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Report title: Proposed Harlow Investment Fund	
Report to: Cabinet	
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County Divisions affected: Harlow	

1. Purpose of Report

- 1.1. The purpose of this report is to ask the Cabinet to agree to invest £5m in the proposed Harlow investment fund, a proposed £50m fund seeking to invest in property in Harlow. The other investors would be Harlow DC, Homes England and Places for People, the developer behind a major development in Harlow.

2. Recommendations

- 2.1. Agree in principle that the Council will invest £5m in the Harlow Investment Fund.
- 2.2. Agree that Executive Director, Place and Public Health may enter into an agreement to subscribe for or purchase shares in the Harlow Investment Fund Limited Partnership and such other entities as may be required in order to participate in the fund, subject to his being satisfied, after consulting the Leader, the Cabinet Member for Economic Growth, the Cabinet Member for Finance and the Monitoring Officer and the Section 151 Officer that the agreements and structure provide sufficient protection for the council's investment.
- 2.3. Agree that the reserved matters with respect to the fund shall be as set out in Appendix 4 and the investment principles shall be as at appendix 3.
- 2.4. Note that the Leader will decide about who to appoint as ECC's nominee as a director of the Investment Fund.

3. Summary of issue

- 3.1. ECC has collaborated with Harlow District Council (HDC), Homes England (HE), and Places for People (PfP) (the Parties), over the past 18 months, exploring opportunities to catalyse private sector development and unlock key sites in order to secure the growth and regeneration required in Harlow.
- 3.2. Through this work it has been identified that whilst Harlow is a place of significant opportunity, low land values and disorganised landholdings in the town centre have been barriers to attracting private investment which in turn

constrains the growth potential of the economy of the area. In these circumstances, public sector-led investment is needed to stimulate change.

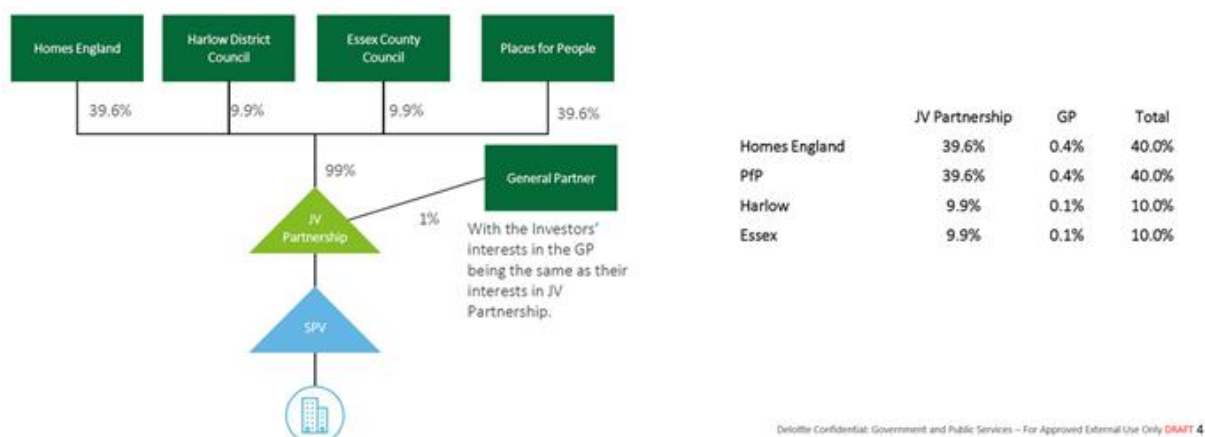
Investment in the fund

- 3.3. Having sought advice from independent legal and financial professionals, the Parties have concluded that a revolving investment fund for Harlow Town Centre should be developed. This will address extant market failure, investing public sector capital to create a portfolio of property investments focused on sites with marginal viability. It will focus on those which are too complex for the private sector to develop or where the return profile is too limited for the private sector, but development of which will create the conditions catalysing private investment and regeneration as well as deliver a financial return.
- 3.4. The Fund is seeking to attract £50m of shareholder capital to be invested in development of residential-led development sites in Harlow Town Centre. The Parties have agreed to make the following investment commitments;
- Homes England (£20m) (40% equity)
 - Places for People (£20m) (40% equity)
 - Harlow District Council (£5m) (10% equity)
 - Essex County Council (£5m) (10% equity)

