Merton Council

Cabinet

20 March 2017

Second Supplementary agenda

This page is intentionally left blank

Committee: Cabinet

Date: 20 March 2016

Wards: All

Wholly Owned Local Authority Property Company (LAPC)

Lead officers:
Chris Lee – Director of Environment and Regeneration, Caroline Holland, Director of Corporate Services

Lead members:

Cllr Martin Whelton – Cabinet Member for Regeneration, Environment and Housing
Cllr Mark Allison – Deputy Leader and Cabinet Member for Finance

Contact officer:
James McGinlay – Assistant Director for Sustainable Communities

---

Recommendations: That Cabinet

A. Note the work that has been carried out to date in relation to the setting up of a wholly-owned local authority property company ("LAPC").

B. Approve the setting up of a wholly owned local authority property company.

C. Approve the business case for the local authority property company.

D. Agree the proposed governance arrangement set out in this report.

E. Agree to:

(i) Establish a Sub-Committee of Cabinet and (subject to (iii) below) delegate to that Sub-Committee authority to exercise the Council's rights and responsibilities as shareholder of the company;

(ii) Nominate Members to sit on the Shareholder Cabinet Sub-Committee;

(iii) Delegate to the Director of Environment and Regeneration authority to take decisions on matters reserved to the Council in circumstances where the expenditure to be incurred in any one instance does not exceed two hundred and fifty thousand pounds (£250,000)

F. Delegate, to the Chief Executive and Monitoring Officer, authority to set up the company including finalisation and approval of all relevant documentation, and registration with the Registrar of companies.

G. Note that appropriate amendments will need to be made to the Council's constitution with respect to the Cabinet Sub-Committee and that Cabinet recommend to Full Council the appropriate amendments.

H. Recommend to Full Council, the capital investment funding of £13,022m for the first four sites plus working capital of up to £4m.

I. Delegate to the Director of Corporate Services the finalisation of the loan agreement between the Council and the LAPC .

J. Recommends to Council an allocation of a further £10 million in the capital programme for the strategic acquisition of sites, subject to the business case for each acquisition is agreed by the council's Property Asset Management Board.

K. That Cabinet (approval will also be required by full Council):

i) Approve the increase in the Capital Programme to reflect the proposals in this report, and

ii) Approve the revised Treasury Management Strategy inclusive of revised Prudential indicators

---

1 PURPOSE OF REPORT AND EXECUTIVE SUMMARY

1.1. To demonstrate to Cabinet a sound financial business case and governance structure for the establishment of a Local Authority Property Company.

1.2. To approve the setting up of a wholly owned Local Authority Property Company ("LAPC") with the purpose of generating revenue for the Council and increasing the supply of housing in Merton. Over 100 Local Authorities across the Country have established or are in the process of establishing LAPCs. These Councils, like Merton, have seen the real and significant financial benefits that can be realised through the use of a company structure alongside the powers of Local Authorities. This is in addition to the way companies can be used to accelerate and increase the supply of housing.

1.3. To approve the proposed structure, business plan, and the mechanics of how the company will operate and be governed (Appendices 1-4).

1.4. This report summarises the work which has been undertaken to develop the business case for setting up a wholly owned Local Authority Property Company ("LAPC") to develop housing and commercial property on Council owned land to generate income to the Council by way of finance charges and dividends to the Council as sole shareholder of the LAPC.

2 DETAILS

2.1. The Localism Act 2011, through the general power of competence introduced a power for local authorities to do anything that individuals generally, of full legal capacity, may do, subject to certain, specified, limitations and restrictions. A number of local authorities, most notably, Croydon, Sutton, Lambeth, Ealing, Thurrock, Enfield, Havering, and Newham have already used this power to establish subsidiary housing development companies. Across the country 110 local authorities have set up or in the process of setting up property companies.

2.2. A wholly owned Local Authority Property Company(LAPC) offers the opportunity to the council to develop its land holdings and utilise its capital borrowing facilities to develop housing and commercial property to generate an annual revenue return to the council. The company would develop property in accordance with council planning policy; however the company intends to sell any affordable housing units developed to registered providers [Housing Associations] as the council does not have its own housing revenue account and the company is being set up purely for commercial purposes.

2.3. Principles / Set-up

i. The property company would be a private company limited by shares, wholly owned by the Council with the principle purpose of generating revenue to assist the council with its financial challenge. Developing housing as its key product will also assist in creating and accelerating housing supply (and where appropriate commercial units).

ii. The company would be commercially focused, with the objective of developing properties for rent but also as appropriate, for sale. Officers have identified that there is strong local housing demand in the area through on-going research with local agents and developers with gaps in the market for sale and for rent which the company could help to fill.

iii. The plan to build property for private rent, private sale, affordable rent, shared ownership etc. is in recognition of the role that the Council feels the Company could play in delivering housing supply within the Council's boundaries and maximising the income to the Council as its sole shareholder (see Business Plan Appendix 1). The establishment of the LAPC is not restricted to developing solely in Merton. The company will also have the flexibility of acquiring and developing sites outside the borough following the same principles as already stated.

iv. In order to comply with both State Aid rules and Her Majesty's Revenue & Customs (HMRC) requirements in relation to capitalisation the Council would fund the company through a mix of both equity and loan finance. In the initial business plan it is proposed that the Council would transfer the sites, as and when required, to the LAPC and take equity in the company through the acquisition of shares to the full value of the land consideration, thereby meeting the requirements of section123 of the Local Government Act 1972.

v. In addition, the Council would lend money to the company at a commercial lending rate, in order to provide the company with the finance required to plan, design, and construct the new properties (see Business Plan Appendix 1).

vi. The company could also purchase sites, land, or property, if the business case generates a good financial return and is in line with the company's memorandum and articles.

vii. The company may set up joint ventures with trusted partners for the development of some larger sites that require specialist land assembly skills and larger sums of cash to assist with delivering the development if this is deemed to be appropriate and support the business case.

viii. The company would contract with construction specialists and construction companies for the development of sites.

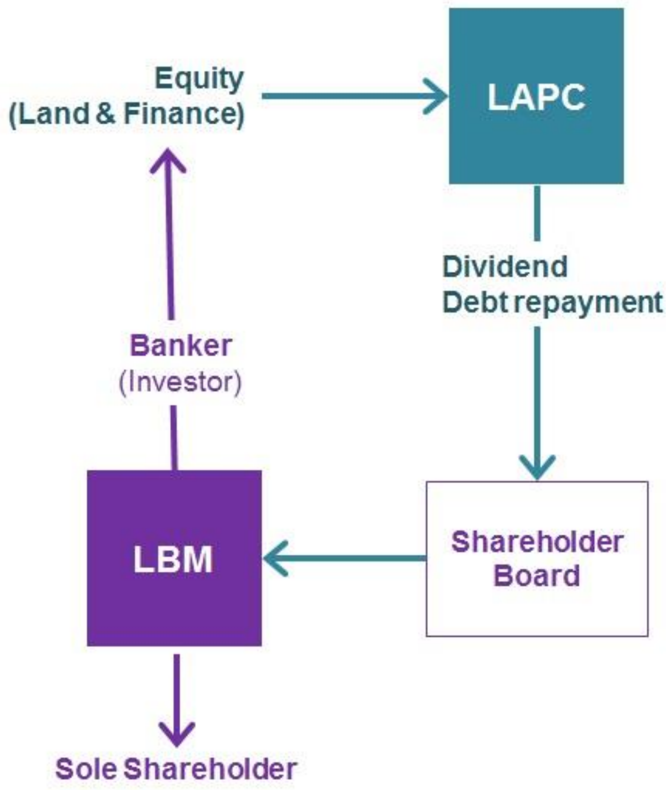
ix. The developments will be planning policy compliant (subject to viability).

x. The return to its shareholder (the Council) would be in the form of –

- Dividends from profit
- Income from debt financing
- In the medium to long term, enhanced capital value growth of the assets.

The diagram below shows the, proposed, relationship between the council and the company.

The diagram below demonstrates the flow of money from the company to the council.



2.4. <u>Sites</u>

2.4.1 The Council's strategic property group PAMB (Property Asset Management Board) oversees the council's property portfolio and is the strategic decision making group for all land and property.

2.4.2 The Property and Asset Management Board list shows property and assets requiring strategic decisions (Please see Appendix 3 – Property List).The list identifies sites that the council owns and which have the potential to yield up to1500residential and commercial units.

2.4.3 Six sites were initially identified, surveyed and then modelled. After being independently surveyed and valued by BBP Regeneration, advisors to the Council, and the costs and values inputted in to an established housing model supplied by Price Waterhouse Coopers two sites were eliminated. One site was eliminated due to the council's corporate requirements and priorities changing during the process, and the second site, a very small and constrained site, did not meet the criteria of the company of generating a long term rental stream.

2.4.4 BBP Regeneration provided independent surveying and valuation advice as part of the site selection and modelling process. BPP assessed the shortlisted four sites and identified that 77 units could be built across the four sites and these were economically viable and would deliver an acceptable return to the company and council.

2.4.5 The four sites have been identified and selected, based on location, planning consideration, and market values. The sites have also been selected based on their availability for development e.g. land assembly not required. The planning designation and the financial modelling have been tested against theselected four sites. These four sites are:

- Farm Road Church, Morden
- Land at the Canons, Mitcham
- Raleigh Gardens, Mitcham
- Elm Nursery, Mitcham

2.4.6 The first four sites of the first tranche will deliver approximately 77 units. Two of the four sites have the potential to contain a mix of housing and ground floor retail; these two sites are Raleigh Gardens and Elm Nursery Car Park.

2.4.7 The company will sell affordable housing to registered providers and retain the private rented units within the company, seeking to establish a structure of 2-4 year assured short hold tenancies to give private renters more security, minimise void periods, and to stabilise revenue flow into the company. The company would either retain or sell the ground floor retail/commercial property depending on market conditions at the time of practical completion.

2.4.8 Council officers reviewed the opportunity at the P4 site, however the company's key purpose and principles is to specialise in developing housing as its product, with ground floor retail in some sites. The company at this point is not in a position to diversify and venture into developing high quality office accommodation.

2.5. <u>Background / Market Conditions</u>

2.5.1 The London property market over the past five years has seen strong growth in the numbers of properties developed for investment and private rent. This inward investment has pushed house prices up and seen rental values continuing to increase.

2.5.2 The following values in the table below are real rental values advertised on the website rightmove.co.uk during September 2016 for the London Borough of Merton area, i.e. Mitcham, Wimbledon etc.

2.5.3 Current Monthly Market Rents – Merton values compared to housing cap

Property Type	**Range (Lowest)**	**Range (Highest)**	**Housing Cap**
1 Bedroom	£825	£1,950	£724-£1,099
2 Bedroom	£1,000	£2,900	£912-£1310
3 Bedroom	£1,395	£3,400	£1,209-£1,535

2.5.4 The table shows a wide range of monthly rental levels across Merton, skewed by the higher value premium rentals in Wimbledon. The table shows the difference between market rent and the housing cap rent. The company will take advice from local agents to determine appropriate rent levels for each site after development.

2.5.5 Merton is one of the most expensive boroughs to rent, in outer London with the average 2 bedroom properties in the borough costing around £1,300 per month to rent.(www.london.gov.uk).

2.5.6 The cost of buying a home in London has risen on average by 11.2% since the start of 2015 according to the government's website www.gov.uk, with Merton rising by 10.6% with an average house price of £509,000. These high property values are making it increasingly difficult for first time buyers to get mortgages; with average deposits required starting at 10%, buying in Merton would require at least a £20,000 deposit for a studio or 1 bedroom flat in the east of the borough (www.rightmove.co.uk, 9/18/2016).

2.5.7 Due to the current market conditions, this has created what developers and government policy makers now know as "generation rent". According to research carried out by Price Waterhouse Coopers, by 2025, 60% of 25-39 year olds will be renting, with only 26% having joined the housing ladder.

2.5.8 These market conditions have created a strong rental market in London for now and the foreseeable future. This market segment of young renters has been relatively untapped by developers. However a few have started to change their business model to take advantage of this growth market.

2.5.9 PWC has advised that Brexit has not had much impact on the rental market which remains strong. PWC and RICS have however identified a slowdown in house sales and a softening of prices across London. Local agents in the borough have advised that there is a strong demand for rental properties in the borough despite Brexit.

2.6. Market Competitors

2.6.1 All though not currently in Merton, Fizzy Living and Grainger plc have already developed established Private Rental Sector (“PRS”) products in Newham and Kensington and Chelsea. The PRS product by Fizzy Living in Canning Town is a fully serviced apartment block, contains a concierge service, gym and dry cleaning services on the ground floor. Fizzy living offer a concierge service where there are developments of over 85 units on a single site, the number required to make the concierge system viable in the first instance.

2.6.2 The Fizzy Living and Grainger developments offer flexible rental terms, with renters able to have a bit more security (Commonly a 2 year assured short hold) around their tenancy. The developments also have an onsite building managers and a concierge service. The developments also have offers on a range of value added products to tenants such as free wifi, deals on TV and broadband packages etc

2.7. Private Rented Developments

2.7.1 Research around PRS developments has been undertaken, looking at housing developers to learn from their experience in the design and maintenance requirements specifically for privately rented stock. The market is now investing heavily in private rented developments as a long term income stream. Private rented developments have become increasingly attractive to investors who are prepared to purchase whole development sites for investment funds.

2.7.2 Some of the key aspects of optimised build to rent developments are:

- Maximised units per floor
- Highly efficient spatial planning
- Standardisation of components for all developments
- Whole life costings considered at the beginning
- Smaller unit sizes
- Specification driven by whole life costings, i.e. robust finishing, building fabric etc

2.7.3 Research with market specialists and discussions with other authorities also found that Private Rented Sector (PRS) Developments require a different approach in terms of assessing viability as part of seeking planning consent. Private Rented Developments unlike traditional developments carry debt and risk for a much longer period of time, and requires a flexible business model that includes a cash reserve to be retained in the company to weather market conditions and allow the company to stay solvent. Unlike traditional developments that are built for sale, building for rent presents more risk as the product is subject to market influence and pressure for up to 30 years.

3 ALTERNATIVE OPTIONS

3.1. Option 1:

An alternative option is that the council sells land to generate capital receipts (estimated at £8,413,000 for the four sites). This has been the practice historically, to leave it to the private market to build the housing. This delivers a one off receipt for the Council, rather than an on-going revenue stream back to the council. This short term gain approach results in a declining asset portfolio and also almost certainly less affordable housing being supplied year on year. The income generated from capital receipts would be interest earning only and result in a reduced financial return to the Council. Anticipated red book value £8,413,000 – Estimated Interest rate @ 0.55% = £46,271 per annum interest return.

3.2. Option 2:

Another option would be for the Council to partner with a developer to reduce its risk and exposure to the market. This option delivers less risk but also less of a return for the council, the proposed articles of the company allows for joint ventures as and when they are required. The developer will have a target margin to make it a viable investment as a small project, and will require units to be sold off earlier to get a return on their initial investment leaving the company with less rental properties, less affordable housing and a much lower annual income stream.

3.3. Option 3:

The Council could partner with a Registered Provider. This option is being considered for larger developments and is allowed for in the company's articles and business plan, however would impact on the level of return to the council. The council has a duty to get best value for the sites and would not be able to offer or sell any land to a registered provider less than this without secretary of state approval.

4 CONSULTATION UNDERTAKEN OR PROPOSED

4.1. The process of establishing the company has involved senior staff and council members to ensure the concept is acceptable and presents a sound case for council investment. The council has also sought legal advice from SLLP and Trowers&Hamlins, financial advice from the council's internal business model advisor, alongside Price Waterhouse Coopers (PWC), and Surveying advice from BBP Regeneration.

4.2. The team has also consulted and carried out research with local agents to ascertain the levels of demand in Merton.

4.3. The combination of professional advice and consultation with senior staff and members has helped develop the business model to ensure it represents a sound investment for the council, maximising the gain from some of the Council's land and asset portfolio.

4.4. The housing company has been discussed at the scrutiny task groups for housing supply and commercialisation as a method of assisting the council both with its financial challenge and creating additional housing supply. The proposals herein are consistent with the aims of these Task Groups particularly increasing revenue and accelerating housing supply utilising the Councils land and powers.

5 TIMETABLE

Cabinet Approval	March 2017
Full Council Approval	April2017
Company Set up and Land Transfer	June 2017
Procurement starts (Project Consultants/ Constructor)	July 2017
Procurement Completed	Nov 2017
Design Completed	Marc 2018
Planning Permission	June 2018
Construction Starts	July 2018
Construction Completed	Dec 2018
Properties Occupied	Feb 2019

6. RESOURCE AND PROPERTY IMPLICATION

6.1 <u>Property</u>

The Council's Property and Asset Management Board (PAMB) will agree sites that can be released to the company for the development. The objective of the LAPC will be to generate revenue stream to the council whilst providing housing and commercial property to maximise the value of the council's land and assets. A proposed pipeline can be found in the company business plan (Appendix 1).

7. FINANCIAL IMPLICATIONS

7.1 Financial projections have been modelled using software designed by Price Waterhouse Coopers (PwC) with assistance in compiling the data from the Councils development surveyors BBP Regeneration Ltd. The caveats and assumptions used within the model are provided within Appendices 5b and 5c.

7.2 The financial implications for the company and the Council are an integral part of the model and are summarised in the paragraphs below. Detailed consideration is given to the following within Appendix 5:

a) The use of Discounted Cash Flow (Net Present Value) for Evaluation
b) Caveats on the PwC Model
c) Assumptions within the PwC Model
d) Principal Repayment of Debt
(this is termed “Minimum Revenue Provision” within local authorities)
e) Sensitivity Analysis
f) Land Valuations
g) Tax and VAT Advice
h) The Council
i) The LAPC
j) Revised Treasury Management Strategy (including revised Prudential Indicators)

7.3 <u>The Council</u>

7.3.1 The proposed Local Authority Property Company (LAPC) structure involves the Council investing cash and available land as equity and providing loan finance sufficient to fund the company’s development programme for an estimated 77 housing units including 20 affordable units.

The Table below also shows the provisional draw down of the funding required:

Financing Drawdown	**£m**	**Year 1 £000s**	**Year 2 £000s**	**Year 3 £000s**
Land as equity	8.413	8,413	0	0
Loan	13.022	620	6,480	5,922
Cash Equity Investment	3.256	155	1,620	1,480
Total	24.691	9,188	8,101	7,402

7.3.2 During Year 4 an estimated £2.707 million from the sale of the affordable housing to a registered provider, will be repaid by the company, reducing the funding requirement from that year to an estimated £10.315 million. The Loan repayment will be treated as capital; interest on the loan and dividends received by the Council are treated as revenue.

7.3.2 <u>Land Equity</u> – the land equity transferred to the company at market value to provide best consideration to the Council. The four sites are detailed within Appendix 5f.

7.3.3 Loan – The model assumes that the Council will borrow from the Public Works Loans Board to fund the loan for an estimated period of 22 years. This loan would be at an interest rate of 3.26% The Council will provide a loan to the LAPC at a rate of 6.5% a commercially competitive rate. The interest rate used within the model of 6.5% reflects the tailored repayment profile being provided to the company and Appendix 5h provides detail from the model of the estimated impact on the Council's balance sheet and income and expenditure account over the next 30 years. Officers are currently modelling how best to fund the loan from internal resources and would envisage that this would be achieved for the early part of the loan period. The longer the loan can be funded internally the greater the margin achieved from the loan to the housing company. However, care must be taken on the timing of any external loans and the interest rate that can be achieved from the market. The Authority would also be mindful of the maturity profile of its loan base.

7.3.4 Cash Equity – In addition to the land equity the Council will also be required to provide £3.256 million cash equity. This sum is required to provide an acceptable gearing ratio when equity is compared to loan capital. Including land equity the company will have a gearing ratio of 53%, excluding land this ratio increases to 80%.

7.3.5 Discounted Cash Flow - Officers have also undertaken a Discounted Cash Flow model to weight the flow of cash over time. The results of this analysis are detailed at Appendix 5a but show that the net anticipated cashflow from the company over the 30 years modelled is anticipated to be £53.704m, discounting these net cashflows by 3% per annum provides a net positive discounted cashflow of £16.906m.

