
Performance and Finance Scrutiny Committee

Date 28 November 2022

Update after first year of Joint Venture in Property Development

Report by Assistant Director Property and Assets

Summary

This report provides a progress update on the first year of the County Council's joint venture partnership, now registered as Kinsted LLP. It also provides the outcome of a recent internal audit report on the governance of the partnership.

The appointed partner, Lovell Partnerships Limited, part of the Morgan Sindall Group plc was appointed in July 2021. Since then, relations with the Council have developed well into supportive and productive teamwork. The partnership structure is shown in appendix 1.

The governance of the joint venture has been reviewed by the Council's internal auditor, which reported in October. The report is attached as appendix 2.

Three sites have advanced into planning applications for housing, with one consent being received.

External advisers have been appointed to provide expertise and general oversight in cost control and the value of the return to the Council in relation to its land holdings within the joint venture.

Focus for Scrutiny

The committee is asked to consider the report and note the progress made in the first year of the partnership. The committee should also consider the internal audit report of governance arrangements attached as Appendix 2. Key lines of enquiry for scrutiny include:

- That satisfactory progress has been made in establishing the Joint Venture partnership arrangement
- That the aims/objectives of the arrangements are clear and that they meet the needs of the Council Plan and the Capital Programme to ensure the priorities and targets of the County Council can be met
- That governance arrangements and working practices have been agreed to ensure that the performance and outcomes can be managed and monitored effectively
- That a plan of development sites has been agreed and work is underway to commence work on these to ensure the best outcomes for the Council can be achieved

- That the strategy/proposals include a plan or commitment in relation to the Council's climate change priorities
 - How evidence or learning from other areas that have implemented similar arrangements have been considered
 - Whether any significant risks have been identified and to seek assurance of the effectiveness of actions planned to manage these
 - Plans to monitor the implementation and impact of the proposal/strategy and identify how scrutiny could add value to this process in the future.
 - How any implications for key areas of Council policy or its overarching legal responsibilities have been assessed (legal implications, equality duty, climate change, crime and disorder, public health, social value) and the effectiveness of any mitigations put in place to address these (do these provide assurance that potential adverse impacts are understood and being addressed?)
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1 **Background and context**

- 1.1 In July 2021 a Partnership Agreement between the County Council's wholly owned company, Edes Estates Limited and Lovell Partnerships Limited commenced.
- 1.2 The operating arrangement of the Joint Venture (JV) is a Limited Liability Partnership, initially registered as West Sussex Property Development LLP, now in the process of being re-named as Kinsted LLP. A structure chart is attached at Appendix 1. A range of technical advisers have been appointed to assist the development of the plans for the sites.
- 1.3 To provide additional assurance, the Council's internal auditor was requested to review the governance and setup of the joint venture partnership. The audit report issued in October 2022, gave an overall 'green' rating and concluded "there is a generally sound system of governance, risk management and control in place". This report is attached at Appendix 2.

2 **Proposal details**

- 2.1 Ten sites were optioned to the JV (Kinsted LLP) in the key decision OKD69 20-21. These were to be progressed to provide site layout design, which was optimised for market facing development returns, a planning consent and finally assessed for viability via a full business case.
- 2.2 Before starting work on housing design for the sites, a set of standard house types with varying numbers of bedrooms was created. The standard designs were briefed to meet the Government's Nationally Described Space Standards, being attractive to buy, economical to build, sustainable and with low carbon features. The standardised basis of house types will now be repeated across all sites for economy of scale.
- 2.3 The sites located at Tilgate Crawley (100 units), Wantley Fields Henfield (25 units), Althelstan Way Horsham (70 units), The Hatches West Chiltington (12 units), Church Lane Rudgwick (20 units) have design layouts. All of these sites fall into the Hardham Water Neutrality area and under present guidance cannot currently progress through to a planning determination.

2.4 The remaining optioned sites, where progress has been made, are located at: -

- Eastbrook Southwick (22) - full planning consent granted in August, detail design underway for 85% fixed price during February 2023, to commence on site after March 2023
- Bartons Bersted (21) - planning application in progress but delayed at Arun District Council, decision expected December, detail design for 85% fixed price during March 2023, commence on site after April 2023
- Littlehampton (100+) - planning in progress delayed at Arun District Council decision expected February 2023, detail design for 85% fixed price during April 2023, commence on site mid 2023
- Ancton Lane Middleton (80) this site is not in the settlement area for a planning use designation but has been advanced in place of the Water Neutrality delayed sites. A layout has been completed and pre-app progressing with positive comments from planners

2.5 The Tannery Chichester (25) is a significantly contaminated site. A third ground investigation was completed in August and the Environment Agency was appointed in September 2022 to consider remedial options. An architect is being selected by tendering process. The approach to remediation recommended by the Environment Agency is to clear the site.