Proposed Structure of the Fund

- 3.5. A Limited Partnership "LP" has been recommended as the most appropriate investment vehicle for the Fund. A limited partnership is not a legal entity but a relationship between partners and as such will be regulated by a partnership agreement. LPs consist of one or more "limited partners" and a "general partner". Limited partners are essentially silent investors in relation to the partnership's day to day management as in order to enjoy limited liability status, they cannot take part in the management of or bind the partnership. The limited partners will consist of ECC alongside HE, PFP and HDC.
- 3.7. The LP will appoint a 'General Partner' which will take the form of a company limited by shares created for the purpose. Each of the Parties will be a shareholder of the General Partner, purchasing £1 of shares for each percentage of their initial investment. ECC will therefore have ten £1 shares. Holders of these shares will be under an obligation to lend money as limited partners in proportion with their shareholding – 10% for ECC.

Harlow Investment Fund



- 3.8. The Harlow Investment Fund has an equity requirement of £50,000,000. parties' equity will be subscribed and pooled at a General Partner level. Essex County Council will be expected to contribute the following:
- a 10% investment in the share capital would require a £10 subscription of shares (or the equivalent under an LLP) in the Harlow Investment Fund Limited Partnership;
 - 10% investment in the share capital would require a £10 subscription of shares (or the equivalent under an LLP) in the Harlow Investment Fund Limited Partnership (General Partner); and
 - a corresponding 10% share of the Loan Notes equalling £5,000,000.
- 3.9. The Fund will create project specific Special Purpose Vehicles (SPVs) through which development projects will be undertaken. The General Partner will then loan the money onto special purpose vehicles created for each company project SPV's through Loan Notes. The activities of the SPV(s) will be reported back to the Board of the Fund but the interface will be managed by a competitively procured Commercial Manager and Development Manager who will advise on acquisitions, investments and operations of the Fund.
- 3.10. The equity return will be payable as dividends via the share equity and not via the Loan Notes.
- 3.11. Further detail on the structure and operation of the Fund is outlined at appendix 2.

Decision making, governance and fund management

- 3.12. Decisions in regard to the running of the fund will be taken at a Board of the General Partner with each of the Parties appointing one director on the Board with reserved matters and shareholder reserved matter provisions used to ensure a requirement for unanimity for some decisions regardless of the investment of each of the Parties ensuring the interests of each party is safeguarded (appendix 4). The Leader will decide who will be the ECC director on the Board.

- 3.13. Organisations will be appointed to act as commercial manager and development manager on behalf of the parties in identifying opportunity sites and developing proposal papers for approval in line with investment criteria set by the board and delivered as part of an annual investment plan.
- 3.14. The Commercial Manager and Development Manager will be asked to identify sites which meet the criteria of the Fund overall, and to minimise risk to the investors through the choices they make on behalf of the fund. They will report to and be accountable to the Board of the General Partner.
- 3.15. An illustrative pipeline of projects has been identified to demonstrate that the principles of the fund can be achieved. Following establishment of the Fund the Commercial and Development Managers will financially appraise and test viability of each project in order to deliver an annual investment plan for agreement by the parties.

Returns on investment/fund expectations

- 3.16. It is planned that all funding will be assigned in the 2021/22 financial year and returns are expected to be realised in 2023/24 as initial development sites are completed and sold. It is proposed a longer-term return will be achieved through re-investment of the proceeds of sale.
- 3.17. The Parties have set a series of investment criteria, against which eligible projects will be tested, with these set out at appendix 3. Initial work has suggested that as part of a £50m capitalisation of an investment Fund, ECC's investment will:
 - Directly leverage £45.0m of funding from HDC, PfP and HE.
 - Directly enable the development of approximately 750 new homes and secure affordable homes across all tenures at local plan policy levels.
 - Catalyse the development of an additional 2,500 – 3,000 homes in the District, including those within the planned Gilston Garden Town.
 - Provide confidence to the successful delivery of the Garden Town.
 - Enhance the quality of the town centre, creating a mixed community through direct delivery and promotion of better designed, sustainable and higher quality homes, services and the built environment.
- 3.18. By investing, ECC will be taking a commercial risk. Whilst this is considered as an investment proposal aiming to deliver regeneration of Harlow Town Centre, a priority growth location for ECC and the South Essex Local Enterprise Partnership (SELEP) it is also planned that investment will generate a return on investment for ECC.