7.3.6 Internal Rate of Return - The indicated internal rate of return of 6.48%(Blended 6.39%)will need to be re-visited following sensitivity analysis and adjusting the parameters to optimise the model's outputs.

7.3.6 Repayment of Debt - The proposed draw-down of funding and the repayment schedule along with proposed debt repayments (this is termed "Minimum Revenue Provision" MRP, within local authorities) adjustments are currently being fed into the Capital Programme Funding Model. At present debt repayments, if required, will be matched to loan repayments to minimise the impact on the Council. The financial impact from the capital model will then be fed into the Medium Term Financial Strategy (MTFS). The Council's approach to the treatment of MRP has already been clarified with PwC and our specialist financial advisors. It would be prudent to also discuss this approach with our external auditors.

Balances	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 15	Year 20	Year 25	Year 30
Council equity														
Cash equity in WOC	-155	-1,775	-3,256	-3,256	-3,256	-3,256	-3,256	-3,256	-3,256	-3,256	-3,256	-3,256	-3,256	-3,256
Land equity in WOC	-8,190	-8,190	-8,190	-8,190	-8,190	-8,190	-8,190	-8,190	-8,190	-8,190	-8,190	-8,190	-8,190	-8,190
Repaid share capital											0	0	0	11,446
	-8,345	-9,965	-11,446	-11,446	-11,446	-11,446	-11,446	-11,446	-11,446	-11,446	-11,446	-11,446	-11,446	0
Loan to WOC	-640	-7373	-13966	-10301	-10315	-10295	-10247	-10164	-10044	-9881	-8,298	-5,540	-905	0
Council loan from PWLB	788	9046	16864	12840	12603	12324	12009	11651	11250	10801	7,721	2,878	0	0
	-8,197	-8,292	-8,548	-8,907	-9,158	-9,417	-9,684	-9,959	-10,240	-10,526	-12,023	-14,108	-12,351	0

Gen Fund - I & E	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Years 1 - 10	Years 11-15	Years 16-20	Years 21-25	Years 26-30	Cumulative
Dividends	0	0	0	0	0	0	-0	-0	-0	0	0	35	676	1,165	57,870	59,746
Interest receivable (if not rolled up)	20	252	672	908	670	670	669	666	661	653	5,841	3,042	2,373	1,257	59	12,572
Interest payable	-13	-158	-416	-550	-419	-411	-402	-391	-380	-367	-3,505	-1,581	-964	-161	0	-6,211
Net interest income	8	95	256	358	251	260	267	275	281	286	2,336	1,462	1,409	1,097	59	6,362
Total	8	95	256	358	251	260	267	275	281	286	2,336	1,497	2,085	2,262	57,929	66,108

The total reflects the annual return to the Council as shareholder

WOC – Wholly owned Company

7.3.7 By managing the cash required using the Council's own financial resources it will enable officers to provide some fine tuning the transfer of money to the LAPC. The level of flexibility offered will be contained within the loan agreement, and this will be reflected in the interest rate agreed, variation from this would be accommodated at a cost to the company within penalty clauses. The Council will also be able to optimise the external funding utilised to manage its cash flow position. Benefits to the Council will arise from the margin between any internal/external borrowing costs and the lending rates on loans to the company, and dividends payable from company profits

7.3.8 Council approval will be required for the loan, cash equity, land equity, and a budget for acquisitions. Council approval will be sought to provide cash and loan equity up to the figures detailed in this report. The company will have a £10million acquisitions budget approval in place to quickly take advantage of any market opportunities for land or assets.

7.3.9 Accounting Arrangements – The LAPC will need to be set up as a separate entity within Merton's accounts, with a separate bank account. Officers will draw on expertise developed when progressing CHAS arrangements. Officers will also be recommending that the LAPC uses the same external auditor.

7.3.10 Overheads – Overhead calculations and any recharges are based on the approach adopted for CHAS, the Council wholly owned company.

7.4 The Local Authority Property Company (LAPC)

7.4.1 The LAPC would be wholly owned by the Council. The company will plan to maximise profits and provide an ongoing income stream back to the council. Construction will be undertaken in the first 3 years and non-PRS properties will be sold when complete to Registered Providers, the remaining PRS properties will be rented at market rates.

7.4.2 The company reaches an in-year breakeven position in Year 5, however, the project as a whole breaks even in Year 15. This is reflected in the first dividends falling due in that year.

7.4.3 Appendix 5i details the output from the model in terms of the LAPC. The discounted cash flow shows a more modest return to the company.

7.4.4 Value Added – The flow of income and expenditure preclude effective calculation of a Discounted Cash Flow and Internal Rate of Return. However, it is possible to review the value added by the company – over the 30 year modelling period it is estimated that the LAPC will add £11.446 million value to the Council

7.4.5 It is envisaged that the company will adopt the CHAS support model mentioned in paragraph 7.3.9

7.4.6 Tax advice in respect of the company is contained in Appendix 5g

7.4.7 Insurance – The LAPC will need separate commercial insurance.

7.5 Sensitivity Analysis

7.5.1 Capital finance has undertaken four elements of sensitivity analysis on the model. Officers have:

1. Increased price inflation from 2.5% to 4.5%
2. Reduced income inflation from 4.5% and 4.3% to 2.5%
3. Varied the interest on the loan:
   a. Increasing the loan rate by 0.5% (i.e. increasing Merton's Margin)
   b. Increasing Merton's margin by 0.5% but reducing the PWLB loan Rate (Loan Rate is still 6.5%)

7.5.2 Analysis has shown that lower inflation levels in respect of selling prices and rentals will have a marked adverse impact on the profitability of the scheme for the Council when the timing of cash flows are analysed. This level of inflation would severely undermine the viability of the LAPC.

7.6 Review of Prudential Indicators

7.6.1 The financial proposals contained in this report will have a substantial impact on the Authority's Capital Programme 2017/21 and will require a revised Treasury Management Strategy (including revised prudential indicators) and this will require approval by both Cabinet and Council.

7.6.2 Loan and Cash Equity Investments, loan repayment and interest have been added to the capital funding model from information contained in the PWC model. In addition, it has been assumed that all the £10 million required for acquisitions will be utilised in 2017/18. As additional information becomes available financial planning documentation will be updated.

7.6.3 Impact on the Capital Programme - Allowing for slippage in the programme building in the proposals contained in this report will have the following impact on expenditure and funding:

Capital Expenditure	**2016/17 Estimate £'000**	**2017/18 Estimate £'000**	**2018/19 Estimate £'000**	**2019/20 Estimate £'000**	**2020/21 Estimate £'000**
Capital Expenditure	38,465	**50,316**	**41,305**	**23,478**	8,432
Slippage*	(6,698)	**(235)**	**2,323**	**664**	**475**
Leasing Budgets in Programme after Slippage	(223)	(125)	(45)	(572)	(29)
Total Capital Expenditure	31,544	**49,956**	**43,583**	**23,570**	**8,878**
Financed by:					
Capital Receipts	14,105	19,475	855	328	4,536
Capital Grants & Contributions	15,306	15,070	13,081	5,486	628
Capital Reserves	-	-	-	-	-
Revenue Provisions	2,061	6,959	61	4	0
Other Financing Sources	-	-	-	-	-
Net financing need for the year (a)	**72**	**8,452**	**29,586**	**17,753**	**3,714**

7.6.4 Whilst part of the additional expenditure is funded from the loan repayment, the bulk of the expenditure would be funded from internal borrowing. Based on current assumptions over the funding period this will just trigger the need to start to borrow externally in the financial year 2024/25.

7.6.5 The proposals contained in this report will result in the following revenue impact, interest on the loan has been included within investment interest netting off against the cost of borrowing:

Total Borrowing Costs Net of Investment interest

	2017/18 £000s	2018/19 £000s	2019/20 £000s	2020/21 £000s	2021/22 £000s
Original	12,229	10,917	12,290	12,917	13,114
Revised	12,229	11,195	13,161*	13,135	13,547**
Variance	0	278	871	218	433

* For the first three years of operation the Housing Company will capitalise the interest payable it impacts in this year as there is a large draw down of funding

** Assumes a lower rate of interest within the market – prior years have been adjusted for current performance

7.6.6 The main cause of the increase in borrowing costs is the £10 million acquisitions budget, this will cost an estimated £385k per annum. At present no income generation potential has been added for this scheme only the cost of servicing the debt.

7.6.7 Revising Prudential Indicators - The impact of the proposals in this report has been incorporated into the revised Treasury Management Strategy attached as Appendix 5j. All the prudential indicators have been reviewed and updated. The most pronounced impact is on the Authorised Limit for External Borrowing which has had to be increased by £20m in 2018/19 and £30m in 2019/20, because of the rise in the Capital Financing Requirement (CFR). The increase in the CFR is summarised in the table below:

Capital Financing Requirement	**2016/17 Estimate £'000**	**2017/18 Estimate £'000**	**2018/19 Estimate £'000**	**2019/20 Estimate £'000**
Original	189,978	181,644	192,997	193,274
Revised with Housing Company and Acquisitions Budget	189,978	189,864	211,412	219,158
Increase	0	8,220	18,415	25,883

8. LEGAL AND STATUTORY IMPLICATIONS

8.1 Legal advice has been provided by South London Legal Partnership (SLLP) and external lawyers Trowers&Hamlins. Legal advice has been sought on the type of company that is required, powers, ministerial statement, high level tax and VAT advice, the articles of the company (appendix 4), the shareholder agreement (Appendix 2), the governance arrangements and the contracting status of the company.

8.2 Powers

8.2.1 The council is able to use its general power of competence set out in section 1 of the Localism Act 2011 (the 2011 Act).

8.3 Ministerial Statement

8.3.1 Advice received from Trowers&Hamlins have given a clear steer that the Council is not currently at risk of contravening a Ministerial Statement, issued on 20 March 2015, which reviewed the progress made by Councils in increasing house-building and provided a warning that house-building by Councils should not be pursued in a way such as to undermine the Government's commitment to right-to-buy. The purpose of establishing the proposed company is what might be characterised as a commercial one. The Council wants to make the most of its assets and meet the potential for a return from its property-related activities.

8.4 Governance Arrangements

8.4.1 The company will be set up and governed as a wholly owned company of the Council. The company's day to day governance will be managed by a board of directors consisting of council nominated personnel, with a nominated shareholder representative present from time to time as part of the Council's governance arrangement.

8.4.2 As set out in the Recommendations a Sub-Committee of Cabinet will be established as the Council's shareholder board (See Appendix 2 – Shareholder Agreement) which will exercise the rights and responsibilities of the Council as shareholder (subject to paragraph 8.8 below) including, amongst other things agreeing and approving the company's annual business plan and funding arrangements and monitoring progress against the business plan on behalf of the council.

8.4.3 The sub-committee will also control "Reserved Matters", which are contained within the Shareholder Agreement; the list consists of decisions required from recruitment, acquisitions, and key financial decisions.

8.4.4 The Director of Environment and Regeneration will have delegated authority to take decisions on reserved matters in circumstances where the financial expenditure to be incurred, in any one instance, is below two hundred and fifty thousand pounds (£250,000).

8.5 Controlled Regulated Companies

8.5.1 The Local Government and Housing Act 1989 deals with companies: (a) under the control of local authorities; and (b) subject to local authority influence. The LAPC is likely to fall within one of these categories and will, therefore, be required to comply with the, relevant, provisions of the Local Authority (Companies) Order 1995.

8.6 Contracting Status and Procurement

8.6.1 The company will be wholly owned by the Council. It will be governed by the Council through a Cabinet Sub-Committee. For the purposes of European procurement rules it will be a 'contracting authority' and will, therefore, be required to comply with the public procurement regime in its procurement of goods, services and works which have contract values above the, relevant, threshold. This will include the procurement of contractors to develop out the sites.

8.6.2 However, the company will need to formulate its own procurement procedure for goods and services below the European threshold as it is a standalone commercially driven company, for example lettings, management and maintenance etc.

8.7 <u>Land</u>

8.7.1 In order to comply with both State Aid rules and HMRC requirements in relation to capitalisation the Council would fund the company through a mix of both equity and loan finance. The company would initially utilise sites from the Councils asset list (Appendix 3) paying the Council best consideration reasonably obtainable for the site as an equity stake in the company. The Council would transfer the sites, as and when required, to the LAPC and take equity in the company through the acquisition of shares to the full value of the land consideration. Transfer of the property at best consideration reasonably obtainable should satisfy the requirements of section123 of the Local Government Act 1972.

8.8 <u>Staffing</u>

8.8.1 In the initial set up stage council staff will be seconded to the company to carry out the work necessary to deliver the company's business plan, reviewed. Formal secondments agreements will be entered into between the Council and the LAPC in relation to such staff.

8.8.2 The seconded staff team would run the day to day management of the company; overseeing the design planning, procurement and construction process through strong project management processes and monitoring the performance of contracts such as letting and management agents.

8.8.3 The staff team would commission specialist consultants and contractors to undertake the detailed design, planning and implementations work.

8.9 The LAPC will contact with the Council through a series of SLAs for HR, finance, legal advice etc. The cost of staff and specialist support will be met by the LAPC.

8.10 <u>Contracting Services from the Council</u>

8.10.1 Any arrangement between the LAPC and the Council will need to be on commercial terms, so as not to contravene the rules on state aid, and to ensure that, in its interests, the company is not paying more for such services than it would have to pay on the open market.

8.11 <u>Shareholder Agreement</u>

8.11.1 A shareholder agreement usually regulates the relationship of shareholders with each other. In the case of the LAPC the shareholder agreement will be between the Council and the LAPC and will, amongst other things, identify those matters in respect of which the Council wishes to reserve decision-making and right of action to itself (See Appendix 2).

8.11.2 The Sub-Committee will control "Reserved Matters", which are contained within the Shareholder Agreement, the list consists of decisions required from recruitment, acquisitions, and key financial decisions. Please see Schedule 1 of the Shareholder agreement – Appendix 2 for the full list of reserved matters.

8.12 Articles

8.12.1 A company's Articles of Association (see Appendix 4 – Articles of Association), together with any special resolutions, comprise the company's constitution. The LAPC's articles will be based on the model set of Articles, for companies limited by shares, tailored to suit the LAPC. They will set out, amongst other things, the internal management structure of the LAPC; the procedures for appointing and removing directors and the conduct of meetings.

9. HUMAN RIGHTS, EQUALITIES AND COMMUNITY COHESION IMPLICATIONS

9.1 One of the key objectives of developing council owned sites is to increase the supply of housing to the market and support regeneration. The LAPC will generate a profit that will be returned back to the Council as revenue to fund much needed council services.

9.2 Although the LAPC's key objective is to generate a profit from professional segment in the rental market, the supply of affordable housing as part of the company's business plan is to assist the Council in meeting local housing needs.

10. CRIME AND DISORDER IMPLICATIONS

10.1 None for the purpose of this report.

11. RISK MANAGEMENT AND HEALTH AND SAFETY IMPLICATIONS

11.1 The land value of the portfolio will inevitably change as the design develops from the current early stage, and the timing of any land transfer will be critical. Officers have therefore provided a more detailed commentary on how the financial performance of the portfolio can be improved and how development risk can be mitigated up to the construction phase, as well as beyond that.

Opportunities to improve financial performance

11.2 The success of any development project relies upon proactive development management throughout the programme. If the project is approved by the Council's officers and any development partner(s) will continue to refine the development schemes, providing opportunities to improve their financial performance. Such opportunities include:

- Increasing the quantum of development through more detailed design, with architect input.
- Optimising unit mix and sizing to maximise sales and rental values.
- Refining the specification to optimise sales and rental income relative to development cost.
- Adjusting tenures based on updated assumptions about the performance of the portfolio, changes in market conditions and consider introducing new affordable tenure types e.g. starter homes.
- Seeking cost savings, with input from quantity surveyors and engineers
- Adjusting contingencies to reflect the level of risk appropriate to each stage of development.
- Transferring risk to parties best placed to manage them – such as through use of contractors / development partners.

- Adjusting the timing of each stage of development based on market conditions.

Opportunities to address potential deterioration in financial performance

11.3 Even after Cabinet approval, the LAPC will have multiple opportunities to address potential deterioration in financial performance compared to its business plan, including through delegated powers.

11.4 Prior to planning permission:

- Disposal of the site without planning permission if, for example, sites with greater potential become available, or land values increase substantially in a certain part of the Borough

11.5 Between planning permission and construction:

- Delaying start on site if, for example, the relationship between sales values and build costs worsens
- Disposal of the site with planning permission if, for example, tender returns for the construction works are too high
- Revision to planning permissions to further optimise financial performance if, for example, another use becomes more viable
- Investigating alternative delivery structures, to reduce construction risk and lower construction costs
- Applying for affordable housing grant if, for example, the scheme can no longer support the level of affordable housing committed in a Section 106 agreement

11.6 Throughout construction:

- Early marketing / forward sales of units earmarked for disposal, to reduce sales risk in a declining market
- Ongoing value engineering and contract variations, including the phasing of site development so that the programme can be paused or terminated

11.7 Post-construction:

- Disposal of completed units if, for example, rental values decrease or sales values increase relative to rental values
- Negotiating rental guarantees / other risk-sharing management arrangements
- Negotiating a leasehold ‘income strip’ agreement with an institutional investor, to reduce holding risks
- Further investment to reduce management and maintenance liabilities
- Temporary or permanent change in tenure mix to manage letting voids

11.8 Throughout the life of the LAPC:

- Removal or addition of sites if, for example, sites with greater potential become available
- Renegotiation of finance arrangements if, for example, rates can be reduced through refinancing through alternative sources, or interest can be reduced by early repayment.

Appendices – the following documents are to be published with this report and form part of the report

Appendix 1: Company Business Plan

Appendix 2: Shareholder Agreement

Appendix 3: Property Asset Management Board Sites List

Appendix 4: Articles of Association

Appendix 5:
- a) The use of Discounted Cash Flow (NPV) for Evaluation
- b) Caveats on the PwC Model
- c) Assumptions within the PwC Model
- d) Principal Repayment of Debt
  (Termed “Minimum Revenue Provision” within local authorities)
- e) Sensitivity Analysis
- f) Land Valuations
- g) Tax and VAT Advice
- h) The Council
- i) The Housing Company
- j) Revised Treasury Management Strategy

The use of Discounted Cash Flow (Net Present Value)for Evaluation

The proposed Local Authority Property Company (LAPC) structure involves the Council investing cash and available land as equity and providing loan finance sufficient to fund the company's development programme.

Cash flows between the Council and the LAPC will include cash injections to the company (loan and equity) and payments (of interest and dividend) back to the Council. Forecasts are based on a 30 year programme, though there will be options to close the company before or after that time.

To evaluate the viability of the scheme Merton has utilised a Price Waterhouse Coopers (PWC) Financial Model. Financial officers have worked with PWC and BBP (specialist property and economic development consultants). Net Present Value calculations have been added to the original model.

When evaluating cashflows over such a long term time frame it is necessary to adjust the value of cash flows based on when it is anticipated that the money would be received. Net Present Value (NPV) is ideal for long term projects such as the Housing Company as it allows for the value of the cashflows to be weighted in accordance with when they occur e.g. £1million received today is worth more than £1 million received in a year's time. The results of this analysis are shown below:

Total Cashflows Over the 30 Year Modelling Period

Item	£000s
Equity land transfer	(8,190)
Equity cash injection	(3,256)
LAPC (Loans) & repayments*	0
PWLB Loans & (repayments)*	0
PWLB Loan interest (paid)	(6,211)
LAPC Loan interest received	11,614
Dividend & share cap repayment	59,746
Net Value (Paid)/Recd in year	53,704
Discount factor	3%
Discounted Cash Flow (Net Present Value)	16,906

*These items net to zero over the modelling period, however, annual discounting calculations would include movements.

This calculation demonstrates a reasonable return on the money invested. The PwC model calculates the internal rate of return of 6.48%(Blended 6.39%)with the inflation assumptions stated in Appendix 5c, this calculation will be re-visited following sensitivity analysis (Appendix 5e) and adjusting the parameters to optimise the model's outputs.

