the PSP);
- this option or land agreement will then require the LLP, working through the PSP, to satisfy a series of conditions, such as gaining a planning consent, testing and proving financial viability, clean title/vacant possession etc. in the business case;
- only on the satisfaction of these conditions will the land then formally transfer into the LLP;
- the typical structure would therefore see the land transfer being after planning consent being obtained so that the corresponding value uplift from planning is returned to the County Council;
- further sites which might be put forward by the County Council will go under option once the LLP has undertaken initial due diligence and the LLP Partners have agreed to their inclusion and;
- although this is an established model working well in other similar local authority JVs, it is intended to agree a clear mechanism with high transparency to preserve the County Council's land asset values. The County Council's independent advisers and valuers will provide the assurance of best practice and quality control.

3.3 As referred to above, one of the key advantages of the JV corporate model in setting up the companies is its lasting flexibility in the ability it provides to bring further sites to the partnership at a later stage, also to potentially acquire new sites rather than having to provide a definitive list at the outset.

3.4 The initial offering to the market does need to present a sufficiently attractive commercial proposition and to provide a certain level of guaranteed opportunities, subject to viability performance. The County Council has identified a number of surplus sites that could be available in the short, medium and longer term.

3.5 Any analysis of these sites to assess suitability for inclusion will need to have regard to a number of factors including: -

- Timing of availability;
- planning status and;
- development potential.

3.6 The County Council's aims and objectives for the partnership will also influence the assessment of suitability. The objectives will be developed during the competitive dialogue process as it is important to include feedback from potential PSPs in the identification of objectives due to the equal share partnership basis and the overall requirement to maintain a viable outcome.

3.7 Similarly, the resource capability of the likely partner needs to be factored into the analysis. For example, were 10 similar and immediately available sites to be offered to the JV, it is likely the partner would only have the capacity to work up schemes for some of them, potentially sterilising others and deferring receipts. In those circumstances, it may be more appropriate to bring forward some of the sites by another route e.g. standard conditional sale, always being aware to avoid creating market competition.

A balance needs to be struck between offering sufficient guaranteed sites to make the proposition attractive to the market, always with the potential for more in the future, but never too many so as to result in some sites being delayed through overstretching the partner, the supply chains or sales.

3.8 A first tranche of operationally surplus sites has been identified, outlined in appendix 2 (**Part II**), as a potential for redevelopment that the advisers consider a good balance comprising a mix of sites that could be progressed to planning/building immediately but with some needing more promotion work before a planning application. Further examination and appraisal of the sites will be checked through the CD process to ensure compatibility with the business plans of the PSP before being formally agreed. For this reason, the list of key sites will remain as a **Part II** item until confirmation of the final list is agreed and clearly identified in the final Key decision.

3.9 The large and small residential could provide an opportunity of around 350 dwellings. As noted there needs to be a balance identified as having sufficient PSP interest to be attractive, but not too many to result in delivery problems, this will emerge during competitive dialogue to confirm the sites.

3.10 Consideration is to be given to testing commercial elements (i.e. offices/warehouses) as a PSP with the ability to offer a range of development skills could assist the County Council on One Public Estate schemes and Economic Development in the future. Again, testing in the CD tender process to assess the response will provide this indication.

3.11 Overall, the advisers consider the initial site list workable although this will be informed further by soft market testing prior to formal tendering. It is considered that the package of sites the Council has available for development is likely to be attractive to the market and suitable for the type of JV arrangement proposed, with the emphasis on creating a long-term partnership.

3.12 **Financial**

The indicated budget of £700,000 comprising officer time, external legal and financial advice in setting up the companies, assessing the sites and completing the procurement is considered sufficient. Commercial fee agreements for the County Council have been concluded with all considerably within the allocated budget and each adviser has been through a competitively checked/bid selection process.

Factors taken into account

4. Issues for consideration by the Scrutiny Committee

4.1 This is an update paper and notes the overarching principles of company structure that are to be further developed through the competitive dialogue procurement process, also to align with the market and best practice guidance from the expert professional advisers.

4.2 The timing is dictated by the OJEU procurement legislation, which is contained in appendix 1. Broadly, the process is expected overall to be one year within which there are three active stages that are planned between March and November 2020 comprising: -

- Initial selection;
- Detailed submissions and;
- Final tenders.

An award would follow a 'stand-still' period and the successful recommendation of preferred bidder to the Cabinet Member for the final key decision that will enable forming the contract, which will include the proposed partnership agreement, corporate governance and County Council management structure that have been developed and confirmed during the process of competitive dialogue.