Risk

- 3.19. Like any investment, there are risks that the projects supported by the Harlow Investment Fund will not advance or, if they do, will not generate a return on investment. The aim is that the fund takes a blended approach to investments with some of the investments generating a larger return which much more

than offsets the losses in in projects which deliver a low return or fail to deliver a return on investment. The key risks are:

- Risk that overall, the fund fails to generate returns: If this happened then ECC would be unable to capitalise the investment and would have to find revenue to fund it, creating a budget pressure. This will be mitigated to some extent by:
 - The Parties will take proper advice from suitably qualified experts in the form of commercial managers appointed by the fund prior to making investment decisions.
 - Prior to establishing the fund, the Parties have sought input from legal, commercial and economic experts and developed an illustrative pipeline of projects to demonstrate the returns are deliverable.
 - To ringfence risk and, if required to enable the leveraging of debt, the Fund will create project SPV(s) through which projects will be undertaken.
 - ECC will have a nominee on the board of the General Partner with oversight of and delegated decision on approving the investment plan.
 - The investment model assumes that there will be a blended approach to investments and that some will not generate a return however others will generate a larger surplus and that overall, the fund will generate a positive return in line with an established IRR threshold.
- Risk that ECC's position is undermined by conflicts of interests with partner investors or that its position on the board is undermined
 - This risk cannot entirely be mitigated but three of the four partners are public sector organisations who seek to act in the public interest, and we will ensure that the constitution of the partnership and associated agreements provide reasonable protection to ECC.
 - The shareholders have worked together over the course of over a year and a half to negotiate and agree a set of investment principles prior to establishment of the fund ensuring priorities and interests are aligned.
 - The partners individually have aligning corporate priorities and strategic objectives which give confidence that conflicts are unlikely, and where they may exist there are protocols in place to mitigate the impacts of these.
- Risk that projects fail to receive planning permission is a risk in any development, but care will be taken as part of the development appraisal process to select sites and development which are likely to be approved in principle by the local planning authority.

Investment Criteria

- 3.10 To ensure that investments are only made in the strongest cases the Parties have taken steps to ensure that only the strongest and / or most impactful projects are funded. This includes developing seven criteria for project investment, outlined at appendix 3, appointing Commercial and Development managers with appropriate expertise and experience to advise the fund on investment proposals, drawing up an investment plan to be reviewed annually and in preparation of the fund we have developed exemplar projects to test

the operation of the fund and the likely returns profiles available in Harlow from a range of sites which has demonstrated the IRR.

Exiting the fund

- 3.11 The participation of Homes England in the fund is restricted by law to where there is market failure. Therefore, once the fund has achieved its purpose and dealt with market failure, Homes England will be required to withdraw its investment. It is likely that Homes England will exit the fund on completion of all investments or after a period of seven years. At the end of this period it is anticipated that the partners have the following options:
- HE's equity stake in the Fund is acquired by an external entity acceptable to the remaining partners, probably following a competitive marketing exercise undertaken by Homes England.
 - Other partners acquire the value of HE's equity at fair market value.
 - The winding up of the Fund and distribution of proceeds in accordance with the agreed cascade in the agreement between the partners.
- 3.12 At the end of the 7-year initial operating period ECC will have the option to:
- Continue, potentially with the addition of a private sector entity should Homes England exercise their right to leave the Fund and should the remaining partners not wish to acquire Homes England's ownership.
 - ECC offers sale of its shares in the Harlow Investment Fund Limited Partnership to other shareholders (at fair market value).
 - Shareholders to agree to a formal winding up of the Harlow Investment Fund Limited Partnership Company and distribution of the proceeds in line with the agreed dividends in return for the share equity.

4 Options

- 4.1 **Option 1: Do not participate in the establishment the Harlow Investment Fund.** This would result in ECC forgoing the opportunity to invest in the fund and possibly a capital return from investments that are made. By not investing we would also reduce the growth potential in Harlow District, potentially constraining the delivery of Harlow Gilston Garden Town, which acknowledges its own dependency on the Town Centre to attract residents and be the vibrant heart of a new Harlow. This would also place significant limitations on the sustainable growth of Harlow of which a high-quality town centre is a key requirement. By not investing we would however avoid the risk of having to fully or partly write off the investment should the investment fund fail to deliver on the planned priorities.
- 4.2 **Option 2: Participate in the establishment in the Harlow Investment Fund involvement and subscribe £5,000,000 (Recommended Option).** This would see ECC investing £5,000,000, leveraging £45m from partners and seeking to leverage a return on investment and create potential economic growth and regeneration benefits for Harlow the wider areas. It does involve a

level of risk as set out in the report, but we have sought to mitigate and manage these risks through the measures outlined above.