Caveats on the PwC Model

The assessment of the viability of the company has been undertaken utilising a Price Waterhouse Cooper developed model which forecasts activity over a 30 year time span. There will be options to close the company before or after that time. This software has previously been used with other Local Authorities including several London Boroughs. The model is based on a commercially driven, arm's length company, wholly owned by the Council. As with any future forecasts assumptions have been made and PWC have place the following caveat on the model:

"The Model has been developed using data and assumptions from a variety of sources. PwC have not sought to establish the reliability of those sources or verified the information so provided, nor has the Model been audited by PwC. Accordingly no representation or warranty of any kind (whether express or implied) is given by PwC to any person (other than the Council in accordance with the Engagement) as to the internal consistency or accuracy of the Model nor any output from it. Moreover the Model does not absolve any recipient from conducting its own audit in order to verify its functionality and/or performance.

PwC accepts no duty of care to any person (except to the Council under the relevant terms of the Engagement) for the development of the Model, its use, nor in respect of any output from it. Accordingly, regardless of the form of action, whether in contract, tort or otherwise, and to the extent permitted by applicable law, PwC accepts no liability of any kind and disclaims all responsibility for the consequences of any person (other than the Council on the above basis) acting or refraining to act in reliance on the Model and/or its output or for any decisions made or not made which are based upon such Model and/or its output"

The specialist property information/inputs and assumptions used to populate the model and generate the base financial case have been provided by BBP Regeneration. This has included the provision of up to date market rental and sales values, up to date build costs, and estimated contingencies required for each of the four sites. As part of this work their report lists several pages of assumptions and data sources used.

Assumptions within the PwC Model

The Housing Company will require the following funding to be made available for it to draw down on to progress the four sites:

Financing	£m	Description
Land as equity	8.413	Land is transferred from LBM to the company in exchange for equity in the company. Detailed in Appendix 5f
Loan	13.022	The Council provides a loan to the company to cover the majority of the costs of construction
Cash Equity investment	3.256	The Council provides sufficient additional cash equity to the company in order ensure that the company's loan to value ratios is maintained at or below 70%-75%. This level of lending complies with state aid rules
Total	**24.691**	

In addition the following assumptions have been made:

Input	Commentary
Land	The first four sites have been selected and nominated through the Property and Assets Management Board, as sites surplus to requirements that have no school requirements.
Tenure Mix	The company will take the approach of a private developer, allowing only for 70/30 split of private rent to affordable.
Land cost	The land in the model has a red book (RICS) estimated value that is retained within the company as an equity stake.
Construction costs	The model requires the BCIS figures to be inputted which are based on market rates for development per square foot. In version two of the financial business plan real costs will be entered into the model from constructors.
Rental Income	Rental income is based on today's estimate plus inflation of 4.3% p.a. This is considerably higher than widely available forecasts for general United Kingdom inflation which is generally expected to be circa 2% (CPI).
Operating costs	Management, maintenance and lifecycle costs reflect industry norms. It has been assumed that council officers will be seconded to the company at this point for part of their time, e.g. 0.4 FTE. (The charge to the company, in relation to this, will be at commercial rates.)
Bad debts and voids	An allowance for 3.5% for bad debt and voids on residential rental income has been inputted into the model. No allowance has been made for commercial voids.
Input	**Commentary**
Interest	The interest rate which the Council will pay on its borrowing reflects PWLB rates in May 2016 plus 0.5%.Since this date the rate has dropped considerably to 1.85% as at September 2016. Interest on the loan to the company will be at market rates to ensure state aid compliance. The model assumes 6.5%, which would not change, the reduction in the PWLB rate will provide a greater return to the Council.
Loans	It has been assumed for the purposes of modelling that the loan will only be drawn down when required. It is not envisaged that the practical

	application of this assumption is viable.
Inflation factors	The inflation indicators used are as follows: CPI 2.5% (used for calculation of construction and operating costs), HPI 4.5% and Rent 4.3%. The long term government target from CPI is 2%.
Tax and VAT	Corporation tax, Land tax and VAT are incorporated into the model.

Principal Repayment of Debt (Minimum Revenue Provision (MRP))

Local authorities are required to make a minimum revenue contribution to debt each financial year this is called the Minimum Revenue Provision (MRP). The MRP charge is the means by which capital expenditure which is financed by borrowing or credit arrangements is paid for by council tax payers. Local Authorities are required each year to set aside some of their revenues as provision for this debt, the sum is calculated taking into account the useful life of the asset.

An authority's duty under regulation 28 of the 2003 Capital Finance Regulations (as amended) is to determine for each year an amount of MRP which it considers to be prudent. This clearly would limit an authority from setting an MRP that is too low to be prudent, but the key question is then whether the duty stops an authority from determining an amount that is over-prudent. If this is the case, then an authority does not need to charge MRP in cases where no contribution towards prudence would be made.

This is particularly relevant to loans to other parties. Under proper accounting practices, loans are not expenditure and only become so when an allowance might need to be made where repayment becomes doubtful. From a financing point of view, it would be prudent not to set aside resources for capital loans – whilst the expectation remains that they will be repaid, an authority will just have exchanged one asset (cash) for another (debtor). However, as capital loans have the same effect on an authority's underlying need to borrow as its own capital expenditure, regulation 25(1)(b) of the 2003 Regulations brings them within the scope of the definition of capital expenditure, with the intention that capital loans will be limited in the same way as "normal" capital expenditure. The Statutory Guidance on MRP (here) then has an expectation in paragraphs 23 and 24 that if capital loans are not financed from capital receipts or grants MRP will be provided over the estimated life of the assets in relation to which the third party expenditure is incurred. When the loan is repaid, the repayments will be capital receipts, which are usually then applied to discharge the outstanding financing requirement and give a "refund" of the MRP made to date (albeit in the form of increases in capital receipts rather than a credit back to revenue).

The argument is how the Government expectation sits with an authority's over-riding duty. The Statutory Guidance is clearly intended to limit increases in an authority's borrowing by generating a revenue charge that wouldn't otherwise be needed, whereas the authority's duty is to manage its underlying need to borrow prudently (which does not require a revenue charge, except for doubtful debts). As the Government intention would lead to an authority setting aside more than it needs to maintain a prudent position, authorities have two options:

- Accept that the Statutory Guidance supplements the statutory duty and bring capital loans within the authority's MRP arrangements per the Statutory Guidance
- Reject the Statutory Guidance as being contrary to the statutory duty and not make MRP for capital loans

As the second of the options requires the Statutory Guidance to be disregarded, an authority taking it up would need to demonstrate that it had had regard to the Guidance but decided that it was not appropriate in this instance. The Informal Commentary on the Guidance acknowledges that departures may be justified. However, paragraph 14 does say that. Officers are seeking the advice of Legal Services and External Audit to determine acceptable treatment. Depending on the outcome of this consultation will determine whether or not the narrated approach to MRP will need to be amended.

In summary, there is a possibility that MRP does not have to be charged on capital loans, but in order to take up this option an authority must have assured itself that it would be reasonable to disregard the expectations of the Statutory Guidance in the light of the authority's duty to determine a prudent charge. There is anecdotal evidence to suggest a growing number of authorities are finding themselves able to take such a position.

Form of MRP

If the Council determines that it should make MRP for a capital loan, there is still flexibility to schedule how it might be made. The Statutory Guidance confirms an expectation that charges will be based on the period that the public will benefit from any assets acquired by the borrower as a result of the loan, not the repayments agreed. Under this expectation, there is no reason as to why MRP would match the profile of principal repayments by the borrower (especially as MRP will be a charge to revenue but the principal repayments will be credited to the Capital Receipts Reserve).

Deferring an MRP charge would be reasonable if the agreement with the company to repay principal reflected a situation that it will not be creating any substantial operational assets until after the first three years. Similarly, an MRP that is skewed to the later years of the loan may be appropriate if the benefits generated by the investment increase during the years that the loan is outstanding.

Investment in a Company

If the Council were to acquire an investment in the company rather than provide it with loans, the same discussions about the need for MRP apply as to capital loans. Regulation 25 defines the acquisition of share capital as capital expenditure, and paragraph 24 of the Statutory Guidance sets an expectation that MRP will be provided for the investment over a maximum of 20 years, despite the fact that under proper accounting practices no expenditure will have occurred (a cash asset being exchanged for an investment).

MRP and PWLB Repayments

PWLB repayments can be made at any time, provided that the Council has sufficient cash balances to meet the payment. When principal repayments are made under a capital loan, these will be capital receipts, to be paid into the Capital Receipts Reserve. If these receipts are posted into the Capital Adjustment Account, the cash that backed them will effectively become available to support cash out flows to the PWLB. There is not necessarily any direct connection, however. MRP reduces an authority's overall underlying need to borrow. Whether borrowing is actually reduced depends on wider consideration of the authority's treasury position.

MRP if applicable to the scheme

If MRP does apply the Council will need to make provision from revenue for the repayments of the loan principal and well as paying for the interest on the loan, however, the repayment of principal from the housing company will need to be treated as a capital receipt and therefore could not be used for this purpose as such if this is the case the Council would require income from the housing company of at least the interest rate changed by PWLB plus 5 percentage points.

It would be prudent to ensure that repayments to the Council on loan(s) taken out by the LAPC cover the repayments of Council borrowings from the PWLB to fund both the loan to the company and the cash equity invested in the company.

Loans made by PWLB and the Council can be structured on an annuity basis and satisfy this requirement. A Minimum Revenue Provision each year for the repayment of debt connected to PWLB loans would be based on a 20 year annuity loan. Interest at 6.5% on £13.022m loan to the LAPC covers the repayments of Council loans from the PWLB of £16.278m at 3.26%.

Sensitivity Analysis

Officers have received training on the PwC Model and received a final copy of the model on 1 December 2016. The model is similar to that developed in-house to model the funding scenarios for the capital programme. The following sensitivity analysis has been undertaken:

1. Increasing price inflation from 2.5% to 4.5%
2. Reducing income inflation from 4.5% and 4.3% to 2.5%
3. Varying the interest on the loan:
   a. Reducing the loan interest by 0.5%
   b. Increasing the loan interest by 0.5%

BBP information in respect of the selling and rental income for the 3Mitcham sites appear high when checking local property information, reducing this income will reduce the profitability of the company.

Land Valuation

The council is under an obligation under s123 of the Local Government Act 1972 when disposing of an interest in land to obtain best consideration reasonably obtainable. The Authority's valuer has valued the 4 sites being progressed by the Housing Company as:

Site	Market Value	Total Units	Affordable Housing	
	£000s		Number	%
Farm Road Church	553	9	4	44%
Land at the Canons	3,355	22	5	23%
Raleigh Gardens	2,453	22	2	9%
Elm Nursery Car Park	2,052	24	9	38%
Total	**8,413**	**77**	**20**	**26%**

Best consideration for these sites would be the market value. The valuation guidance provides no allowance for the impact of affordable housing on the site value.

Tax and VAT Advice in relation to the Housing Company

Generally, limited companies are considered not to be the most tax efficient vehicles for investment by local authorities, as local authorities do not pay corporation tax whilst a limited company pays corporation tax on its profits and can only declare dividends out of its net-of-tax profits.

However, the council will be able to make management charges, to the company, for staff time and costs and the company will be able to deduct such costs from profits before tax.

In terms of VAT, the company will be unable to recover VAT for repairs in the way the council does. Renting properties is an exempt activity for VAT purposes, however landlords pay VAT on repairs. The company would also be liable for council tax on any void periods.

Stamp Duty Land Tax ("SDLT") on land transfers: SDLT is payable on transfer/disposal of land. Where the purchaser of land is connected with the vendor SDLT is payable on the market value of the land (or the consideration given if higher).

The LAPC may well be "connected" with the Council on the basis that the Council controls the LAPC. However, it might be possible to obtain group relief from SDLT in respect of the land transferred to the LAPC from the Council. Two companies (or in this case the LAPC and a body corporate (the Council) will be in the same SDLT group if one is the parent of the other.

A company is the parent of another if it is the beneficial owner of at least 75 per cent of the ordinary share capital of the other and it is beneficially entitled to at least 75 per cent of any profits available for distribution. As the Council is proposed to be the sole shareholder of all of the paid up share capital, SDLT group relief should be available so there would be no SDLT payable on land transfer from the Council to the LAPC.

The Council

The council will receive the interest from the company on the loan and dividends from the company's profits from the cash equity investment. In order for the council to loan the £13.022m to the company and provide £3.256m cash equity, cash reserves maybe used or loan(s) of £16.278m would be required from the PWLB.Modelling has prudently assumed a PWLB Loan will be required. PWLB interest charges to the Council and interest receipts are set out in Tables over the page:

LBM Balance Sheet - Years 1 to 5 (£'000)

Item	Year 0 (£'000)	Year 1 (£'000)	Year 2 (£'000)	Year 3 (£'000)	Year 4 (£'000)	Year 5 (£'000)
Cash	0	(0)	0	0	0	0
Land	(8,413)	(8,190)	(8,190)	(8,190)	(8,190)	(8,190)
Investment	8,413	640	7,373	13,966	10,301	10,315
Long Term Debtor	0	8,345	9,965	11,446	11,446	11,446
Long Term Loan (LAPC)	0	(788)	(9,046)	(16,864)	(12,840)	(12,603)
Net Asset Impact (Surplus/(Deficit) excl MRP	0	8	102	358	716	968
Capital Receipt	0	0	0	0	2,707	0
NET ASSET IMPACT (Surplus/(Deficit) with MRP	0	8	102	358	3,424	968

LBM Balance Sheet Impact in 5 Years Periods

Item	Year 5 (£'000)	Year 10 (£'000)	Year 15 (£'000)	Year 20 (£'000)	Year 25 (£'000)	Year 30 (£'000)
Cash	0	0	0	0	4,018	74,298
Land	(8,190)	(8,190)	(8,190)	(8,190)	(8,190)	(8,190)
Investment	10,315	9,881	8,298	5,540	905	0
Long Term Debtor	11,446	11,446	11,446	11,446	11,446	0
Long Term Loan (LAPC)	(12,603)	(10,801)	(7,721)	(2,878)	0	0
Net Asset Impact (Surplus/(Deficit) excl MRP	968	2,336	3,832	5,917	8,179	66,108
Capital Receipt	2,708	434	1,583	2,758	4,634	905
NET ASSET IMPACT (Surplus/(Deficit) with MRP	3,676	2,770	5,416	8,675	12,813	67,013

The base model incorporates a repayment profile that prioritises early debt repayment starting in year 4 and covers 22 years. An annuity loan over 20 years is a preferred option as it involves simple, equal annual payments to the Council, meets statutory requirements and includes interest and principal.

Further guidance is being sort regarding whether Minimum Revenue Provision will apply to this type of investment. This is discussed in Appendix 5d. This would not undermine the viability of the scheme.

The Housing Company

The company will plan to maximise profits and provide an ongoing income stream back to the council. Construction will be undertaken in the first 3 years and non-PRS properties will be sold when complete to registered providers,the remaining PRS properties will be rented at market rates.

The forecasts show an in year deficit in the first 4 years, whilst the planning and construction work take place. Profits arise in year 3 when completed social housing is sold and increases steadily over the remaining years when PRS properties are rented. Distributions culminate in a final dividend of accumulated profits in year 30.Interest has been rolled up in the first years in the model, though immediate payment of interest could provide the Council with a margin on interest at the outset but will require high borrowing initially.

The tables below show income and expenditure for the proposed company over the first 5 years and in 5 year blocks over the modelled life of the company.

LAPC Income and Expenditure Impact - Years 1 to 5

Item	Year 0 (£'000)	Year 1 (£'000)	Year 2 (£'000)	Year 3 (£'000)	Year 4 (£'000)	Year 5 (£'000)
Profit on sales	0	(200)	0	(1,001)	(800)	0
Net rental income	0	0	120	723	622	655
Net Interest/(Cost)	0	(101)	(137)	(301)	(908)	(655)
Interest income on surplus cash balance	0	0	0	0	0	0
Profit/(Loss) before tax	0	(301)	(17)	(579)	(1,086)	(0)
Corporation tax	0	0	0	0	0	0
Profit/(Loss) after tax	0	(301)	(17)	(579)	(1,086)	(0)
Dividends	0	0	0	0	0	0

LAPC Income and Expenditure Impact in 5 Years Periods

Item	Year 0-5 (£'000)	Year 6-10 (£'000)	Year 11-15 (£'000)	Year 16-20 (£'000)	Year 21-25 (£'000)	Year 26-30 (£'000)
Profit on sales	(2,000)	0	0	0	0	51,126
Net rental income	1,581	3,838	4,949	6,350	8,110	10,343
Net Interest/(Cost)	(1,563)	(3,319)	(3,042)	(2,373)	(1,257)	(59)
Interest income on surplus cash balance	0	0	0	0	0	0
Profit before tax	(1,982)	518	1,908	3,977	6,852	61,410
Corporation tax	0	(85)	(324)	(676)	(1,165)	(10,687)
Profit after tax	(1,982)	434	1,583	3,301	5,687	50,723
Dividends	0	0	(35)	(676)	(1,165)	(69,316)

LAPC Balance Sheet - Years 1 to 5 (£'000)

Item	Year 0 (£'000)	Year 1 (£'000)	Year 2 (£'000)	Year 3 (£'000)	Year 4 (£'000)	Year 5 (£'000)
Land	0	8,190	4,074	0	0	0
Cash	0	(0)	(0)	(0)	(0)	(0)
Capitalised interest	0	20	272	851	668	682
WIP/Stock	0	136	3,379	4,567	0	0
Investment properties	0	337	9,295	19,097	19,097	19,097
Capitalised veh costs	0	0	0	0	0	0
Corp tax creditor	0	0	0	0	0	0
Long term loan	0	(640)	(7,373)	(13,966)	(10,301)	(10,315)
Equity cash element	0	155	1,775	3,256	3,256	3,256
Equity land element	0	8,190	8,190	8,190	8,190	8,190
P&L Reserve	0	(301)	(318)	(897)	(1,982)	(1,982)

Note: The loan from the Council is fully repaid after 20 years. Corporation tax is largely deferred until PRS stock is revalued at the end of the planned programme and therefore subject to the rates of corporation tax at that time.

LAPC Balance Sheet - Years 1 to 30 (£'000)

Item	Year 5 (£'000)	Year 10 (£'000)	Year 15 (£'000)	Year 20 (£'000)	Year 25 (£'000)	Year 30 (£'000)
Land	0	0	0	0	0	0
Cash	(0)	33	54	(0)	(0)	9,328
Capitalised interest	682	682	682	682	682	(0)
WIP/Stock	0	0	0	0	0	0
Investment properties	19,097	19,097	19,097	19,097	19,097	0
Capitalised veh costs	0	0	0	0	0	0
Corp tax creditor	0	(33)	(89)	(169)	(281)	(9,328)
Long term loan	(10,315)	(9,881)	(8,298)	(5,540)	(905)	0
Equity cash element	3,256	3,256	3,256	3,256	3,256	3,256
Equity land element	8,190	8,190	8,190	8,190	8,190	8,190
P&L Reserve	(1,982)	(1,548)	0	2,624	7,147	(11,446)

Note: The commercial lending rate for the loan to the company has been modelled at 6.5%.

Dividends become payable on realised profits and have been modelled to start in Year 15 in relation to PRS rental profits. There is a stepped increase in dividend in year 27 when all the debt has been repaid

Liquidity - The model assumes optimum cash flows, with no significant cash holdings. Working capital will be required but detailed drawdown arrangements for Council loans will enable this to be operated at an optimum level.

Advice from Price Waterhouse Coopers has been to agree a loan facility and draw down on a cash flow model ensuring that neither the company nor the council lends money before it’s required and incur unnecessary interest charges. It is intended that advances and repayments will be implemented on a commercial basis and a cash balance will be maintained to ensure sufficient liquidity in the company. The loan percentage of 6.5% represents limited flexibility on drawn down arrangements which would be detailed in the loan agreement. Greater flexibility would trigger a higher interest rate. This will be considered as part of the sensitivity analysis.

Land values - The model has been based on land values calculated on a market value. It is recommended that an independent valuation of the four sites is obtained.

LONDON BOROUGH OF MERTON
TREASURY MANAGEMENT POLICY STATEMENT

1. INTRODUCTION

1.1 Background

London Borough of Merton have adopted the Chartered Institute of Public Finance and Accountancy (CIPFA) definition of Treasury Management, which is:

> *"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."*

The Council is required to update and approve its policy framework and strategy for treasury management, annually, to reflect the changing market environment, regulation, and the Council's financial position. The key issues and decisions are:

a) To set the Council's Prudential Indicators for 2017/18 to 2019/20
b) Approve the Minimum Revenue Provision (MRP) policy for 2017/18; and
c) To agree the Treasury Management Strategy for 2017/18. This will include the annual investment strategy, containing the parameters of how the investments are to be managed.