3 Consultation, engagement and advice

3.1 The Council is directly supported by the following advisers:

- **Montagu Evans** property consultant, with expertise in valuation, to provide assurance oversight of the Kinsted LLP operation and site return finances.

They have reviewed the Kinsted LLP arrangements and confirmed that they comply with the market standard.

- **Sharpe Pritchard** provided all the legal advice during contract writing and procurement and retain legal oversight on the commercial operation, land contracts and contract obligations.
- **31ten** provided all the financial assessment evaluation and contract clauses in the procurement and retain oversight on the financial returns in terms of the contract obligations.

3.2 Kinsted LLP is also supported by advisers required by the Partnership Agreement to provide assurance advice in cost and value, with equal duty of care to both the Council and Lovell as follows:-

- **Strutt & Parker** –property valuation adviser owned by BNP Paribas Real Estate. Provides the Royal Institution of Chartered Surveyors (RICS) Red Book valuations for all land values returning to the Council and carries out the development appraisal checks.
- **Calfordseaden** – Quantity Surveyor cost manager providing cost management and checks for benchmark construction costs, analysis of Lovell pricing and Key Performance Indicator (KPI) reporting.

- **Joint Venture Adviser** – a tender is in progress to appoint an adviser with general oversight of all processes in an assurance of best practice role.

4 Finance

- 4.1 The Council's finance department has reviewed the progress and is working to support Kinsted LLP with external advisers. Accountants KPMG for corporate strategic advice and Keston Reeves for general book-keeping accountancy.
- 4.2 Edes Estates Limited, is the Council's wholly owned company, partnering 50/50 in Kinsted LLP with Lovell Partnerships Limited. In the current financial year, Edes Estates is returning to an active company and becoming the Council's corporate vehicle in terms of the joint venture partnership objectives
- 4.3 The principle of the joint venture is that each partner will input assets or resources for each site at equivalent monetary value to then obtain an equal split of the net profits at completion of a development. Should the land value and development costs not be equitable then there is the opportunity for one party to loan money to Kinsted LLP. This will be recovered as the development proceeds with interest on the loan. The decision on whether or not the Council will loan funds will be determined at the time taking into account such factors as central government policy.
- 4.4 For the Council, Edes Estates, the land value is input by an amount independently verified as open market value by the RICS code of practice. This amount is matched by Lovell Partnerships Limited in terms of the value paid for design, planning approval and construction work.
- 4.5 The Partnership and Options Agreements set out conditions to be met relating to land value, viability, planning consent and profit return. Lovell is required to demonstrate these conditions which will then be independently verified by advisers before any site can progress to development.
- 4.6 With a full business case and a valid planning consent in line with the partnership agreement, the schemes can proceed to works starting on site subject to the usual commercial considerations. Edes Estates will act for the Council in this process.
- 4.7 The business cases for the first two sites, Southwick and Bersted, are currently being reviewed and these will include a review of the land value to ensure best value and compliance with section 123 of the Local Government Act. When the Business Case Conditions are met, the land can transfer to Kinsted LLP for development. At that point Edes Estates Limited will become liable for 50% of any loan costs that are incurred on transferred sites, but only payable once all sales are complete and the profits divided at completion. Essentially these are 'top sliced' from the gross profit.
- 4.8 The important starting point for the Council is the confirmation of land value. This is set by the RICS Red Book valuation rules. This value is set at the point where the land transfers from the Council to the Kinsted LLP. This is a Business Case Condition.
- 4.9 Another important Business Case Condition, and to ensure viability of the scheme, is that 85% of the construction costs are confirmed as fully tendered fixed costs figures.