5. Consultation

5.1 The concept of a JV in the redevelopment of County Council assets was originally outlined in the Cabinet Member key decision on PropCo Policy taken in July 2016;

5.2 At its quarterly full meetings, the PropCo Panel reconsidered the JV with leading professional advisers to the County Council and provided continued support to the proposal at its meetings in December 2018, March, September and December 2019;

5.3 The Performance and Finance Select Committee considered the proposal and supported the Cabinet Member in taking a key decision to procure a partnering enterprise at its meeting on 22 May 2019.

6. Risk Implications and Mitigations

6.1 Risk log

No	Risk	Mitigation
1	Managing, maintaining and building on the change of culture at the interface from local authority to an entrepreneurial business that chases financial success, through compliance in public spending accountability, local authority regulations/approval timing and standard setting in good practice	Rigorous care in selection of partnering company with track record of setting up effective public/private partnership and understands how to work effectively with a local authority
2	Failure to identify what WSCC wants then changing ideals as emerging pressures towards prioritising outcomes that reduce financial efficiency	Clear set of outcomes for West Sussex that equate to commercial good practice but are compatible with emerging sustainable development leads
3	Failure to select appropriate partnering company	The market in partnering companies working in development with local authorities is established and a good level of interest is predicted by the Council's advisers
4	Partnering company changes or ceases trading WSCC no longer a key client	In the selection process look at record of company's gearing and its core trading area to establish record and intentions
5	Failure to appoint staff and directors	Many local authorities become partners with commercial organisations where the company is made responsible for virtually all the resourcing and organisational input, the council then links with visionary and goal setting guidance that is informed by the company. Working initially in this way will allow the County Council to build experience and focus on the areas of support needed
6	Creating and maintaining commercially acceptable margins that can be split to the partner and still provide a commercial company with a viable outcome	The opportunity of shared management costs across several sites, together with a trading environment of reduced risk and standardisation provide a lower operating burden on the financial appraisals
7	Failure to provide a sufficiently high standard of land to be viable	Planning land over 5, 10, 15 and more years will enable the partner to progress promotion work that can be market aligned or supplemented through work with District & Boroughs
8	Failure to provide high standard and quality of design and product to attract demanding buyers	Work with partner to select high standard designers and create a product that is market aligned and not head-to-head with the main housebuilders
9	Political risks seen in land impacting on the feelings of local voters that are living beside new developments	Pressure on land with potential for housing in areas across West Sussex is high, the County Council's involvement can ensure a responsible outcome that may not be present with some developers

10	Political pressure to achieve short term sell results in selling land for early capital receipt	Investing in opportunity is likely to bring a better income overall and returns to wider budgets such as revenue
11	Political pressure to start all schemes at once	The commercial partner will provide detailed guidance on what can be achieved, which can be checked by the advisers
12	Political pressure to produce types of homes, such as social housing, that may not maximise the potential of land	The planning policy in local development plans will list out the type of homes for a demographic balance and departing from this will raise concerns with planning authorities, also the commercial partner
13	Technical risks in missing opportunities of using or evaluating innovative systems such as modular homes	Working with partner to introduce innovation in line with what can be sustainably delivered
14	Technical risks in creating homes with defects	Working with partner's experience and designers to achieve specifications that can be built to the highest quality within the budget and skill set of trades
15	Financial planning to promote land	Identify land in future and fund with returns from completed developments
16	Value of land increase shared with partner	Clear and contractually ordered progression of land in the partnership agreement from option to purchase into the partnership to build out that has value checks by independent advisers
17	Land becoming available is considered by members as should always tested for sale on the open market first to prove value is not better to sell before development	Selling developed property on the land will bring in the market potential, although it will be important to maximise the land value return to the County Council to avoid sharing uplift. Constant testing on the market is likely to raise concern in the local market through a sense of distrust that land will follow through to sale and in the long-term risk land bids being not reflective of the market when there is a need to sell land
18	Land valued and put in the JV is then raised further in value before development and the amount becomes shared with the partner	Prepare for the situation with advisers, such as by putting the land in just before building and in phases across large sites or retaining the land in title of the County Council and paying the partner for the work equity adding an agreed uplift
19	Agreement difficulties on cost of promotional work over long period	Costs met by returns from early developments
20	VAT, SDLT, corporation tax complexities	Unexpected missed tax reduction opportunities
21	A partnering company that does not keep up with company growth and technical innovation	Examine company record during the tendering period
22	Shortage of building skills resulting from Brexit and major SE England projects	Advisers and partner keep careful watching brief and adjust development programme to market