1.2 Statutory Requirement

The Local Government Act 2003 (the Act) as amended and supporting regulations, require the Council to 'have regard to'

(a) such guidance as the Secretary of State may issue; and
(b) such other guidance as the Secretary of State may by regulations specify for the purposes of this provision

http://www.legislation.gov.uk/ukpga/2003/26/section/15

The Guidance requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy. The Council has adopted CIPFA's revised Code of Practice on Treasury Management.

1.3 Balanced Budget Requirement

Section 33 of the Local Government Finance Act 1992 requires the Council to set a balanced budget. This means that cash raised during the year will meet cash expenditure. Part of the treasury management function is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Cash yet to be used are invested in low risk and good credit quality counterparties or instruments with the consideration first for security, liquidity and yield.

The other main function of treasury management is the funding of the Council's capital plans. These capital plans provide a guide to the long or short-term borrowing need of the Council, essentially the longer term cashflow planning, to ensure that the Council can meet its capital spending obligations. The management of longer term cash may involve arranging long or short dated loans, or using longer term cashflow surpluses. Subject to S151 Officer's approval, any debt previously drawn may be restructured or repaid to meet the Council's risk or cost objectives.

1.4 Treasury Management Strategy for 2017/18

The strategy for 2017/18 covers two main areas:

Capital Issues

- To determine the Council's capital plans and prudential indicators for 2017/18 to 2019/20;
- To approve the Minimum Revenue Provision (MRP) policy for 2017/18.

The LG Act 2003 require local authorities to set an affordable borrowing limit (http://www.legislation.gov.uk/ukpga/2003/26/section/3).

Treasury Management Issues

- To agree the Council's treasury management strategy for 2017/18
  - current treasury position as at 30 November 2016;
  - treasury indicators which limit the treasury risk and activities of the Council;
  - prospects for interest rates;
  - borrowing strategy;
  - policy on borrowing in advance of need;
  - debt rescheduling and early repayment of debt review;
  - Annual Investment Strategy and alternative investment instruments (Policy on new lending and borrowing instruments);
  - creditworthiness policy;
  - Treasury Management Practices (**Appendix 5**);and
  - cash flow policy

These elements cover the requirements of the Local Government Act 2003, the CIFPA Prudential Code, the Communities and Local Government (CLG) MRP Guidance, the CIPFA Treasury Management Code and the CLG Investment Guidance.

2. CURRENT TREASURY POSITION

2.1 Use of the Council's Resources and the Investment Position

The application of resources (capital receipts and reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources, for example, asset sales.

The table below shows the position as at 30 November 2016.

Year End Resources	**2015/16 Actual £'000**	**30 November 2016 Actual £'000**	**31 March 2016/17 Estimate £'000**	**31 March 2017/18 Estimate £'000**
Investments	85,400	107,200	79,166	58,381
Interest on investments	1,140	451	1,262	1,186
Borrowing				
Long-term Borrowing	116,976	116,976	116,976	113,010
Short-term Borrowing				
Total External Debt	**116,976**	**116,976**	**116,976**	**113,010**
Interest on External Debt				
Long-term	6,686	6,702	6,702	6,315
Short-term	1	1		
Total Interest on External Debt	**6,687**	**6,703**	**6,702**	**6,315**

Interest on investments figures above do not include interest from policy investments.

3. CAPITAL PRUDENTIAL INDICATORS 2017/18 - 2020/21

The Council is required to calculate various indicators for the next 3 years. The aim of prudential indicators is to ensure that the Council's capital investment plans are affordable, prudent and sustainable. The prudential indicators set out in **Appendix 6** are calculated for the Medium Term Financial Strategy (MTFS) period. The indicators relate to capital expenditure, external debt and treasury management.

The Council will monitor performance against the indicators and prepare indicators based on the Statement of Accounts (SoA) at year end.

3.1 Capital Expenditure

The Council's capital expenditure plans are fundamental to its treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, which are designed to provide Council members an overview and confirm the impact of capital expenditure plans.

This indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle as reported in the MTFS. Environment and Regeneration figures include projects relating to Public Health programs however these are fully funded and do not have any MRP implications.

Members are asked to approve the capital expenditure forecasts:

Capital Expenditure	2015/16 Actual £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
Children Schools & Families	14,348	13,396	12,920	12,116	6,236	650
Community & Housing	1,355	1,951	1,334	629	280	630
Corporate Services	2,466	8,975	17,596	11,812	9,882	2,135
Environment & Regeneration	10,910	14,143	18,466	16,748	7,080	5,017
	-	-	-	-	-	-
Total	**29,079**	**38,465**	**50,316**	**41,305**	**23,478**	**8,432**

The above financing need excludes other long-term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.

The table below shows how the capital expenditure plans are being financed by revenue or capital resources. A shortfall of resources means a borrowing need. The capital programme expenditure figures used in calculating the financing costs have been adjusted for slippage in the programme as at 30 November 2016.

Capital Expenditure	2015/16 Actual £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
Capital Expenditure	**29,079**	**38,465**	**50,316**	**41,305**	**23,478**	**8,432**
Slippage*	-	-6,698	-235	2,323	664	475
Leasing Budgets in Programme after Slippage		-223	-125	-45	-572	-29
Total Capital Expenditure	29,079	31,544	49,956	43,583	23,570	8,878
Financed by:						
Capital Receipts	9,082	14,105	19,475	855	328	4,536
Capital Grants & Contributions	18,869	15,306	15,070	13,081	5,486	628
Capital Reserves	607	-	-	-	-	-
Revenue Provisions	429	2,061	6,959	61	4	0
Other Financing Sources	-	-	-	-	-	-
Net financing need for the year	**92**	**72**	**8,452**	**29,586**	**17,752**	**3,714**

*In the above table slippage includes slippage in from the previous year and out to the following year.

3.2 The Council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator, Capital Financing Requirement (CFR), is the total historical outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. In other words, a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR includes any other long-term liabilities like PFI schemes and finance leases which have been brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, it should be noted that these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes.

The Council has no Housing Revenue Account (HRA) and no new PFI scheme in 2017/18 is expected. Public Health capital projects are fully funded therefore have no CFR implications. The 2016/17 forecast movement in CFR shows a decrease of £8,638k because the expenditure to be funded from borrowing in 2016/17 is less than the amount of MRP charged in the year.
The current cashflow projection as at 30 November 2016 for 2016/17 year end is an estimated cash balance of £79.6m. The current forecast has been based on assumptions in the MTFS and capital programme spend forecast after slippage. The 2016/17 forecast £31.5m, 2017/18 £49.9m, and 2018/19 £43.6m are based on best estimates which may slip due to unforeseen circumstances and the nature of large projects and the level of grant income. Also, fees and charges for the Council may change. Based on current forecasts the earliest the Council may borrow is in 2017/18 in anticipation for 2018/19. However, the Council can borrow in advance of need if rates fall and borrowing becomes a lot more advantageous than it currently is.

The Council is asked to approve the CFR projections in the following table:

	2015/16 Actual £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
Capital Financing Requirement						
CFR (non-housing)	198,616	189,978	189,864	211,412	219,158	213,145
Total CFR	**198,616**	**189,978**	**189,864**	**211,412**	**219,158**	**213,145**
Movement in CFR	**(9,210)**	**(8,638)**	**(114)**	**21,548**	**7,746**	**(6,013)**
Movement in CFR represented by						
Net financing need for the year (above)	92	72	8,452	29,586	17,753	3,714
Less Capital MRP/VRP	7,587	7,154	7,004	6,579	7,634	7,987
Less Other MRP/VRP (leasing, PFI)	1,118	916	876	724	1,585	897
Less Other MRP/VRP – PFI – Partial termination	597	640	686	735	788	844
Less Other financing movements • Adjustment of PFI Liability • Adjustment of MRP						
Movement in CFR	**(9,210)**	**(8,638)**	**(114)**	**21,548**	**7,746**	**(6,013)**

Actual and estimates of the ratio of financing costs to net revenue stream
This indicator identifies the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream. The indicator shows the proportion of the income received from Council tax, Revenue Support Grant (RSG) and National Non-Domestic Rate (NNDR) that is spent on paying the borrowing associated with delivery of capital investment i.e. principal and interest charges of long-term borrowing.

The table below shows the monetary values for the above ratio

	2015/16 Actual £'000	**2016/17 Estimate £'000**	**2017/18 Estimate £'000**	**2018/19 Estimate £'000**	**2019/20 Estimate £'000**	**2020/21 Estimate £'000**
Net Revenue Financing Costs	19,575	16,731	16,791	16,074	18,908	17,465
Net Financing Stream	155,662	148,139	146,066	139,664	137,453	133,999
Ratio of Financing Costs to Net Revenue Stream (Non HRA)	12.58%	11.29%	11.50%	11.51%	13.76%	13.03%

Estimates of the incremental impact of capital investment decisions on council tax.

The table below shows the incremental impact of changes in the capital programme (incorporating the effects of changes in treasury forecasts and investment decisions) on the band D Council tax. Council tax has remained the same since 2011/12 therefore there has been little or no incremental impact on Council tax band D properties.

	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Incremental Change in Capital Financing Costs (£000)	3,020	-2,844	60	-717	2,835	-1,443
Council Tax Base	69,638	71,327	72,442	72,805	73,169	73,534
Incremental Impact on Council Tax - Band D* (£)**	**43.36**	**-39.87**	**0.84**	**-9.85**	**38.74**	**-19.63**
Council Tax - Band D (£)	1,106.56	1,106.45	1,139.71	1,173.90	1,197.38	1,221.33

***2015/16 is actual council tax amounts, 2016/17 are actual. However the Council tax base for future years is per the MTFS.

4. MINIMUM REVENUE PROVISION (MRP) POLICY STATEMENT

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP). The Council has not made any provision for VRP in its capital expenditure.

For capital expenditure incurred before 1 April 2008 or by Supported Capital Expenditure, the MRP policy follows CLG regulations (option 1). This provides for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be based on the Asset Life Method – CLG regulations (option 3).

This option will be applied for any expenditure capitalised under a capitalisation direction. It should be noted that this option provides for a reduction in the borrowing need over the approximate life of the asset.

The Council is required to have regard for the Local Government Involvement in Health Act 2007. This amended the Local Government Act 2003 enabling the Secretary of State to issue guidance on accounting practices and thus on MRP. Also, the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended) specifies that “A local authority shall determine for the current financial year an amount of minimum revenue provision which it considers to be prudent”. Any MRP implications on how the Council will pay for unfinanced capital assets through revenue will be included in the MRP policy.

Category	Depreciation (Years)
Assets valued over £1m	
Buildings	50
Mechanical & Electrical	20
External	20
Assets valued under £1m	
Buildings	40
Infrastructure (roads etc)	25
15 Year Asset	15
10 Year Asset	10
Computer software	5
Computer hardware	5
Large vehicles – e.g. buses, RCVs	7
Small vehicles – e.g. cars, vans	5
Other equipment e.g. CCTV	5

MRP years where there is no depreciation equivalent	
Land	50
Revenue Expenditure Funded by capital Under Statute e.g. Redundancy costs	20

5. TREASURY MANAGEMENT STRATEGY

5.1 The Prospects for Interest Rates and Economic Forecasts

Consideration is given to economic and interest rate forecasts because they provide likely investment rates (bank rates), likely borrowing rates (PWLB), credit risk profile thereby giving some latitude on when to borrow, repay and invest. However as with every forecast there is also the likelihood of economic factors not following forecasts.

The following table gives the central position on the Council's treasury management adviser's view on interest rates.

Annual Average %	Bank Rate (%)	PWLB Borrowing Rates (%)			
		5 year	10 year	25 year	50 year
March 2017	0.25	1.60	2.30	2.90	2.70
June 2017	0.25	1.60	2.30	2.90	2.70
Sept 2017	0.25	1.60	2.30	2.90	2.70
Dec 2017	0.25	1.60	2.30	3.00	2.80
March 2018	0.25	1.70	2.30	3.00	2.80
June 2018	0.25	1.70	2.40	3.00	2.80
Sept 2018	0.25	1.70	2.40	3.10	2.90
Dec 2018	0.25	1.80	2.40	3.10	2.90
March 2019	0.25	1.80	2.50	3.20	3.00
June 2019	0.50	1.90	2.50	3.20	3.00
Sept 2019	0.50	1.90	2.60	3.30	3.10
Dec 2019	0.75	2.00	2.60	3.30	3.10
Mar 2020	0.75	2.00	2.70	3.40	3.20

Source: Capita Asset Services

The above forecasts reflect broad stimulus measures the Bank of England's Monetary Policy Committee (MPC) took following the vote for the UK to exit the EU (Brexit) at the Referendum on 23rd June 2016, including a cut in base rate from 0.50% to 0.25% on 4th August 2016. Since then, economic statistics suggest that the sharp fall in Sterling strengthened growth and raised inflation forecasts significantly.

During the two-year period (2017 – 2019) post triggering of Article 50, when the UK is negotiating the terms for withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects already adversely impacted by the uncertainties of Brexit. Accordingly, a first increase to 0.50% is not tentatively pencilled in, as above, until Q2 2019, after those negotiations have been concluded, (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases within the UK), were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

Economic forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.
The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. An eventual world economic recovery may also see investors switching from the safe haven of bonds to equities.
The overall balance of risks to economic recovery in the UK remains to the downside.

PWLB rates and gilt yields have been experiencing exceptional levels of volatility that are highly correlated to geo-political, sovereign debt crisis and emerging market developments.

Apart from the above uncertainties, downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Monetary policy action by central banks reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some major developed economies, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.

- Major national polls:
    - US presidential election was held on 8th November 2016. Bank funding costs have risen since the US election and markets believe the policies of Mr Donald Trump, the President-elect, could push up interest rates;
    - Italian constitutional referendum was held on 4th December 2016 with the Prime Minister, Matteo Renzi resigning after his defeat sparking fears about the stability of the Italian banking system;
    - Spain has held two inconclusive general elections and is still unable to form a workable government with a coalition holding a majority of seats; the impasse could lead to a third general election – currently tentatively scheduled for 25th December 2016;
    - Dutch general election 15th March 2017;
    - French presidential election April/May 2017;
    - French National Assembly election June 2017;
    - German Federal election August – October 2017.

- A resurgence of the Eurozone sovereign debt crisis.

- Weak capitalisation of some European banks.

- Geopolitical risks in Europe, the Middle East and Asia, increasing safe haven flows.

- UK economic growth and increases in inflation are weaker than we currently anticipate.

- Weak growth or recession in the UK's main trading partners - the EU and US.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates, include: -

- UK inflation rising to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium in gilt yields.

- A rise in US Treasury yields as a result of Fed funds rate increases and rising inflation expectations in the USA, pushing UK gilt yields upwards.

- The pace and timing of increases in the Fed funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.

- A downward revision to the UK's sovereign credit rating undermining investor confidence in holding sovereign debt (gilts).

5.2 Borrowing Strategy

Current Borrowing Portfolio Position

The table below shows the CFR as at 30 November 2016 against the gross debt position of the Council. The gross debt includes other long-term liabilities like PFI and finance lease obligations. Gross debt should not exceed CFR in the medium to long-term.

Estimated debt may change as the capital programme spends and financing changes. The lease balances do not include adjustments for new implications in 2016/17.

	2015/16 Actual £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
External Debt at 1 April	116,976	116,976	116,976	113,010	113,010	113,010
Expected change in Debt (repayment and new debt)****	0	0	(3,966)	0	0	(2,000)
Closing External Debt	**116,976**	**116,976**	**113,010**	**113,010**	**113,010**	**111,010**
PFI Balance b/f	19,524	18,664	17,959	17,164	16,480	14,926
In year movement	-860	-705	-795	-684	-1,554	-805
Closing Balance PFI	**18,664**	**17,959**	**17,164**	**16,480**	**14,926**	**14,121**
PFI Partial Termination Balance b/f	15,210	14,613	13,973	13,287	12,552	11,764
In year movement	-597	-640	-686	-735	-788	-844
Closing Balance Partial Termination PFI	**14,613**	**13,973**	**13,287**	**12,552**	**11,764**	**10,920**
TOTAL PFI	**33,277**	**31,932**	**30,451**	**29,032**	**26,690**	**25,041**
Finance Leases at 1 April	219	211	81	39	31	92
Expected Change in Finance Leases	-8	-130	-42	-8	60	42
Closing Balance Finance Leases	**211**	**81**	**39**	**31**	**92**	**134**
Salix Loan	**44**	**34**	**25**	**15**	**5**	**0**
Salix in year movement	**-10**	**-10**	**-10**	**-10**	**-5**	**0**
Closing Balance Salix	**34**	**25**	**15**	**5**	**0**	**0**
Actual gross debt at 31 March	**150,498**	**149,014**	**143,515**	**142,078**	**139,792**	**136,185**
Capital Financing Requirement	**198,616**	**189,978**	**189,864**	**211,413**	**219,158**	**215,902**
(Under)/over borrowing	**-48,118**	**-40,964**	**-46,349**	**-69,335**	**-79,366**	**-79,717**

****£3.966m of long-term debt matures in 2017/18

The table above shows the CFR forecast for 2016/17 to 2020/21. Also, there is no maturing debt until 2017/18 hence little borrowing pressure therefore the Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the CFR), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cashflow has been used as a temporary measure. PFI and finance lease portion of the CFR will not be funded by additional loan. Capital forecasts relating to 2018/19, 2019/20 and 2020/21 are very much subject to change at this stage.

The Council's decision to use internal borrowing is prudent as it eliminates the revenue cost of carry as investment returns remain low, there is sometimes slippage on capital programme budgets and counterparty risks remain to a degree. The Council can fund its entire borrowing requirement now if this is affordable. In which case, borrowing will be up to CFR.

Borrowing interest rates have been on a downward trend since 2016. Against this background, the Director of Corporate Services will continue to monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances to maximise short-term savings. However when interest rates begin to rise, the Council will consider borrowing in advance of need than current forecast requirements show. The duration of loans will be driven by the current loan portfolio, affordability, the position on internal borrowing and borrowing rates. The policy of avoiding new borrowing by using spare cash balances, has served well over the last few years. However, this needs to be reviewed carefully to avoid incurring higher borrowing costs in future when the Council will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt.

Council's Year End Balance Sheet Position at 31 March 2016

	2014/15 £'000	2015/16 £'000	Change £'000
CFR	207,826	198,616	9,210
PFI and LEASES	**-35,553**	**-34,123**	**-1,430**
Underlying Borrowing Requirement	**172,273**	**164,493**	**7,780**
External Borrowing	116,676	116,976	300
Under borrowing / Internal borrowing to date	-55,597	-47,517	-8,080

Strategy to 'Unwind' Internal Borrowing

Internal borrowing at 31 March 2016 remains at sustainable levels. However, the Council will commence a review of its strategy to 'unwind' internal borrowing.

Debt Liability Benchmarking

In defining its borrowing strategy, the Council considered the true characteristics of all of the debt instruments in its portfolio, most especially the LOBOs and the various options available to the Council.

Consideration was given to the fact that in the current economic climate the LOBOs in the Council's portfolio will not be called due to their very high interest rate. Should they be called, replacement borrowing will not be required because the council will have cash available in 2017/18 to meet the call options based on the current estimates of the use of internal borrowing for the capital programme.

If all LOBOs are called at once (an unlikely event) then future estimated use of cash to temporarily fund the capital programme may be affected.

All counterparties were contacted in 2016 and most responded and cited a minimum rate they would consider reviewing the call option on the LOBO as being over 3%. Bank of England rate is currently 0.25% with rates not expected to rise to 0.75% before Q4 2019.

The borrowing strategy to temporarily finance its capital programme, led the Council to consider setting a minimum amount of projected liquid cash of £10m. This means that cash outflows for capital purposes would primarily be met from cash investments until £10m was reached, and only at that point, would external borrowing be undertaken except if interest rates were advantageous for long-term loans, then the Council will borrow in advance of need or where interest rates are expected to rise significantly and quickly.

The Council will continue to review, throughout the year, its options around higher and lower levels of cash-backed balances.