- 4.10 The appointment of Lovell Partnership Ltd as our joint venture partner (Kinsted LLP) is for construction under tendered exclusivity conditions, which are subject to KPIs and five-yearly best value reviews for performance and must be evidenced in carrying out all development services successfully.
- 4.11 To start the partnership, in the original key decision 10 initial sites were 'optioned' by the Council to the joint venture LLP to be progressed, under an Options Agreement.
- 4.12 How the joint venture approach to the use of Council assets represents good value:-
- Value is assured by all costs being benchmarked and verified and compared to other similar building works, by professional advisers.
 - The structure of the Partnership Agreement requires independent consultant expert advisers to verify land and construction value.
 - Montagu Evans has reviewed the proposals for Southwick, North Bersted and Littlehampton and confirm that the profit rates in the business case appraisals are aligned with market expectations in value which is important in the confirmation of land sale returning to the Council. Montagu Evans also confirm the profits Lovell can derive from its appraisals are aligned with market rates. The Council will also be entitled to half of the net profit generated in delivering the schemes.
 - The Montagu Evans review includes a separate development appraisal assessment for each of the sites by applicable market assumptions, build costs and sales returns, including tweaking scheme details where the generalised form may deliver something different from Lovell's specific proposal, which is an important check for best monetary return.
 - For both Southwick and North Bersted, Montagu Evans is of the view that the Lovell proposals are at least in line with market values if not better, and the Council should have sufficient confidence at this stage to continue to work up the proposals in detail.
 - For Littlehampton, the work is on-going but initial land values appear in line with expectations of market rates.
 - In all cases the Montagu Evans input, as well as the Kinsted LLP land valuation advice from Strutt & Parker, will be required to support the development value of the land and profit return, with prevailing/predicted market intelligence before recommending a land transfer to commence development.
- 4.13 As further sites outside of those optioned to the JV become available consideration will be given to their future use. This could be development by the JV. In which case transfer to the JV will be in accordance with Council protocols.
5. Future savings/efficiencies being delivered

To remain financially viable in the Kinsted LLP, Lovell must remain motivated towards finding efficiencies to make and enhance profit. The Council benefits from this motivation by sharing in 50% of the profit. The Kinsted LLP is aware of

the relationship between sales value and construction cost, to maximise the difference.

6. Human Resources, IT and Assets Impact

None for the Council save in relation to land assets as described.

7. Risk implications and mitigations

7.1 The residential development market is evidenced as being exceptionally resilient over recent years, despite a number of apparent 'macro-shocks'. The present market volatility is partly being driven by rising interest rates, which may lead to a period of cooling in house price rises. This is coupled with a world-wide inflationary environment. The market economists presently predict recovery within a two-year period.

7.2 The context of risk exposure in the Kinsted LLP is noted by the Council's direct advisers as:-

- The partnership arrangement being shared results in 50% exposure to market risks
- the land value is the Council's maximum input
- the land has not been purchased
- West Sussex is noted to be a tight housing market with strong demand for houses against a background of constrained supply
- the ten optioned sites are exceptionally attractive in surrounding location, noted for sales demand and straightforward to deliver in terms of scale and access constraints
- at this outline business case stage the Council is not committing to definite delivery of the schemes, the full business case will produce 85% cost certainty when construction can commence with further sales market information
- the Council is not obligated to develop or sell the land unless Lovell can demonstrate, and the Kinsted LLP parties agree, that the projects will likely generate the targeted level of commercially acceptable returns
- the context of the Options Agreement is the Council is not materially changing its exposure or commitments before development construction and can therefore allow progression of the sites and rely on existing protections in the event market movement adversely impacts the ability to deliver these schemes before it commits to development

7.3 A risk register is in place for the on-going work and this is shared with Lovell the partnering company. The following table is from the register but does not represent any priority of risk.

Risk	Mitigating Action (in place or planned)
<p>Managing public/private interface of joint venture</p> <p>Organisational differences and values between commercial return and public accountability.</p>	<p>Daily contact, open discussions and a motivated teamwork approach to share important factors, views and obligations in the public sector. The operational context for the private company partner is adapting its processes to the obligations of public authorities.</p>
<p>Value from assets not met</p>	<p>Kinsted LLP's advisers have specific duties in s123 (section 123 of the Local Government Act 1972 (confers a duty that public assets held are not sold below value)) and the Council's direct advisers oversee due performance is achieved and importantly recorded by the Kinsted LLP's advisers. Before progressing developments 85% of construction cost must be firm price tendered and the evidence of best return demonstrated overall.</p>
<p>Support from JV partner company reducing</p>	<p>Lovell is contractually obligated in the agreements to provide Development Management Services to manage and deliver the whole development. This is subject to KPI assessment by advisers with a duty of care to the Council.</p>
<p>Viability of developments not transparent</p>	<p>Developments progress in stages and gateways, each is tested for land value, financial return, planning context and market before progressing.</p>
<p>Political and reputational risks, building homes in the community.</p>	<p>Earliest engagement with locals, members and the wider community to involve them in the design development and listening to be aware of their concerns.</p>
<p>Financial exposure</p>	<p>Developments can be arranged where land value continues as the maximum exposure for the Council. and additional funding if required can be via our partner or through external borrowing.</p>
<p>External factors</p>	<p>International situation will be monitored, developments progress in stages and on-site larger ones in phases to minimise exposure.</p>