- 4.3 **Seek to invest in Harlow in a different way.** This would seek an alternative way of investing ECC capital rather than creating the Harlow Development Fund in the structure set out in this paper. This would enable ECC to exercise greater control over how the fund is invested but it would mean that ECC does not have access to the expertise of partners, could undermine their appetite to set up the fund and could lead to ECC and the other partners competing for sites etc.

5. Issues for consideration

5.1 Financial implications

- 5.1.1 ECC's maximum investment will be £5m and this will be used as equity to make interventions in specific land and property assets in Harlow Town Centre, delivering residential led mixed-use schemes that align to the Investment Fund's priorities and help to accelerate and otherwise support the delivery of the Harlow Town Centre Masterplan and Area Action Plan. ECC's investment represents a 10% equity stake.
- 5.1.2 The full £5m ECC contribution is anticipated to be committed in the 2021/22 financial years and thereafter uses on Investment has been agreed by Recovery Advisory Board on the 26th October and is included in the Capital programme. The initial fund operating period will be seven years, with ECC investment used as a revolving fund within the period. The cost of borrowing is expected to be £1.1m during this period.
- 5.1.3 In the absence of a development pipeline being available prior to establishment of the Fund an illustrative pipeline of 11 potential projects has been developed by consultants Montagu Evans. The ECC project team has taken the top 5 development opportunities to model how the Fund might work. Initial modelling suggests a potential Fund operating profit of £15.2m with ECC receiving a distribution of £6.5m from the Fund and a return of £0.4m after cost of borrowing.

5.2 Legal implications

- 5.2.1 The proposed investment is for ten £1 shares in the General Partner, giving 10% of the voting rights. The Council would therefore be a minority shareholder however will have decision-making through shareholder protections set out in the shareholder agreement.
- 5.2.2 Unless the company engages in wrongful or fraudulent trading, the Council's financial risk in relation to the Investment Fund will be limited to £5m. It is important to note that the Fund will be making investments that carry a degree of risk and there is no guarantee of any return. It is possible that ECC will

lose the entire value of its investment. Equally ECC has the possibility of earning a significant return on its investment.

- 5.2.3 Section 12 of the Local Government Act 2003 gives the Council the power to invest for (a) any purpose relevant to its functions under any enactment (b) the purposes of the prudent management of its affairs. In doing so it is not restricted to investment via a limited company and it is permitted to invest via a limited partnership in this context.
- 5.2.4 Essex County Council has sought advice to ensure that its investment in the Fund is compliant with the rules on state aid. As investments will be made on market terms utilising the LP structure it is assessed that state aid is not applicable to the Council's investment. If as the Fund evolves and investment cannot be made on market terms, or if grant funding is required then further work will need to be done in order to assess compliance at the time. The Cabinet will appreciate that the future of state aid following the end of the EU transition period is as yet unclear. Further detail on compliance with the current state aid position is outlined in Appendix 2.
- 5.2.5 The current discussions have been at a high level only and we have not yet seen detailed drafting on the documents which would form the constitution of the Harlow Investment Fund Limited Partnership or on any proposed shareholder agreement.

6 Equality and Diversity implications

- 6.1 The Public Sector Equality Duty applies to the Council when it makes decisions. The duty requires us to have regard to the need to:
 - (a) Eliminate unlawful discrimination, harassment and victimisation and other behaviour prohibited by the Act. In summary, the Act makes discrimination etc. on the grounds of a protected characteristic unlawful
 - (b) Advance equality of opportunity between people who share a protected characteristic and those who do not.
 - (c) Foster good relations between people who share a protected characteristic and those who do not including tackling prejudice and promoting understanding.
- 6.2 The protected characteristics are age, disability, gender reassignment, pregnancy and maternity, marriage and civil partnership, race, religion or belief, gender, and sexual orientation. The Act states that 'marriage and civil partnership' is not a relevant protected characteristic for (b) or (c) although it is relevant for (a).
- 6.3 The equality impact assessment indicates that the proposals in this report will not have a disproportionately adverse impact on any people with a particular characteristic as the decision relates to the investment in a Limited Partnership.

7 List of appendices

Appendix 1: Equality Impact Assessment

Appendix 2: Structure overview

Appendix 3: Investment criteria

Appendix 4: Board decisions and reserved matters

8 List of Background papers

No documents other than those which include exempt information.