Treasury Risk Analysis - Debt

Whilst it is not mandatory for Local Authorities to adopt the CIPFA Risk Toolkit produced by CIPFA's Treasury Management Panel, the Council will continue to utilise and adopt the risk tool kit and participate in the risk study in 2017/18 as there are some merits for the Council in managing its integrated treasury management portfolio and in considering risk mitigation options for its treasury management review process and benchmarking with its peers.

5.3 Treasury Indicators: Limits to Borrowing Activity

Operational Boundary - this is the limit beyond which external borrowing is not normally expected to exceed.

Operational boundary £'000	2015/16 Actual £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
External Debt	116,976	116,976	113,010	113,010	113,010	111,010
Other Long-term Liabilities	34,123	32,013	30,490	29,063	26,782	25,175
Operational Boundary	151,099	148,989	143,500	142,073	139,792	136,185

Authorised Limit for External Borrowing

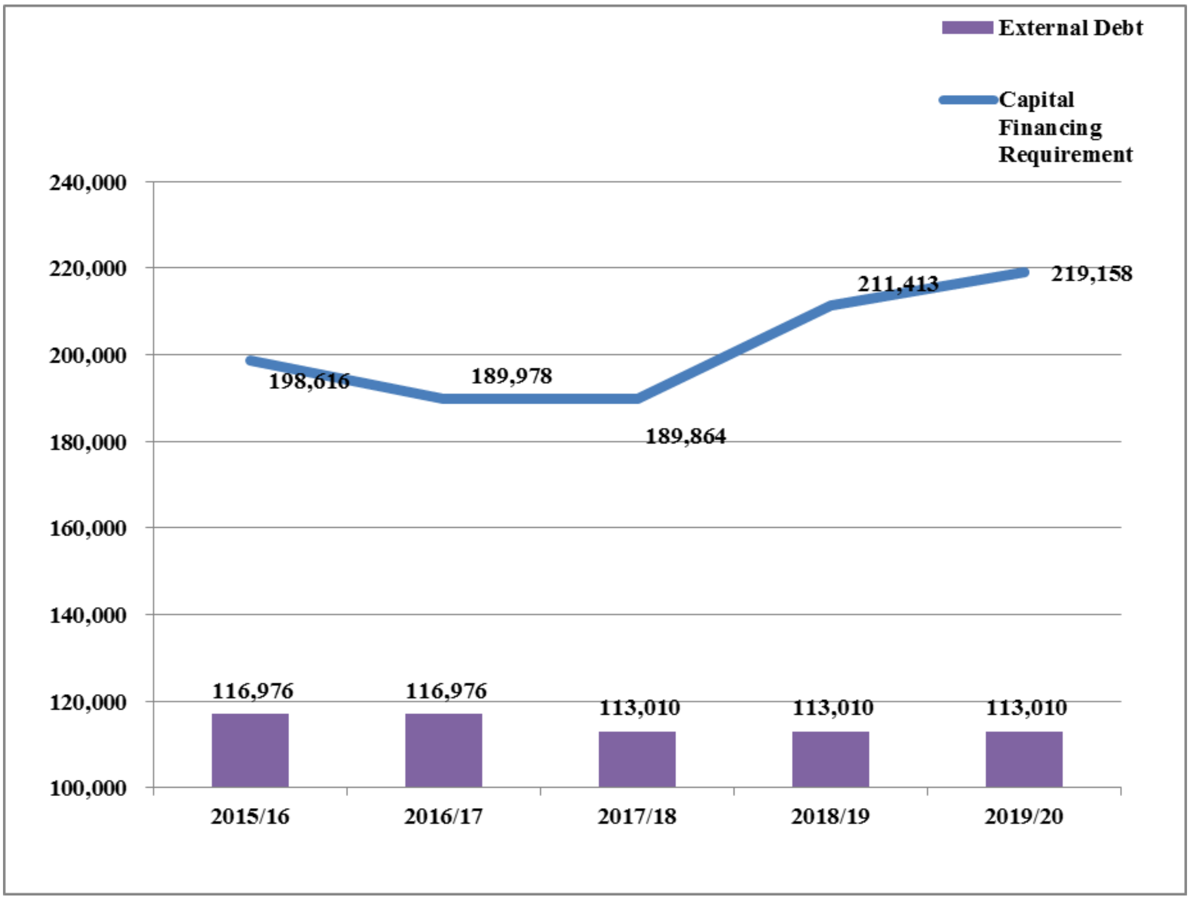
This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. It represents a limit beyond which external borrowing must not go over in the 3 years, and this limit when set is to be revised annually by Council. It reflects the level of external borrowing which, while not desired, could be afforded in the short-term, but is not sustainable in the longer term.

The Council is asked to approve the following authorised limit:

	2015/16 Actual £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
External Debt	151,099	148,989	143,500	142,073	139,792	136,185
Other Long-term Liabilities	60,000	70,000	80,000	100,000	110,000	120,000
Authorised Limit	**211,099**	**218,989**	**223,500**	**242,073**	**249,792**	**256,185**

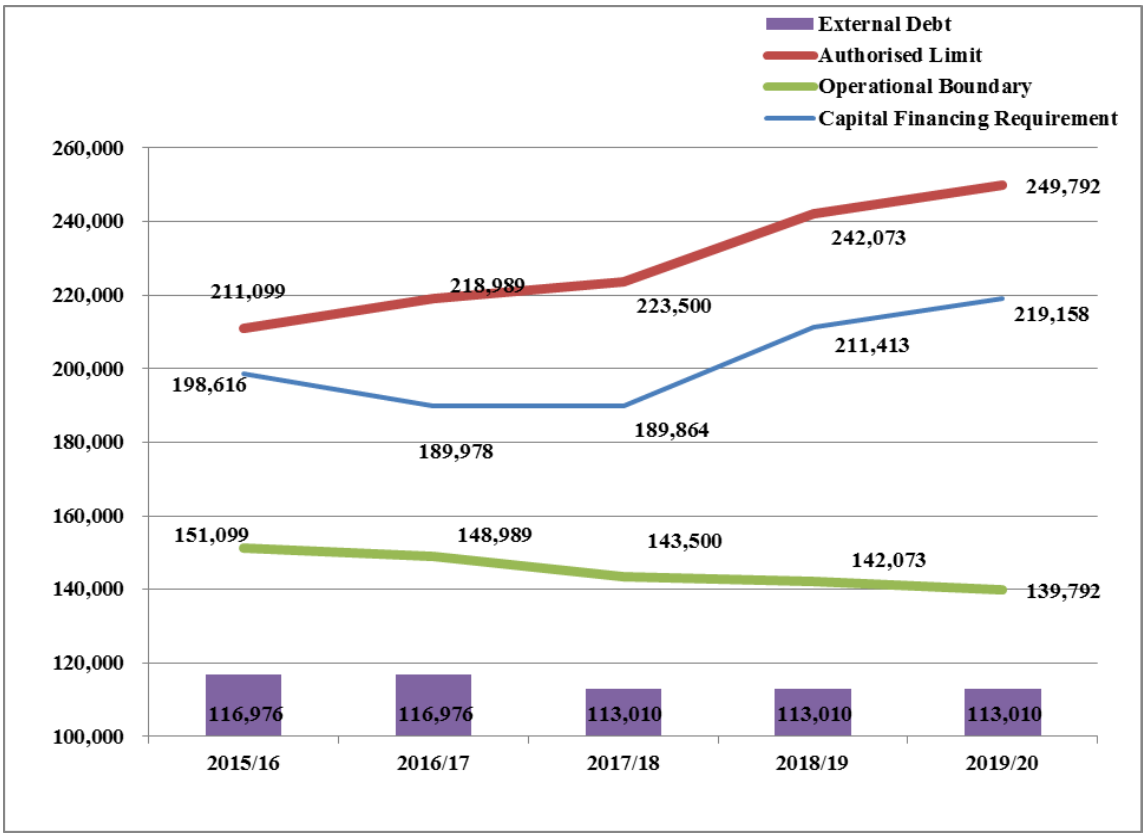
Members are required to note that these authorised limits shows the gross maximum borrowing for the year and, in year regulatory accounting changes which may affect the level of debt in the balance sheet as well as allow for any potential overdraft position and short-term borrowing for cashflow purposes. All of which will be counted against the overall borrowing. The authorised limit also provides headroom for any debt rescheduling which may occur during the year and any borrowing in advance of need.

The following graph shows projection of the CFR and borrowing.



Within the prudential indicators, there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council should ensure that its gross debt does not (except in the short term) exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2017/18 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Director of Corporate Services reports that the Council complied with this key prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the budget.



5.4 Treasury Management Limits on Activity

The table below shows the debt related treasury activity limits.

Members are asked to note that the maturity structure guidance changed in the CIPFA 2011 guidance notes for Lenders Option Borrowers Option (LOBO) Loans, the maturity dates is now deemed to be the next call date.

As interest rates begin to rise, it may be beneficial for the Council to go into some variable rate investments to avoid being locked into long-term investments at low rates in a period of rising interest rates or shorter duration borrowing to gain advantage of low rates.

The table below shows the fixed and variable interest rate exposure

	2016/17	2017/18	2018/19	2019/20	2020/21
Interest Rate Exposures	**Upper Estimate**	**Upper Estimate**	**Upper Estimate**	**Upper Estimate**	**Upper Estimate**
Upper limit for fixed interest rates based on net debt	100%	100%	100%	100%	100%
Upper limit for variable interest rates based on net debt	50%	50%	50%	50%	50%
Limits on fixed interest rates: • **Debt only** • **Investments only**	 100% 100%	 100% 100%	 100% 100%	 100% 100%	 100% 100%
Limits on variable interest rates • **Debt only** • **Investments only**	 50% 50%	 50% 50%	 50% 50%	 50% 50%	 50% 50%

The table below shows the Limits on the Maturity Structure of Borrowing

	Maturity Structure of fixed interest rate borrowing 2017/18				Maturity Structure of variable interest rate borrowing 2017/18		
	Actual at 30/11/2016	**Lower**	**Upper**		**Actual 30/11/2016**	**Lower**	**Upper**
Under 12 months	3.39%	0%	60%		0%	0%	50%
12 months to 2 years	0%	0%	60%		0%	0%	50%
2 years to 5 years	3.42%	0%	60%		0%	0%	50%
5 years to 10 years	22.66%	0%	80%		0%	0%	50%
10 years to 20 years	14.53%	0%	100%		0%	0%	50%
20 years to 30 years	11.54%	0%	100%		0%	0%	50%
30 years to 40 years	27.36%	0%	100%		0%	0%	50%
40 years to 50 years	17.10%	0%	100%		0%	0%	50%

Local Indicators

In setting the indicators below, the Council has taken into consideration investment risks and returns.

The table below shows target borrowing and investment rates

	2015/16 Actual %	2016/17 Estimate %	2017/18 Estimate %	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %
Average Investment Target Return	0.78%	0.84%	0.75%	0.75%	1.00%	1.25%
Average Investment Target – Property Fund	n/a	3.5%	3.5%	3.5%	3.5%	3.5%
Long Term Borrowing Target • Current Portfolio	 5.72%	 5.72%	 5.70%	 5.72%	 5.72%	 5.72%

The average investment target return above is based on the expected target return for the stated periods.

5.5 Policy on Borrowing in Advance of Need

London Borough of Merton will not borrow more than, or in advance of its need, purely in order to profit from the investment of the extra sums borrowed.

Any decision to borrow in advance will be within forward approved CFR estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Borrowing in advance could be made within the constraints that:

- It will be limited to no more than 50% of the expected increase in borrowing need (CFR) over the three year planning period; and
- Would not look to borrow more than 24 months in advance of need. Where possible rates will be locked using forward borrowing to reduce the risk of the Council holding cash in low interest rate environment.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism. The probability of this happening is low.

However should the Council need to borrow in advance of need, then the following will apply.

Year	Maximum Borrowing in advance	Notes
2017/18	No more than 50% of under borrowing requirement	Borrowing in advance will be limited to no more than 50% of the expected increase in borrowing need (CFR) over the period of the approved Medium Term Capital Programme, a maximum of 2 years in advance to reduce carrying costs.
2018-19	No more than 50% of under borrowing requirement	
2019-20	No more than 50% of under borrowing requirement	
2020-21	No more than 50% of under borrowing requirement	

5.6. Debt Rescheduling

Long-term fixed rates have remained relatively unchanged over the past three years. Although borrowing costs remain historically attractive, redemption rates are prohibitive.

The following table shows the maturity profile of the Council's current debt as at 30 November 2016.

Duration	£'000	% of Debt Portfolio
less than 1 year	3,966	3.39
1 - 2 years	0	0
2 - 5 years	4,000	3.42
5 -10 years	26,510	22.66
10 -15 years	4,500	3.85
15- 20 years	12,500	10.69
20 - 25 years	0	0.00
25-30 years	13,500	11.54
30 - 35 years	0	0.00
35-40 years	32,000	27.36
40 -45 years	0	0.00
45-50 years	20,000	17.10
Total	**116,976**	**100.00**

All of the Council's LOBOs are past their non call period, however, should all LOBOs be called at their next interest due date then the maturity profile will be as shown in the table below, an event which is very unlikely in the current low interest rate environment.

Duration	£'000	% of Debt Portfolio
less than 1 year	63,000	53.86
1 - 2 years	1,966	1.68
2 - 5 years	0	0.00
5 -10 years	26,510	22.66
10 -15 years	0	0.00
15- 20 years	3,500	2.99
20 - 25 years	0	0.00
25-30 years	0	0.00
30 - 35 years	0	0.00
35-40 years	22,000	18.81
40 -45 years	0	0.00
45-50 years	0	0.00
Total	**116,976**	**100.00**

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

The Council tests the markets for redemption opportunities should they exist. The PWLB loans portfolio was elected for the early redemption review as at 30 November 2016. A total loan value of £52m would incur redemption costs of £25million in addition to any accrued interest due.

The high cost of early redemption is not economically viable in current markets. However there may be cases where the Council is able to negotiate with the counterparty (**Appendix 1**).

The Director of Corporate Services will continue to review and identify any potential for making savings and provide Cabinet with updates when such opportunities arise. Any rescheduling activity will be reported to Cabinet at the earliest meeting following the transaction.

Use of Derivatives

The Council may use derivatives for risk management purposes in line with relevant statutory powers, recommended accounting practices and legal opinions on the use of derivatives by Local Authorities in the UK.

5.7 Borrowing Options

The Council will use a number of borrowing sources. These include the Public Works Loans Board (PWLB maturity, EIP or annuity loans), Market loans, Municipal Bond Agency, Retail Bonds, Loans from other Local Authorities and temporary loans. It is hoped that borrowing rates will be lower than those offered by the PWLB. The Council intends to make use of this new source of borrowing as and when appropriate.

5.8 Changes Which May Affect Treasury Management

- Future Regulatory Changes to Money Market Fund Valuation

Proposed EU legislative changes will require money market funds with constant net asset value to change to variable net asset value. This will mean that investors in the fund will be liable for their share of losses as a result of counterparty failure. Consultation continues on the expected changes.

- Proposed Changes to Leasing

Future changes to accounting for leasing may mean that the cost of service will increase along with increases in MRP and CFR which will affect the Council's underlying borrowing requirement. It is anticipated that there may be some impact on both capital and revenue income and the changes will require all leases to be included on the balance sheet and be measured on PV of future lease payments. The new lease standard (IFRS 13) issued in 2015 is not anticipated to be adopted until 2019/20.

- Municipal Bond Agency

It is likely that the Municipal Bond Agency currently in the process of being set up will be offering loans to local authorities in the near future. It is also hoped that borrowing rates will be lower than those offered by the PWLB.

- Future Challenges to Local Government Funding

Future challenges to local government funding and their effect on cash flow remains a challenge.

6. ANNUAL INVESTMENT STRATEGY

6.1 Investment Policy

London Borough of Merton's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

6.2 Investment Strategy

The Council does not place cash with fund managers as all of its cash is managed in-house. Base rate is forecast to remain at 0.25% till Q4 2019.
The forecast rates have been built on the basis that bank rate is expected to remain unchanged until around the fourth quarter of 2019, however if interest rates do not rise then future income expectations may not be met. Local indicators /benchmark for investments set is included in paragraph 5.4 of this report.

In order to maximise returns, cash available for investments will be split into three categories;

- Operational cash (under 3 months)
- Core cash (available for 3 to 6 months)
- Strategic cash (available for over 6 months)

The aim is to invest strategic cash for a minimum period of 12 months to enable the Council to secure advantageous rates, taking account of counterparty risk. However this is also constrained by counterparty risk. Operational cash will predominantly be lent overnight or for periods less than three months.

6.3 Alternative Investment Instruments

The Council has in the past restricted its treasury activities to simple investment structures like fixed deposits and money market funds.
However, in the current market, regulatory and economic environment, the Council may be required to utilise various instruments. **Appendix 5** of this report gives a detailed overview of the types of instrument and investment options available to the Council.

The global financial crisis of 2008 led to a major overhaul of regulation, market practices and financial institutions across the world. The changes have been aimed at promoting greater transparency and investor confidence.

Some of these measures include more institution-level regulatory changes like stringent capital, leverage and liquidity requirements in addition to The European Union (EU) Directives on Bank Recovery and Resolution (BRRD) and Deposit Guarantee Schemes (DGSD) among a few are key in this reform. Although these changes are ultimately designed to make financial systems more robust, they are not expected to have a fundamental impact on insolvency creditor hierarchy.

Although the Council does not expect a fundamental change in type of instruments it uses in the delivery of its treasury management activities, a number of new instruments have been included to provide flexibility should there be changes in the economic environment which may warrant their use.
As with any investment, there are varying degrees of risk associated with each instrument or investment options.

Should the Council decide to invest in any asset class a comprehensive analysis will be conducted to understand the associated risk and each instrument will be signed off by the Director of Corporate Services prior to any activity.

6.4 **Investment Treasury Indicator and Limit** - total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and are based on the availability of funds after each year-end.

	31 Dec 2016 Actual £'m	**2016/17 Estimate £'m**	**2017/18 Estimate £'m**	**2018/19 Estimate £'m**	**2019/20 Estimate £'m**	**2020/21 Estimate £'m**
Estimated Principal sums invested greater than 364 days	5m	18m	40m	40m	30m	30m

In addition to fixed deposits, a number of other financial instruments like Property funds will fall under the category of investments with duration exceeding 364 days. In addition to using money market funds, call accounts and notice accounts, the Council will seek to utilise other liquid and transferable instruments like certificate of deposits and gilts for its cashflow balances.

6.5 **Use of Specified and Non-Specified Investments**
Investment instruments identified for use in the financial year are as follows:

Specified Investments
These are sterling investments of not more than one-year maturity, or those which could be for a longer period where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure by virtue of regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146 as amended with:

- The investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling;

- The investment is not a long-term investment;
- The making of the investment is not defined as capital expenditure]; and
- The investment is made with a body or in an investment scheme of high credit quality or with one of the following public-sector bodies:
  - The United Kingdom Government;
  - A local authority in England or Wales (as defined under section 23 of the 2003 Act).

Non-Specified Investments
Non-Specified investments are defined as those not meeting the above criteria and exceeding 365 days in duration.

6.6 Investment Risk Benchmarking

These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change

Revenue Pressures – 0.1% improvement on £20m is £20k income generated and the cost of no risk is lost revenue therefore risks must be balanced to the Council's risk appetite.

Security - The Council's maximum security risk benchmark for the current portfolio:

- Liquidity – in respect of this area the Council seeks to maintain:
  - Bank overdraft - £1m
  - Liquid short-term deposits of around £5m or more available with one day access.

6.7 Risk Management and Creditworthiness Policy

This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- Credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- Sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years
- Dark pink 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25
- Light pink 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.5
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

	Colour (and long term rating where applicable)	Money Limit	Time Limit
Banks	**yellow**	**£35m**	**5yrs**
Banks	**purple**	**£25m**	**2 yrs**
Banks	**orange**	**£25m**	**1 yr**
Banks – part nationalised	**blue**	**£25m**	**1 yr**
Banks	**red**	**£10m**	**6 mths**
Banks	**green**	**£5m**	**100 days**
Banks	**No colour**	**Not to be used**	
Limit 3 category – Council's banker	**Lloyds bank**	**£5m**	**1 day**
Other institutions limit	**-**	**£5m**	**1yrs**
DMADF	**AAA**	**unlimited**	**6 months**
Local authorities	**n/a**	**£5m**	**1yrs**
	Fund rating	**Money Limit**	**Time Limit**
Money market funds	**AAA**	**£35m**	**Instant**
Enhanced money market funds with a credit score of 1.25	**Dark pink / AAA**	**£25m**	**Instant**
Enhanced money market funds with a credit score of 1.5	**Light pink / AAA**	**£10m**	**Instant**

The Capita Asset Services' creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored regularly. The Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services' creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Capita Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on any external support for banks to help support its decision making process.