23	Insufficient staff resources and quality of experience at WSCC and advisers	Work with partner to manage skills and workloads
24	Aftercare at low standard resulting in complaints	Work with partner and advisers to plan and implement effective response
25	Work progresses without full understanding at member, corporate and senior management level or outside of agreed limits to meet programme as approval gateways not clearly set or mistimed	Agree tolerances that have high safety factor to allow for approval timing
26	Compliance and quality control	Independent advisers and inspection regime to monitor work in progress
27	Lost opportunities to promote good news story messages	Work with public relations experts
28	Public relations problems in media and social exchanges reporting money being spent of development as opposed to core services, particularly if implied those in special measures are at risk of funding reduction	Work in anticipation of this and have results of providing improved funding returns out of development returns as a planned future to support the services
29	Lack of joined up process at the County Council misses the opportunities to involve internal departmental support for initiatives that could be incorporated in developments	Promotional work at County Council and advisers bring in examples of other local authority initiatives
30	Large contractors with legal strength to press company interest above WSCC	Select partnering company with good joint venture record
31	Lack of notice for potential opportunities coming up in years ahead misses the potential as promotional work needed is over several years	Develop property review strategy at County Council and make all local Districts & Boroughs aware of potential opportunity to acquire surplus land and assist/provide opportunities
32	Grant and assistance opportunities missed	Work with specialist advisers
33	Product positioning is not relative to objectives in the WSCC Plan Outcomes in Economy	Review potential with advisers to align in developing Employer's Requirements to target County Council's long-term objectives
34	USP that conflicts with that of house builders	Work with advisers and ultimately partner to create a market response and avoid problems with imbalanced mix on site affecting long term value/reputation
35	Lessons missed from other similar initiatives and repeat of mistakes	Visit many similar JVs at local authorities and examine issues

7. Other Options Considered

7.1 This is an update of work in progress on the Cabinet Member key decision taken in June 2019 for a JV partnership in property development.

8. Equality Duty

8.1 The Council's equality duty will be considered when taking the further decisions to set up the JV arrangement, although this and the following areas of responsible and sustainable trading are vital assessments in the performance of potential partners during the competitive dialogue (CD) process.

9. Social Value

9.1 During the CD process potential partners will be required to provide information on wider areas of responsible and sustainable trading in how the company works towards the future, community strengthening, the local economy, training, developing young people entering the construction and property business.

10. Crime and Disorder Implications

10.1 Bidders will be asked during CD how design and construction will be considered and produced to support police and security work in the community.

11. Human Rights Implications

11.1 The performance record, company policy and future plans of bidders will be examined during the CD process.

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Appendix 1 – Target timeline
Appendix 2 - First tranche of operationally surplus sites **(Part II)**

Appendix 1 Target timeline	
Stage 1: Selection Questionnaire	**Target Dates**
Issue Contract Notice and the release of Selection Questionnaire and Procurement Pack	Monday 2nd March 2020
Final Date for Clarification Questions	Friday 26th March 2020
Final Date for Applicant to Submit Selection Questionnaire	Thursday 2nd April 2020
Conclude Selection Questionnaire Evaluation	Friday 1st May 2020
Stage 2: Competitive Dialogue Detailed Solutions	
Issue Invitation to Participate in Dialogue (ITPD) and Invitation to Submit Detailed Solutions (ISDS)	Friday 8th May 2020
Dialogue Sessions	w/c 11th May 2020 25th May 2020 8th June 2020
Deadline for Clarification Questions	Friday 10th July 2020
Deadline for Submission of Detailed Solutions	Friday 17th July 2020
Conclude ISDS Evaluation	Friday 11th September 2020
Stage 3: Final Tenders	
Feedback on Detailed Solutions (Short Listing)	w/c 14th September 2020
Dialogue Sessions	w/c 21st September 2020 w/c 5th October 2020 w/c 19th October 2020
Stage 3: Final Tenders	
Call for Final Tenders	Monday 26th October 2020
Deadline for Clarification Questions	Monday 2nd November2020
Deadline for Submission of Final Tender	Friday 6th November 2020
Preferred Bidder Notified and Unsuccessful Tenderers Advised (Standstill Letters)	Friday 8th January 2020
Stage 4: Contract Commencement	
Optimise Contract	2 months
Final Award Contract	1st March 2021
Contracts Signed	15th March 2021