Risk	Mitigating Action (in place or planned)
Partnering company difficulties	Lovell is provided with a full parent company guarantee from Morgan Sindall, sixth largest UK construction company founded in 1977. It has a workforce approaching 7,000 and loyal support from employees.
Relationship with partnering company	The first year has progressed with exceptionally good working relations, the team with Lovell is established. Progress in the developments is closely monitored and any concerns can be raised at Lovell main board level.
Partnering company gains commercial advantage	The Partnership Agreement contains KPI criteria that are monitored in relation to bench-mark prices, also exclusivity is reviewed every five years and after the second renewal construction services must open market tendered.
Poor construction leads to after sales reputation	Lovell has 50 years' experience in housing development and a quality/aftercare.

8. Policy alignment and compliance

8.1 Our Council Plan

A central part of the Kinsted LLP Business Plan is formally documented to support the objectives of the Council in achieving its key priorities for the period to 2026, all of which are underpinned by an awareness of climate change and in the groups of: -

- 1) Keeping people safe from vulnerable situations
- 2) a sustainable and prosperous economy
- 3) helping people and communities to fulfil their potential
- 4) making the best use of resources.

These priorities are central to the design briefing process and can be evidenced in audit.

8.2 Legal implications

The legal adviser Sharpe Pritchard has an on-going oversight in contracts and performance. The County Council's Director of Law is a director and

chairman of Edes Estates Limited, thereby remaining in close contact with commitments and obligations.

8.3 Equality duty and human rights assessment

The Kinsted LLP is an independent operation, but fully sighted on the Council's policies and commitments. Lovell, in the Morgan Sindall Group plc, has responsible, and market aligned policies in human rights. This area was part of the tendering selection assessment.

8.4 Climate change

The Government's vision, to climate change and protection of the environment, is set through statutory standards such as in the Building Regulations and the Environment Act, which work towards the target of all new homes being 'net zero ready' by 2025.

The Kinsted LLP schemes are all designed to fully comply with the latest Building Regulations, which for example from June 2022 require 31% lower carbon dioxide emissions from dwellings than previously, with a particular emphasis on low carbon heating. This will include, where practicable Air/Ground Source Heat Pumps and photo-voltaic solar panels.

To move forward each scheme must have a commercially viable business case. Inclusion of enhanced environmental standards will be measured against this requirement.

8.5 Crime and disorder

The schemes are reviewed by Secured by Design SBD throughout the design process and the features for security incorporated. Housing Associations for the affordable provision generally require Section 2 which is achieved.

8.6 Public health

The developments meet all standards and in the early design stages are dialogued with local authorities.

8.7 Social value

The tendering documentation and Partnership Agreement for the JV set out a comprehensive programme of social impact activities to support the County Council in delivering its key objectives towards improving the quality of life for its residents. Lovell as part of the Morgan Sindall Group has its own 'Total Commitments' programme supporting social value and the JV approach will align the two and generally support Sustainable Development Goals.

Typical areas in an overarching approach will be to visibly demonstrate social value credentials, and to include these in a marketing approach to create a brand that is respected and valued:

- Using the Supply Chain Social Value Bank or other agreed measurement tool to reliably forecast and calculate the

economic, environmental and social value created from the West Sussex projects, in line with best practice valuation methodology as used by HM Treasury in its Green Book.

- Agree and set targets and measure performance against them: at an overall business plan level and on a project by project level.
- Create a Social Value Charter within its first year to illustrate the aims to be achieved in the delivery of the projects; focussing on the five West Sussex strategic priorities through our social value process.
- Set clear targets based upon the Charter commitments within the JV Business Plan and be accountable for achieving them.

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Appendices: –

Appendix 1 - Joint Venture structure chart

Appendix 2 - Internal Audit report on governance

Background papers - none