6.8 Country and Sector Limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in **Appendix 3**. This list will be added to, or deducted from by officers should ratings change in accordance with this policy.

6.9 Banking Arrangements

The Council's bankers are Lloyds bank. The Council's bank accounts include some school accounts and client bank accounts managed as part of its Appointeeship role for residents that require this support. All schools are responsible for the management of their bank accounts.

From time to time the Council may open bank accounts with other banks for specific reasons, subject to approval by the Director of Corporate Services.

6.10 Lending to Community Organisations, Other Third Parties and RSLs - Any loans to or investments in third parties will be made under the Well Being powers of the Council conferred by section 2 of the Local Government Act 2000 or Localism Act of 2011.

The Well Being power can be exercised for the benefit of some or all of the residents or visitors to a local authority's area. The power may also be used to benefit organisations, schools, local enterprises, local companies or even individuals. Loans of this nature will be under exceptional circumstances and must be approved by Cabinet or by delegated authority to the Director of Corporate Services. Authorisation from the Financial Conduct Authority (FCA) will also be sought where applicable.

Where it is deemed necessary, additional guarantees will be sought. This will be via security against assets and/or through guarantees from a parent company. The Council will also consider other factors like the statutory powers in place, reasonableness of the investment, FCA, objective and revenue earnings for the Council, MRP requirements, accounting issues and categorisation of the expenditure as capital or revenue.
In other instances, the Council may receive soft loans from government agencies.

6.11 Non-Treasury Investment Lending
The Council may be required to make policy investments for the good of its community by lending to local organisations and in some cases schools. Legal agreements are drawn which stipulate the terms of the loan which includes the ability of the organisation to make repayments. The Council may also lend to its wholly owned companies.

6.12 Comparative Reviews - The Council participates in various comparative and benchmarking clubs.

7. Cashflow Management

7.1 CIPFA requires all monies to be under the control of the responsible officer and for cashflow projections to be prepared on a regular and timely basis. Cashflow provides outline of operations. Actuals and forecast are recorded using Logotech systems. At the end of each day the net receipts and payments is either invested or borrowed to ensure that the Council's bank account is kept at a minimum.

Forecasts are based on best estimates which may slip due to unforeseen circumstances and the nature of large projects. The Council can borrow in advance of need if rates fall and borrowing becomes a lot more advantageous than it currently is.

7.2 Purchase and Corporate Credit Cards

The use of corporate credit cards like other accounts payable methods carries significant risks. The Director of Corporate Services is responsible for ensuring that the Council has appropriate controls in place to protect the Council's funds.

8. Policy on the use of External Service Providers

The Council recognises CIPFA's guidance on Treasury Management that the responsibility for Treasury Management cannot be delegated outside the authority and recognises that any external service provider used by the Council is to support the in-house Treasury Management function. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review. The Council is aware of the CIPFA Treasury Management Advisors Regulation and Services issued in March 2010.

The Council is also mindful of the requirements of the Bribery Act 2011 as amended in its dealings with external providers. A copy of the Council's policy can be found in the link below.

http://www.merton.gov.uk/democratic_services/w-agendas/w-nonexecreports/1115.pdf

9. Training

A key outcome of the recent investigations into Local Authority investments is the need to ensure that all relevant Treasury Management staff receive appropriate training and knowledge in relation to these activities. Training is provided in-house on the job, via CIPFA seminars and training courses, treasury adviser seminars and training courses and sometimes counterparties conduct training. In addition, members of the team attend national forums and practitioner user groups.

10. The Localism Act

10.1 A key element of the Act is the "General Power of Competence": "A local authority has power to do anything that individuals generally may do." CIPFA emphasise that where the legality of the use of derivatives is confirmed, then there is a need for a framework for their use. The Council currently does not use derivatives. Should the need for the use of derivatives arise as a requirement for managing its interest rate exposure or hedging its investments, the Council will take legal advice and report to members before use.

11. Treasury Management Practices

11.1 The 2011 Code reinforces a framework of 12 Treasury Management practices (TMPs), which define the manner in which authorities seek to achieve the policies and objectives outlined in their Treasury Management policy statement. The Council's detailed Treasury Management practices approved in March 2012/13 can be found on the Council's intranet. An updated version is included as **Appendix 5**

12. Appendices

12.1 Appendix 1– Early Repayment of Debt Estimate

Appendix 2 – Policy Investments (Non-Treasury Management Investments)

Appendix 3 – Approved Countries for Investment

Appendix 4 – The Treasury Management Role of the S151 Officer

Appendix 5 – Treasury Management Practices 2017/18

Appendix 6 – Prudential Indicators for 2016/17 to 2019/20

Appendix 7 – Glossary

Appendix 8 – Cashflow Forecast

13. Background Papers

- CIPFA Prudential Code for Capital Finance in Local Authorities 2013 Edition
- 2016/17 Treasury Management Strategy report
- The Guide to Local Government Finance (2013 Edition) Module 4: Treasury Management
- CIPFA Practical Considerations in Using Financial Instruments to Manage Risk in the Public Sector
- London Borough of Merton Capital Strategy 2017/21

APPENDIX 1 – Early Repayment of Debt Estimates for a Selection of Debt

PWLB loan Early Redemption Estimates at 30 November 2016

Internal Reference No.	Lender	Last Date Interest was Paid	Loan Start Date	Loan Term (yrs)	Loan Maturity Date	Loan Principal Outstanding (£)	Loan Rate (%)	Term left on Loan (Yrs)	Next Interest Due Date	Discount Rate (%)	Accrued Interest to 30 Nov 2016 (£)	Premium/Discount (£)	Total Due (£)
1000484711	PWLB	31/10/2016	13/11/2000	24	31/10/2024	5,000,000	5.000	7.9	30/04/2017	0.97	20,547.95	1,532,107.50	6,552,655.45
1000484981	PWLB	31/10/2016	30/11/2000	24	31/10/2024	1,500,000	4.750	7.9	30/04/2017	0.97	5,856.16	431,119.08	1,936,975.24
1005489969	PWLB	20/11/2016	20/05/2005	30	20/05/2035	2,500,000	4.450	18.4	20/05/2017	1.85	3,047.95	1,013,124.14	3,516,172.09
1005490706	PWLB	21/11/2016	21/11/2005	26	21/11/2031	1,000,000	4.250	14.9	21/05/2017	1.69	1,047.95	337,449.67	1,338,497.62
1005490967	PWLB	25/07/2016	10/01/2006	50	25/07/2055	10,000,000	3.950	38.6	25/01/2017	1.74	138,520.55	6,199,143.25	16,337,663.80
1005490976	PWLB	25/07/2016	10/01/2006	50	25/07/2055	5,000,000	3.950	38.6	25/01/2017	1.74	69,260.27	3,099,571.62	8,168,831.89
1006491475	PWLB	28/10/2016	28/04/2006	45.5	28/10/2051	7,000,000	4.400	34.8	28/04/2017	1.81	27,846.58	4,676,574.39	11,704,420.97
1097480120	PWLB	30/09/2016	15/10/1997	25.5	31/03/2023	310,000	6.625	6.3	31/03/2017	0.72	3,432.29	113,120.87	426,553.16
1097480121	PWLB	30/09/2016	15/10/1997	26.5	31/03/2024	12,000,000	6.500	7.3	31/03/2017	0.89	130,356.16	4,768,440.63	16,898,796.79
1097480232	PWLB	30/09/2016	11/11/1997	26.5	31/03/2024	1,700,000	6.750	7.3	31/03/2017	0.89	19,177.40	705,632.88	2,424,810.28
1098480925	PWLB	31/10/2016	30/04/1998	26	30/04/2024	6,000,000	5.875	7.4	30/04/2017	0.89	28,972.60	2,142,364.86	8,171,337.46
						52,010,000					448,065.86	**25,018,648.89**	77,476,714.75

APPENDIX 2 – Policy Investments (Non-Treasury Management Investments)

Type	Duration	
Joint Development Companies	One month to 10 years	Subject to specific terms
Loans to Registered Landlords	One month to 5 years	Subject to specific terms
Open Loan Facility to RCL’s with an affiliation with Merton	One month to 5 years	Subject to specific terms
Loans to wholly owned companies	One month to 30 years	Subject to specific terms
Loan to any other type of organisation	One month to 10 years	Subject to specific terms

APPENDIX 3 – APPROVED COUNTRIES FOR INVESTMENTS (as at 30 November 2016)

Below is the current list of approved countries for investments for use by the Council's treasury team. The countries on the Council's approved list may change from time to time as Sovereign ratings change.

This list is based on those countries which have sovereign ratings of AA- or higher and also, (except - at the time of writing - for Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Capita Asset Services credit worthiness service.

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- U.K.
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- Qatar

AA-

- Belgium

APPENDIX 4

Treasury Management Role of the Section 151 Officer

The S151 Officer (Director of Corporate Services)

- recommending clauses, Treasury Management policy / practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular Treasury Management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the Treasury Management function;
- ensuring the adequacy of Treasury Management resources and skills, and the effective division of responsibilities within the Treasury Management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of Treasury Management external service providers.
- Approval of appropriate money market funds for the Council to invest in.

APPENDIX 5

LONDON BOROUGH OF MERTON
TREASURY MANAGEMENT PRACTICES 2017/18

TMP 1: RISK MANAGEMENT

The Director of Corporate Services – the responsible officer will implement and monitor all arrangements for the identification, management and control of treasury management risk, will report at least annually on the adequacy / suitability thereof, and will report, as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the organisation's objectives in this respect, all in accordance with the procedures set out in TMP6 Reporting requirements and management information arrangements. In respect of each of the following risks, the arrangements which seek to ensure compliance with these objectives are set out in the schedule to this document.

1.1 Credit and Counterparty Risk Management

The Council regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with which funds may be deposited, and will limit its investment activities to the instruments, methods and techniques referred to in TMP4 Approved Instruments Methods and Techniques and listed in the schedule to this document. It also recognises the need to have, and will therefore maintain, a formal counterparty policy in respect of those organisations from which it may borrow, or with whom it may enter into other financing or derivative arrangements.

Policy on the use of credit risk analysis techniques

- The Council will use credit criteria in order to select creditworthy counterparties for placing investments with.
- Credit ratings will be used as supplied from all three rating agencies - Fitch, Moody's and Standard & Poor's.
- Treasury management consultants will provide regular updates of changes to all ratings relevant to the Council.
- The treasury manager will formulate suitable criteria for assessing and monitoring the credit risk of investment counterparties and shall construct a lending list comprising maturity periods, type, group, sector, country and counterparty limits.

1.2 Liquidity Risk Management

The Council will ensure it has adequate, though not excessive cash resources, borrowing arrangements, overdraft or standby facilities to enable it, at all times, to have the level of funds available to it which are necessary for the achievement of its business/service objectives. The Council will only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme or to finance future debt maturities.

The treasury management team shall seek to minimise the balance held in the Council's main bank accounts at the close of each working day. Borrowing or lending shall be arranged in order to achieve this aim. At the end of each financial day any unexpected surplus funds are transferred to the main bank account.

Bank overdraft arrangements – A £1 million net overdraft at 2% over base rate on debit balances has been agreed as part of the banking services contract. The overdraft is assessed on a group basis for the Council's accounts. Separate facilities are available for the Pension Fund bank account.

a. Short-term borrowing facilities
   The Council accesses temporary loans through approved brokers on the London money market.
b. Special payments
   Where an urgent clearing house automated payment system (CHAPS) payment is required, a CHAPS payment request form must be completed and forwarded to the Head of Transactional Services who then checks for correct required signatures and supporting paperwork. Further guidance can be found on the Council's intranet.

c. Inter account transfer
   From time to time, transactions occur between the Pension Fund and the Council. Reimbursement where necessary is by inter-account transfers between both bank accounts.

1.3 Interest Rate Risk Management and use of Derivatives

The Council will manage its exposure to fluctuations in interest rates with a view to containing its interest costs, or securing its interest revenues, in accordance with the amounts provided in its budgetary arrangements as amended in accordance with TMP6 Reporting requirements and management information arrangements. It will achieve this by the prudent use of its approved financing and investment instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates. This should be the subject to the consideration and, if required, approval of any policy or budgetary implications.

The Council does not use derivatives, the Council's S151 Officer will ensure that any hedging tools such as derivatives are only used for the management of risk and the prudent management of financial affairs and that the policy for the use of derivatives when used will be clearly stated to members. The treasury management strategy has full details of interest rate exposure limits.

Policies concerning the use of instruments for interest rate management.

- Forward Dealing

  Consideration will be given to dealing for forward periods depending on market conditions. When forward dealing is more than a 364 day period forward, the approval of the Director of Corporate Services is required.

- Callable Deposits
  The council may use callable deposits as part as of its Annual Investment Strategy (AIS). The credit criteria and maximum periods are set out in the Schedule of Specified and Non Specified Investments appended to the AIS.

Policy on Use of Lender's Option Borrower's Option (LOBO) Loans

LOBOs give the lender the option to propose an increase in the interest rate at pre-determined dates, and the borrower, the option to accept the new rate **or** redeem the loan without penalty.

Use of LOBOs is considered as part of the Council's annual borrowing strategy. All long-term borrowing must be approved by the S151 Officer.

1.4 Exchange Rate Risk Management

Occasionally, the Council has to make foreign exchange payments, the Council will manage its exposure to fluctuations in exchange rates so as to minimise any detrimental impact on its budgeted income/expenditure.

1.5 Refinancing Risk Management

The Council will ensure that its borrowing, private financing and partnership arrangements are negotiated, structured and documented, and the maturity profile of the monies raised are managed, with a view to obtaining offer terms at renewal or refinancing, if required, which are competitive and as favourable to the organisation as can reasonably be achieved in the light of market conditions prevailing at the time.

The Council will actively manage the relationships with counterparties in such a manner as to secure the above objective, and will avoid overreliance on any one source of funding if this might jeopardise achievement of the above.

The Council will establish through its Prudential and Treasury Indicators the amount of debt maturing in any year. Any debt rescheduling will be considered when the difference between the refinancing rate and the redemption rate is most advantageous and the situation will be continually monitored in order to take advantage of any perceived anomalies in the yield curve. The reasons for rescheduling include:

a) to generate cash savings at minimum risk;
b) to reduce the average interest rate; and
c) to amend the maturity profile and/or the balance of volatility of the debt portfolio

Any rescheduling will be reported to the Council at the meeting immediately following the action.

1.6 Legal and Regulatory Risk Management

The Council will ensure that all of its treasury management activities comply with its statutory powers and regulatory requirements. It will demonstrate such compliance, if required to do so, to all parties with whom it deals in such activities. In framing its credit and counterparty policy under TMP1 1.1 Credit and Counterparty Risk Management, it will ensure that there is evidence of counterparties powers, authority and compliance in respect of the transactions they may effect with the organisation, particularly with regard to duty of care and fees charged.

The Council recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to minimise the risk of these impacting adversely on the organisation.
The Council will ensure that its treasury management activities comply fully with legal statute, guidance, Codes of Practice and the regulations of the Council.

The Council’s powers to borrow and invest are contained in the Local Government Act 2003, section 12 and Local Government Act 2003, section 1. The treasury management scheme of delegation is contained in the Corporate Services Scheme of Delegation. This document contains the officers who are authorised signatories. The Council’s monitoring officer is the Assistant Director Corporate Resources while the S151 Officer is the Director of Corporate Services.

1.7 Fraud, Error and Corruption, and Contingency Management

Treasury tasks are segregated and adequate internal checks have been implemented to minimise risks and fraud. Procedures are documented and staff will not be allowed to take up treasury management activities until they have had proper training and are subject to an adequate and appropriate level of supervision.

Records will be maintained of all treasury management transactions so that there is a full audit trail and evidence of the appropriate checks being carried out. Periodic backups will be made to ensure contingency of systems is available.

Details of Systems and Procedures to be Followed, Including Internet Services

The Council uses Logotech Treasury systems as its treasury management recording tool.

- The Corporate Services Scheme of Delegation sets out the delegation of duties to officers and the Council’s constitution details delegated authority of treasury management to the Section 151 Officer.
- All loans and investments are negotiated by the Treasury Manager or other authorised persons.
- All long-term loans must be authorised by the Section 151 Officer.

1.8 Market Risk Management

The Council will seek to ensure that its stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the principal sums it invests, and will accordingly seek to protect it from the effects of such fluctuations. This is controlled mainly by setting limits on investment instruments where the principal value can fluctuate. The limits are detailed in the Treasury Management Strategy

TMP 1: SCHEDULE 1 – SPECIFIED AND NON SPECIFIED INVESTMENTS

This is included in the Treasury Management Strategy.

TMP 2: PERFORMANCE MEASUREMENT

2.1 Evaluation and Review of Treasury Management Decisions

Periodic Review During the Financial Year

The Director of Corporate Services will hold treasury management review meetings with the Treasury Manager, periodically or as required to review actual activity against the Treasury Management Strategy Statement (TMSS) and cashflow forecasts. This will include:

- Total debt (both on-and off- balance sheet) including average rate and maturity profile.
- Total investments including average rate and maturity profile and changes to the above from the previous review and against the TMSS.
- Cashflow forecast against the actual.

Annual Review After the end of the Financial Year

Annual Treasury Report will be submitted to the Full Council each year after the close of the financial year.

Comparative Review

Each year or on a quarterly basis, comparative review is undertaken to see how the Council's performance on debt and investments compares to other authorities with similar size portfolios (but allowing for the fact that Prudential and Treasury Indicators are set locally). Such reviews are: -

- CIPFA Treasury Management statistics published each year for the last complete financial year
- CIPFA Benchmarking Club
- CIPFA Risk Study
- Other

2.2 Benchmarks and Calculation Methodology

2.2.1 Debt management

- Average rate on all external debt
- Average rate on external debt borrowed in previous financial year
- Average period to maturity of external debt
- Average period to maturity of new loans in previous year

2.2.2 Investment

The performance of investment earnings will be measured against any of the following benchmarks:

- In-house benchmark and when necessary other benchmarks such as Bank of England base rate, 7-day LIBID uncompounded, 7-day LIBID compounded weekly, 1-month LIBID and 3-month LIBID compounded quarterly

Performance will also be measured against other local authority funds with similar benchmark and parameters managed by other fund managers using the CIPFA treasury management benchmark service.

2.3 Policy Concerning Methods for Testing Value-for-money in Treasury Management

The process for advertising and awarding contracts will be in-line with the Council's Contract Standing Orders and procurement guidelines.

2.3.1 Money-broking Services

From time to time, the Council will use money-broking services in order to make deposits or to borrow, and will establish charges for all services prior to using them. An approved list of firm of brokers is maintained by the Treasury Manager. The list takes account of both prices and quality of service. No firm of brokers will be given undue preference.

2.3.2 Consultants / Advisers Services

The Council's treasury management adviser is Capita Asset Services.

TMP 3: DECISION-MAKING AND ANALYSIS

3.1 Funding, Borrowing, Lending, and New Instruments/Techniques

3.1.1 Records to be kept

The following records will be retained:

- Daily cash balance forecasts for the day and previous day
- Money market deal booking and deal approval confirmation emails
- Dealing slips for all investment and borrowing transactions
- Brokers' confirmations for all investment and temporary borrowing transactions made through brokers

- Confirmations from borrowing / lending institutions including money market fund portals
- PWLB loan confirmations
- PWLB interest due schedule
- Certificates for market loans, local bonds and other loans
- Deal confirmation letters for deals over one month
- Banking and other contract documents which the treasury team has responsibility for.

3.1.2 Processes to be pursued

- Cashflow analysis
- Debt and investment maturity analysis
- Ledger/Logotech/Bank reconciliations
- Review of counterparty limits in addition to monitoring of counterparties
- Review of opportunities for debt restructuring
- Review of borrowing requirement to finance capital expenditure (and other forms of financing where those offer value for money)
- Performance information (e.g. monitoring of actuals against budget for debt charges, interest earned, debt management; also monitoring of average pool rate, investment returns, etc)
- Treasury contracts management

3.1.3 Issues to be addressed

3.1.3.1 In respect of all treasury management decisions made the Council will:

a) Above all be clear about the nature and extent of the risks to which the Council may become exposed
b) Be certain about the legality of the decision reached and the nature of the transaction, and that all authorities to proceed have been obtained
c) Be content that the documentation is adequate both to deliver the Council's objectives and protect the Council's interests, and to deliver good housekeeping
d) Ensure that third parties are judged satisfactory in the context of the council's creditworthiness policies, and that limits have not been exceeded
e) Be content that the terms of any transactions have been fully checked against the market, and have been found to be competitive; and
f) Ensure that adequate investigation on security of the Council's funds has been conducted

3.1.3.2 In respect of borrowing and other funding decisions, the Council will:

a) Consider the ongoing revenue liabilities created, and the implications for the organisation's future plans and budgets
b) Evaluate the economic and market factors that might influence the manner and timing of any decision to fund

c) Consider the merits and demerits of alternative forms of funding, including funding from revenue, use of reserves, leasing and private partnerships; and

d) Consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.

3.1.3.3 In respect of investment decisions, the Council will:

a) Consider the optimum period, in the light of cash flow availability and prevailing market conditions; and

b) Consider the alternative investment products and techniques available, especially the implications of using any which may expose the Council to changes in the value of its capital

TMP 4: APPROVED INSTRUMENTS, METHODS AND TECHNIQUES

4.1 Approved Activities of the Treasury Management Operation

- Borrowing;
- Lending;
- Debt repayment and rescheduling;
- Consideration, approval and use of new financial instruments and treasury management techniques;
- Managing the underlying risk associated with the Council's capital financing and surplus funds activities;
- Managing cash flow;
- Banking activities;
- Use of external fund managers (other than Pension Fund)
- Leasing;
- Undertaking all treasury management activities for the Pension Fund including its strategy setting.

4.2 Approved Instruments for Investments

English and Welsh authorities: The Annual Investment Strategy has a list of approved instruments.

4.3 Approved Techniques

- Forward dealing
- LOBOs – Lender's Option, Borrower's Option borrowing instrument
- Structured products such as callable deposits

4.4 Approved Methods and Sources of Raising Capital Finance

Finance will only be raised in accordance with the Local Government Act 2003 and within this limit the Council has a number of approved methods and sources of raising capital finance. These are:

On Balance Sheet	**Fixed**	**Variable**
PWLB	●	●
EIB	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Market (LOBOs)	●	●
Bonds administered by the Municipal Bond Agency	●	●
Stock issues	●	●
Local (temporary)	●	●
Local Bonds	●	
Overdraft		●
Negotiable Bonds	●	●
Internal (capital receipts & revenue balances)	●	●
Commercial Paper	●	
Medium Term Notes	●	
Leasing (not operating leases)	●	●
Deferred Purchase	●	●

Other Methods of Financing

Government and EC Capital Grants
Lottery monies
PFI/PPP
Operating and Finance leases
Revenue Contributions

Borrowing will only be done in British Pound Sterling. All forms of funding will be considered dependent on the prevailing economic climate, regulations and local considerations. The Director of Corporate Governance has delegated powers in accordance with Financial Regulations, Standing Orders and Scheme of Delegation to Officers to take the most appropriate form of borrowing from the approved sources.

4.5 Investment Limits

The Annual Investment Strategy sets out the limits and the guidelines for use of each type of investment instrument.

4.6 Borrowing Limits

The Treasury Management Strategy Statement and Prudential and Treasury Indicators state all appropriate limits.

TMP 5: ORGANISATION, CLARITY AND SEGREGATION OF RESPONSIBILITIES, AND DEALING ARRANGEMENTS

5.1 Allocation of Responsibilities

(i) Council (Budget)

- Receiving and reviewing reports on treasury management policy, practice and activity; and
- Approval of annual strategy

(ii) Cabinet

- Approval of/amendments to the Council's adopted clauses, treasury management policy statement and treasury management practice;
- Budget consideration and approval;
- Approval of the division of responsibilities; and
- Receiving and reviewing regular monitoring reports and acting on recommendations.

(iii) Overview and Scrutiny Commission (Financial Monitoring Task Group)

- Reviewing all treasury management reports and making recommendations to the Cabinet

5.2 Principles and Practices Concerning Segregation of Duties

5.2.1 The following duties are undertaken by separate officers: -

Tasks	Duties	Responsible Officer
Dealing	• Negotiation and approval of deal	Treasury manager
	• Entering of deal into Logotech	Treasury manager/ Fund officer
	• Sending confirmation letter to counterparty (to be signed by authorised signatory)	Treasury manager/Fund officer
	• Checking of brokers and counterparty confirmation notes against Logotech	Fund officer
	• Reconciliation of FMIS Codes and reconciliation to bank statement	Fund officer
	• Sign off of reconciliations	Treasury manager Fund officer

Accounting Entry	• Processing of accounting entry into FMIS (bank reconciliation team)	Bank reconciliation team
Authorisation / Payment of Deal	• Inputting CHAPS on Lloyds link • Approval of CHAPS on Lloyds link and CHAPS form authorisation	Treasury manager/Fund officer Authorisers per bank mandate

5.3 Statement of the Treasury Management Duties/Responsibilities of Each Treasury Post

5.3.1 Responsible Officer

The Responsible Officer is the person charged with professional responsibility for the treasury management function and in this Council it is the Director of Corporate Services and is also the S151 Officer   This person or delegated persons will carry out the following duties: -

a) Recommending clauses, treasury management policy / practices for approval, reviewing the same regularly, and monitoring compliance
b) Submitting regular treasury management policy reports
c) Submitting budgets and budget variations
d) Receiving and reviewing management information reports
e) Reviewing the performance of the treasury management function
f) Ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
g) Ensuring the adequacy of internal audit, and liaising with external audit
h) Recommending the appointment of external service providers.
i) The Responsible Officer has delegated powers through this policy to take the most appropriate form of borrowing from the approved sources, and to make the most appropriate form of investments in approved instruments.
j) The Responsible Officer may delegate her power to borrow and invest to members of her staff. The Treasury Manager, the fund officer. Treasury management team staff must conduct all dealing transactions, or staff authorised by the responsible officer to act as temporary cover for leave / sickness.
k) The Responsible Officer will ensure that Treasury Management Policy is adhered to, and if not will bring the matter to the attention of elected members as soon as possible.
l) Prior to entering into any capital financing, lending or investment transaction, it is the responsibility of the responsible officer to be satisfied, by reference to the Council's legal department and external advisors as appropriate, that

the proposed transaction does not breach any statute, external regulation or the Council's Financial Regulations

m) It is also the responsibility of the responsible officer to ensure that the council complies with the requirements of The Non-Investment Products Code (formerly known as The London Code of Conduct) for principals and broking firms in the wholesale markets.

5.3.2 Treasury Manager

The responsibilities of this post will be: -

a) Drafting the treasury management strategy and annual report
b) Execution of transactions
c) Adherence to agreed policies and practices on a day-to-day basis
d) Maintaining relationships with counterparties and external service providers
e) Supervising treasury management staff
f) Monitoring performance on a day-to-day basis
g) Submitting management information reports to the Responsible Officer; and
h) Identifying and recommending opportunities for improved practices

5.3.3 Head of the Paid Service – the Chief Executive

The responsibilities of this post will be: -

a) Ensuring that the system is specified and implemented; and
b) Ensuring that the Responsible Officer reports regularly to the full Council / Cabinet or General Purpose Committee on treasury policy, activity and performance.

5.3.4 Monitoring Officer

The responsibilities of this post will be: -

a) Ensuring compliance by the Responsible Officer with the treasury management policy statement and treasury management practice and that they comply with the law
b) Being satisfied that any proposal to vary treasury policy or practice complies with law or any code of practice; and
c) Giving advice to the Responsible Officer when advice is sought

5.3.5 Internal Audit

The responsibilities of Internal Audit will be: -

a) Reviewing compliance with approved policy and treasury management practice
b) Reviewing division of duties and operational practice
c) Assessing value for money from treasury activity; and
d) Undertaking probity audit of the treasury function

5.4 Absence Cover Arrangements

Cover for treasury management staff will be to specific delegated staff.

5.5 Dealing Limits

- No investment deal must exceed £5million per transaction
- No borrowing deal at any point in time must exceed £10 million except when existing loans are being repaid.

5.6 List of Approved Brokers

A list of approved brokers is maintained by the Treasury team and a record of all transactions conducted with them can be obtained from Logotech.

Policy on Brokers' Services
It is the Council's policy to rotate business between brokers.

5.7 Policy on Taping of Conversations

The Council currently does not tape conversations with brokers **but** ensures that confirmations are received from counterparties.

5.8 Direct Dealing Practices

The Council will deal direct with counterparties if it is appropriate and the Council believes that better terms will be available. There are certain types of accounts and facilities, however, where direct dealing is required, as follows;

- Business Reserve Accounts
- Call Accounts
- Money Market Funds
- Gilt/CD purchase via custodian; and
- Fixed period account e.g. 15-day fixed period account

5.9 Settlement Transmission Procedures

A confirmation letter signed by an authorised signatory per the Council's bank mandate must be sent to the counterparty if the deal period exceeds one month. Copy of forms folder located in H:/techaccy/treasury/Daily Treasury for PF
For payments, any transfer to be made via Lloyds link CHAPS system must be completed by 2.00 p.m. on the same day to ensure it is authorised. Money market funds may have earlier cut-off time/deadlines.

5.10 Documentation Requirements

For each deal undertaken, a record should be prepared giving details of dealer, amount, period, counterparty, interest rate, dealing date, payment date(s), broker and confirmation fax, email or letter.

5.11 Arrangements Concerning the Management of Third-Party Funds.

The Council holds a number of trust funds, appointeeship and custody bank accounts. The cash in respect of these funds is held in the Council's bank account but transactions are separately coded.

TMP 6: REPORTING REQUIREMENTS AND MANAGEMENT INFORMATION ARRANGEMENTS

6.1 Annual Treasury Management Strategy Statement

1. The Treasury Management Strategy Statement sets out the specific expected treasury activities for the forthcoming financial year. This strategy will be submitted the cabinet and then to the Council (budget) for approval before the commencement of each financial year.
2. The formulation of the annual Treasury Management Strategy Statement involves determining the appropriate borrowing and investment decisions in the light of the anticipated movement in both fixed and shorter-term variable interest rates. For instance, this council may decide to postpone borrowing if fixed interest rates are expected to fall, or borrow early if fixed interest rates are expected to rise.
3. The Treasury Management Strategy Statement is concerned with the following elements:
   a) Prudential and Treasury Indicators
   b) Current Treasury portfolio position
   c) Borrowing requirement
   d) Prospects for interest rates
   e) Borrowing strategy
   f) Policy on borrowing in advance of need
   g) Debt rescheduling
   h) Investment strategy
   i) Creditworthiness policy
   j) Policy on the use of external service providers
   k) Any extraordinary treasury issue
   l) MRP strategy

4. The Treasury Management Strategy Statement will establish the expected move in interest rates against alternatives.

6.2 Annual Investment Strategy Statement

At the same time as the Council receives the Treasury Management Strategy Statement it will also receive a report on the Annual Investment Strategy which will set out the following: -

a) The Council's risk appetite in respect of security, liquidity and optimum performance
b) Which specified and non specified instruments the Council will use
c) The Council's policy on the use of credit ratings and other credit risk analysis techniques to determine creditworthy counterparties for its approved lending list
d) Which credit rating agencies the Council will use
e) How the Council will deal with changes in ratings, rating watches and rating outlooks

f) Limits for individual counterparties and group limits
g) Country limits
h) Levels of cash balances
i) Interest rate outlook
j) Budget for investment earnings
k) Policy on the use of external service providers

6.3 Annual Minimum Revenue Provision Statement

This statement sets out how the Council will make revenue provision for repayment of its borrowing using the four options for so doing and will be submitted at the same time as the Annual Treasury Management Strategy Statement.

6.4 Policy on Prudential and Treasury Indicators

1. The Council approves before the beginning of each financial year a number of treasury limits which are set through Prudential and Treasury Indicators.
2. The Responsible Officer is responsible for incorporating these limits into the Annual Treasury Management Strategy Statement, and for ensuring compliance with the limits. Should it prove necessary to amend these limits, the Responsible Officer shall submit the changes for approval to the full Council.

6.5 Other Reporting

- Annual report on treasury management activity
- Other management information reports

TMP 7: BUDGETING, ACCOUNTING AND AUDIT ARRANGEMENTS

7.1 Statutory / Regulatory Requirements

The accounts are drawn up in accordance with IFRS. The Council has adopted in full the principles set out in CIPFA's 'Treasury Management in the Public Services - Code of Practice' (the 'CIPFA Code'), together with those of its specific recommendations that are relevant to the Council's treasury management activity.

TMP 8: CASH AND CASHFLOW MANAGEMENT

8.1 Arrangements for Preparing Cashflow

Cashflow projections are prepared annually, monthly and daily. The annual and monthly cash flow projections are prepared from the previous year's cashflow records, adjusted for known changes in levels of income and expenditure, new grant allocations and changes in payments and receipts dates. These details are supplemented on an ongoing basis by information received of new or revised amounts to be paid or received as and when they are known. Logotech is used to record cashflow.

8.2 Bank Statements Procedures

The Council receives daily bank statements on a daily basis, download into the folder below. Estimates on Logotech cashflow is updated with actuals from bank statement. **H:\TECHACCY\TREASURY\Daily Treasury for GF General Fund Daily**

TMP 9: MONEY LAUNDERING

9.1 Proceeds of Crime Act 2002 and Amendments

See Council's website and intranet for money laundering process and associated policies
http://intranet/anti_money_laundering_policy.pdf

9.2 The Terrorism Act 2000 and Amendment order

See Council's website and staff intranet on policy. Staff should note that all individuals and businesses in the UK have an obligation to report knowledge, reasonable grounds for belief or suspicion about the proceeds from, or finance likely to be used for, terrorism or its laundering, where it relates to information that comes to them in the course of their business or employment.

9.3 The Money Laundering Regulations 2007 and Updates

The Council's money laundering officer is the Head of Audit. See Council's website and intranet for details http://intranet/anti_money_laundering_policy.pdf

Treasury management and banking staff are required to familiarise themselves with all money laundering regulations.

9.4 Procedures for Establishing Identity / Authenticity of Lenders

It is not a requirement under Proceeds of Crime Act (POCA) for local authorities to require identification from every person or organisation it deals with. However, in respect of treasury management transactions, the Council does not accept loans from individuals except during a bond issue.

All loans are obtained from the PWLB, other local authorities or from authorised institutions under the Financial Services and Markets Act 2000. This register can be accessed through the FCA website on **www.fca.gov.uk**.

9.5 Methodologies for identifying Deposit Takers

Other than those organisations mentioned in para section 6.10 and Appendix 2 of the treasury strategy, in the course of its Treasury activities, the Council will only lend money to or invest with those counterparties that are on its approved lending list.

These will be local authorities, the PWLB, Bank of England and authorised deposit takers under the Financial Services and Markets Act 2000. The FCA Register can be accessed through their website on www.fca.gov.uk.

All transactions will be carried out by CHAPS, faster payments or BACS for making deposits or repaying loans.

TMP 10: TRAINING AND QUALIFICATIONS

The Council recognises that relevant individuals will need appropriate levels of training in treasury management due to its increasing complexity.

All treasury management staff should receive appropriate training relevant to the requirements of their duties at the appropriate time.
In addition, training may be provided on-the-job, and it is the treasury manager's responsibility to ensure that treasury management staff receive appropriate training.

10.1 Details of Approved Training Courses

Treasury management staff and members will go on courses provided by the Council's treasury management consultants, CIPFA, money brokers etc.

10.2 Records of Training Received by Treasury Staff

Staff will keep records on their training.

10.3 Member Training Record

Member training will be provided as required.

TMP 11: USE OF EXTERNAL SERVICE PROVIDERS

11.1 Details of Contracts with Service Providers, Including Bankers, Brokers, Custodian Banks, Consultants, Advisers

This Council may employ the services of other organisations to assist it in the field of treasury management. However, it will ensure that it fully understands what services are being provided and that they meet the needs of the Council, especially in terms of being objective and free from conflicts of interest.

11.1.1 Banking Services

a) The Council's supplier of banking services is Lloyds Bank. The bank is an authorised banking institution authorised to undertake banking activities in the UK by the FCA
b) The branch address is:
Lloyds Banking Group
25 Gresham Street, London
EC2V 7HN

11.1.2 Money-Broking Services

The Council will use money brokers for temporary borrowing and investment and long-term borrowing. It will seek to give an even spread of business amongst the approved brokers.

11.1.3 Consultants'/Advisers' Services

Treasury Consultancy Services

The Council receives mail shots on credit ratings, economic market data and borrowing data. In addition, interest rate forecasts, annual treasury management strategy templates, and from time to time, the Council may receive advice on the timing of borrowing, lending and debt rescheduling. The performance of consultants will be reviewed by the treasury manager to check whether performance has met expectations.

11.1.4 Custodian Banks

The Council will use the services of custodian banks when trading in most transferable instruments like treasury bills. Due procurement process will be followed in the procurement of this service. It should be noted that it is the borrower that pays in most cases and not the lender. Property fund on the other hand do not require custody services, the investor pays all fee.

11.1.5 Credit Rating Information

The Council receives notifications of credit ratings from Capita Asset Services.

11.2 Procedures and Frequency for Tendering Services

See TMP2

TMP 12: CORPORATE GOVERNANCE

12.1 List of Documents to be Made Available for Public Inspection

a. The Council is committed to the principle of openness and transparency in its treasury management function and in all of its functions.

b. The Council has adopted the CIPFA Code of Practice on Treasury Management and implemented key recommendations on developing Treasury Management Practices, formulating a Treasury Management Policy Statement and implementing the other principles of the Code.

APPENDIX 6

PRUDENTIAL INDICATORS FOR 2016/17 TO 2019/20

PRUDENTIAL INDICATORS	2016/17 Probable Outturn £'000	2017/18 Forecast £'000	2018/19 Forecast £'000	2019/20 Forecast £'000
1. CAPITAL EXPENDITURE a) Capital Expenditure (includes expenditure funded by supported, unsupported borrowing and other sources) i) General Fund estimated as at 30/11/16 (Net of Leasing)	31,544	49,956	43,583	23,570
Total as at 30/11/16	**31,544**	**49,956**	**43,583**	**23,570**
b) In year Capital Financing Requirement (CFR) i) General Fund (Gross of MRP costs)	7,154	7,004	6,579	7,634
Total in year CFR	**7,154**	**7,004**	**6,579**	**7,634**
c) Capital Financing Requirement as at 31 March (Balance Sheet figures) i) General Fund (Net of MRP costs)	189,978	189,864	211,413	219,158
Total	**189,978**	**189,864**	**211,413**	**219,158**

2. AFFORDABILITY				
a) Ratio of Financing Costs to net Revenue Streams i) General Fund	11.29%	11.50%	11.51%	13.76%
b) General Fund Impact of Prudential (Unsupported) Borrowing on Band D Council Tax Levels (per annum) i) In year Increase	-£39.87	£0.84	-£9.85	£38.74
ii) Cumulative Increase (includes MRP costs)		-£39.03	-£48.88	-£10.14
3. LONG-TERM EXTERNAL DEBT				
a) Debt Brought Forward 1 April	116,976	113,010	113,010	113,010
Debt Carried Forward 31 March	116,976	113,010	113,010	113,010
Additional Borrowing	**0**	**(3,966)**	**0**	**0**
b) Operational Boundary for External Debt (Excludes Revenue Borrowing) i) Borrowing	148,989	143,500	142,073	139,792
ii) Other Long-term Liabilities	32,013	30,490	29,063	26,782
c) Total Operating Debt (Excludes Revenue Borrowing)	181,002	173,990	171,136	166,574
Add margin for cashflow contingency	37,987	49,510	70,937	83,218
Affordable Borrowing Limit (Includes Revenue Borrowing)	218,989	223,500	242,073	249,792
Authorised Limit for External Debt (Includes Revenue Borrowing) • Borrowing	148,989	143,500	142,073	139,792
• Other Long-term Liabilities	70,000	80,000	100,000	110,000

Authorised Borrowing Limit	**218,989**	**223,500**	**242,073**	**249,792**
4. TREASURY MANAGEMENT				
a) Borrowing Limit – Upper Limit for Fixed Interest Rate Exposure Expressed as: Net Principal re Fixed Rate Borrowing/Investments	218,989	223,500	242,073	249,792
b) Borrowing Limit – Upper Limit for Variable Interest Rate Exposure Expressed as a %: Net Principal re Variable Rate Borrowing/Investments	50%	50%	50%	50%
c) Lending Limit – Upper Limit for Total Principal Sums Invested for Over 364 Days Expressed as a % of Total Investments	50%	50%	50%	50%

	LOWER LIMIT	UPPER LIMIT
d) Maturity Structure of new Fixed Rate Borrowing, if Taken During 2017/18		
i) Under 12 Months	0	10%
ii) 12 Months to 24 Months	0	20%
iii) 24 Months to 5 Years	0	30%
iv) 5 Years to 10 Years	0	40%
v) 10 Years and Above	0	100%

APPENDIX 7

GLOSSARY OF TREASURY MANAGEMENT TERMS

Accrued Interest
Any interest that has accrued since the initial purchase or since the last coupon payment date, up to the date of sale/purchase

Basis Point
One hundredth of 1% e.g. 0.01%

Certificate of Deposit (CD)
A Tradable form of fixed deposit. They can be sold before maturity via the secondary market at a rate that is negotiable. Often issued by banks and Building Societies in any period from 1 month to 5 years.

Coupon
The total amount of interest a security will pay on a yearly basis. The coupon payment period depends on the security.

Covered Bond
Covered bonds are conventional bonds (fixed or floating) issued by financial institutions that are backed by a separate group of loans, usually prime residential mortgages or public sector loans.

Credit Rating
A measure of credit worthiness of a borrower. A credit rating can be assigned to a country, organisation or specific debt issue/ financial obligation. There are a number of credit ratings agencies but the main 3 are Standard & Poor's, Fitch and Moody's.

Credit risk
This is the risk that the issuer of a security becomes temporarily or permanently insolvent, resulting in its inability to repay the interest or to redeem the bond. The solvency of the issuer may change over time due to various factors.

Debt Management Office (DMO)
Debt Management Office is an executive agency of HM Treasury. They are responsible for debt management in the UK, in the form of issuing Treasury Bills and Gilts.

Financial Strength Rating
Rating criteria used by Moody's ratings agency to measure a bank's intrinsic safety and soundness.

Floating Rate Note (FRN)
An instrument issued by Banks, Building Societies and Supranational organisations which has a coupon that re-sets usually every 3 months. The refix will often be set at a premium to 3 month LIBOR.

Gilt
A UK Government Bond, sterling denominated, issued by HM Treasury

Index Linked Gilts
A government bond issued by the DMO whose coupon and final redemption payment are related to movement in the RPI (Retail Price Index)

Interest Rate Risk
The risk that an investment's value will change due to a change in the absolute level of interest rate. Interest rate risk affects the value of bonds more directly than stocks, and it's a major risk to all bond holders. As interest rates rise, bond prices fall and vise versa. The rationale is that as interest rates increase, the opportunity cost of holding a bond decreases since investors are able to realise greater yields by switching to other investments that reflect the higher interest rate

LIBOR
London Interbank Offered Rate: set on a daily basis. The rate at which banks lend to each other for different periods

Long Term
Duration in excess of 1 year

Net Asset Value (NAV)
Often used when funds or investment assets are valued. This term generally means the total assets less total liabilities.

Premium
The sale/purchase of an asset at a level that is above the par value or original price. If a security is trading at a premium, current market interest rates are likely to be below the coupon rate of the security.

Short Term
Duration of up to1 year

Support Rating
Fitch Ratings Agency's assessment of extraordinary support given to a financial institution either by the parent and or sovereign.

Supranational Bond
A bond issued by a Supranational organisation (multi-lateral development banks). They are AAA rated organisations in which the share capital is jointly owned and guaranteed by leading developed nations in their respective region.

Treasury Bill (T-Bills)
A Treasury Bills is a short dated instrument issued by HM Treasury. They are issued at a discount, therefore they are not coupon bearing.

Viability Ratings
Assessment of a bank's intrinsic creditworthiness applied by Fitch Ratings Agency. Its aim was to enhance visibility on benefits of support. This replaced the individual ratings.

Yield Curve
The yield curve represents the relationship between yield and maturity. The conventional shape being that as the maturity lengthens, the yield will increase. Each security will have its own yield curve, depending on the yield in every time period available.

Business Plan 2016-2019

Merton Development Company Ltd

IN HOUSE

Contents

Background

In October 2015 the regeneration team, Future Merton, started the initial business plan work to develop the concept of building to rent (PRS) as an option to help develop out council owned sites. The objective, to generate the council income and deliver a quality housing product for the private market to rent.

The team researched and visited other borough's and found the most efficient way of delivering this concept is through a wholly owned council company whose specific business purpose is to build out council owned or purchased sites for either housing or commercial rent. The rationale behind the choice to set up a company was to give the company the agility and expertise to respond to a buoyant housing market where property values have increased significantly in recent years and created, a healthy, but still immature housing rental market.

The growth of the local rental market brings its own challenges as most landlords are individuals. Theinconsistencies with quality, overcrowding, and rogue land lords creates the perfect opportunity for a high quality rental product to intervene in to the local market and deliver better quality residential properties with high quality and responsive management.

The council no longer has a housing revenue account (HRA). The London Borough of Merton transferred all its housing stock to Circle Housing Ltd in 2010. The Local Authority Property Company (LAPC) as part of the business plan will develop sites to be as policy complaint as viably possible and these will then be sold on to registered providers (RP's).

Introduction

Merton Development Company Ltd(name to be confirmed) is the council's wholly owned company that will specialise in developing high quality housing (and commercial property) for market rent.

Merton Development Company Ltd will be a commercially driven vehicle looking to maximise profits and income back to the council, assisting the council in delivering additional housing and stimulating growth and investment opportunities through delivering commercial property in the form of office, retail, and industrial where the opportunity presents itself.

The company will be a wholly owned company with the council as the single (golden share) shareholder, however the company will act like a commercial entity, competing for market segment by delivering a better quality product to customers then traditional private landlords. Merton Development Company Ltd will have a competitive advantage by being the council's preferred residential (PRS) developer.

The relationship with the council will be based on a sound commercial footing. The Council will act as Banker for Merton Development Company supplying working capital and development finance (on commercial terms) for the development and acquisition of sites (council or private).

The council, to begin with, will provide the loan finance to the company to fund the construction of the sites where schemes have demonstrated to being commercially viable through the company's financial model and will deliver a sound return on investment to the council.

As the sole shareholder the council will receive:

- A margin on the interest financing of the company
- An equity stake in the company (the development land value) that can be released when required
- A Shareholder dividend
- The benefit of capital growth in the portfolio over time
- A contribution through planning agreements to affordable housing
- Cash windfalls where market conditions are commercially advantageous

This business plan outlines the development pipeline that the council will allow the company access to. The initial business plan will aim to deliver 77 units for its first projects. Once the company gains momentum the regeneration of Morden town centre will be the company's major project with a potential 600 units being developed in the town centre.

The primary purpose of the company is to deliver the council a sound return on investment through rental on private or commercial properties, however where market sale supports cash flow and financial viability, this will be included to ease any financial burdens the company or the council may face in the current macro environment.

Current Market conditions

The London housing market temporarily slowed during the 2008 recession however it was fairly well insulated due the level of demand for housing in the capital; prices temporarily dropped but quickly returned within a year. The effect of the crash slowed sales and development. Government spending since the crash has been severely curtailed, with councils facing unprecedented cuts to funding and no longer able to offer stimulus investment into the sector, which has heightened the sectors commercial approach resulting in very low levels of affordable housing supply being provided from the sector.

The government's recent changes to the right to buy rules has seen housing supply reduce even further with Registered Providers (RPs) now included in this new government's legislation many developments created by RPs have been halted temporarily whilst they reconfigure there company's business plan to allow for the new legislation.

The government's recent changes to stamp duty for buy to lets and new tax rules on buy to let properties has slowed the investment in private rental market.

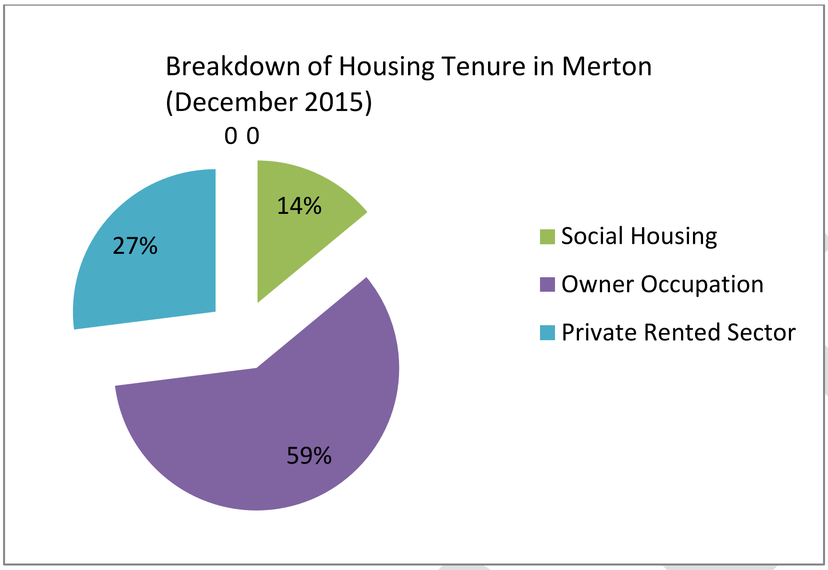
The financial sector has seen stricter rules imposed on banks by government which has had a knock on impact on the accessibility of mortgages, with lenders being stricter and requesting higher deposits for individual mortgages this has made purchasing more difficult for first time buyers with average deposits in London ranging from £40-50,000.

These factors have contributed to accelerate trends away from owner occupation and fuelled the rental market.

The government have put in place help to buy to enable first time buyers to get on the ladder, however due to the level of deposit required by the bank and rent accounting for 60% of the average Londoners salary, saving for a deposit is still a challenge for first time buyers. Property prices are also being driven up by foreign investment into the sector.

The Merton context

The London Borough of Merton has very few company based landlords with predominantly social housing providers selling the service in Merton.



According to the Greater London Authority (GLA) London data store the London Borough of Merton has approximately 207,000 residents living in approximately 83,400 properties. In terms of employment the GLA data store shows the Borough has some healthy economic statistics, with 88% of the residents in the borough being of working age, with 79% of that total being gainfully employed.

For one of London's smallest populations and one of the lowest housing stocks across London it has a strong local economy with 87,000 employed people working within 11,225 active businesses within the borough. In the London Borough of Merton the Public sector only accounts for 12% of the boroughs jobs, this is very healthy statistic when compared to other London Borough's such as Newham which has 23% employed by the public sector.

The salaries earned in the borough are in line with the London average for women and above the London average for Males earning an average salary of over £36,000. The median household income for the borough is approximately £57,000, which is a reasonable income and explains how 29% (GLA 2016) of the borough can afford to privately rent with the percentage of people buying their home just above at 32%. With house prices increasing steadily the average first time buyer deposit in London is now approximately £91,000 according to research carried out by Halifax Bank (2016), potentially strengthening demand for Private rented properties being likely to continue as Londoners struggle to save large deposits.

The above statistics demonstrate the conditions for a new entry into the PRS market locally.

The Private Rented Sector (PRS)

The Private rented sector is growing in the UK , and more significantly in London. The private rented sector consists of 2.7m dwellings in the United Kingdom or 10% of the total housing stock, of this total, 2.4m is in England, representing 12% of the English housing stock.

The sector has grown by over 10% in the last ten years and, according to the Centre for Economics and Business Research, and forecast to grow by a further 40% over the coming ten years.

In 2010 the government ran a large scale survey of the Private Rented Sector and analysed the social and economic spread of private landlords. Some key findings were:

- Eighty-nine per cent of landlords were private individual landlords responsible for 71% of all private rented dwellings, with a further 5% of landlords being company landlords responsible for 15% of dwellings.
- More than three quarters (78%) of all landlords only owned a single dwelling for rent, with only 8% of landlords stating they were full-time landlords.
- Over three-quarters (77%) of all dwellings in the PRS were purchased by the landlord, 9% were inherited and 8% were built by the landlord.
- Eighty-nine per cent of landlords were private individual landlords, 5% were company landlords, and 6% were ‘other organisation’ landlords. These were responsible for 71%, 5% and 14%, respectively, of all dwellings in the sector.
- Twenty-two per cent of landlords had let properties for three years or less with two-thirds (69%) for 10 years or less. Only 5% had let for more than 40 years.
- In terms of formal letting and management practices, nearly all landlords and agents (97%) made use of a written tenancy agreement, with 91% requiring a deposit, and 84% requiring tenants to provide a reference.

Since 2002, the private rented sector has almost doubled, from 10% to 19% in 2014-15. By contrast, the social rented sector has nearly halved, from 31% of all households in 1980, to 17% in 2014-15.

The decrease in social housing is due to the government’s refresh of right to buy, with few houses sold being replaced. The increase in the private rental sector is also partly attributable to right to buy, a recent Central Government select committee report revealed 40% of properties bought through right to buy are now in the private rented sector (English Housing Survey 2016).

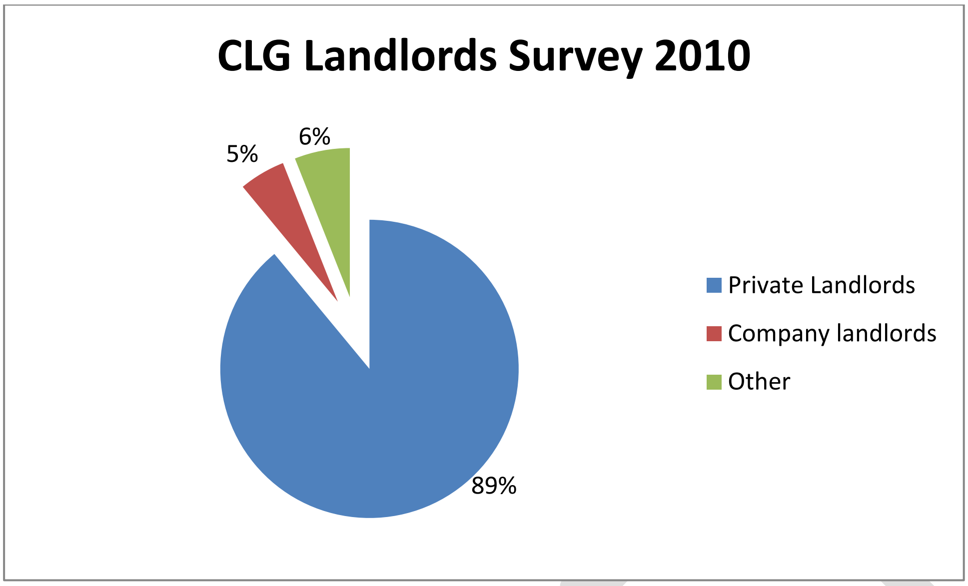


Figure 1 – CLG Landlords survey 2010

The above chart (Figure 1) demonstrates that the bulk of PRS is currently provided by private individuals acting as "amateur landlords", so much so that many local authorities have set up and implemented a property licensing scheme for these landlords to ensure minimum standards are met on health and safety and property management.

The introduction of licensing schemes is an indicator that PRS is a relatively immature market in parts, with plenty of space to enter with a much better product which is professionally run and well managed.

The table on the next page is a description of each of the different types of landlord in the market.

Type of landlord	Description
Private individuals and couples	The largest group of landlords in the PRS. This will include those that have chosen to purchase a single property for buy-to-let purposes, chosen to let a property that they no longer need to live in or have over time developed small portfolio of properties to let. The quality of landlords within this group will vary significantly. At the top end will be those who are letting high quality apartments and houses, through to exploitative landlords offering sub-standard properties.
Partnerships	Partnerships will typically include those private individuals that have chosen to set up a small business to manage their property portfolio. Similar comments on the quality of accommodation let by the private individual group of landlords will apply to partnerships.
Private and listed companies	Accounting for around 5% of the landlords in the PRS this group will include large publically listed companies (e.g. Grainger) as well as other private companies. Large organisations such as Grainger have national large portfolios (e.g. circa 4,000properties) of stock. There are however very few of these types of landlords in the UK. Other private landlord companies may specialise in specific types of accommodation e.g. student housing, hospital related accommodation etc. A number of developers and Registered Providers have entered this market in London in recent years (see key competitors below)
Public sector and charitable organisations	This group of landlord covers housing associations that have become involved in the PRS. It will also include other parts of the public sector that have legacy property portfolios which they let out to residents (e.g. universities, hospitals etc.). A number of Housing associations have recently expanded their portfolios of stock rented at market rent levels. They already have strong housing management practices and believe there are significant benefits to be achieved through expansion into the sector.

PRS tenants Market segments

PRS in London typically accommodates those that are aged between 18-35 and are unable to afford the purchase of their own home, however this is simplifying a more complex picture of individual market segments which are set out below, along with the key features of each of the PRS market segments. (Table 1 – PRS Market Segments)

Market segment	Description
Students	Aged 18 – 21 and attending College / University. Properties are typically located near to an education establishment. The PRS offers this segment affordable housing costs alongside flexible tenancies, which landlords have adapted to meet the specific needs of students. Households in this market segment are typically characterised as being cost effective and includes sharers.
Young professionals (singles / couples and sharers)	This group has largely been created through an increase in mobility and affluence at an earlier age. This group tends to relocate aware from the family home soon after university to seek employment elsewhere. This means, that compared to 20 or 30 years ago, new households are now being formed earlier. And then as home ownership becomes increasingly difficult to access, this group remains in rented accommodation for longer. This group will typically live in accommodation that has a location close to a range of local amenities (transport, nightlife etc.) and will include individuals living along, couples and sharers.
Generation rent	People typically aged under 35 and have good incomes and choose to live in rented accommodation due to lifestyle choice. People typically aged under 35 (but can be older), with good incomes but are unable to raise a deposit to gain a mortgage or are seeking to remain mobile for career reasons.
Young families	Parents aged in their 20s or 30s with children aged under 10. Renting may not be a first choice to this group, but they may not be able to access / afford a mortgage to buy a property. Traditionally this group may have attempted to seek some form of social housing but are now unable to access it. One major concern for this group is on the lack of stability around renting, where 6 months tenancy agreements with private landlords are the norm.
'Empty nesters'	A smaller market segment, it includes couples (usually over the age of 50 – 55) who are looking to downsize as their children have left home. They may be looking to swap a large family home for more modern accommodation close to town centres, or are looking for temporary accommodation to meet the needs of a job / specific phase in life / to provide greater freedom in an attempt to sell a family home. The PRS therefore offers flexibility and choice to this market segment.
Housing benefit	This is a diverse group of residents and for example will include; pensioners, families, singles, those unable to access work through sickness / disability etc. Not all PRS landlords will let their properties to this market and those that do tend to provide a specific focus on this group.
Migrants	For new migrants to UK, the PRS is typically the only accessible form of housing available – social housing will not apply and homeownership may be out of reach for many. An increase in this market segment has also been observed as migration in recent years from the EU has increased. Although this segment is highly diversified - due to pressures on costs a large part of this market segment typically has less choice and may as a result live in less desirable properties in the PRS.

Merton Development Company Target groups

Merton Development Company's target customers are highlighted in Table 1 above. They are young professionals and families looking to rent property that is of a good standard and willing to pay full market rent for this security and comfort.

The majority of our target market is below the age of 35 who are looking for modern facilities to come as part of the property, this includes features such as:

- Broadband/Wi-Fi
- Bike/sports equipment storage
- Resident Gym's - Advanced
- Concierge services – Advanced
- Good on site security arrangements
- TV packages such as freeview and Sky on discount

The above list of features is a general list and certain advanced items e.g. concierge and gym services can only be achieved if the property itself has over 100 units in the same development or adjacent developments.

The first tranche of sites will deliver 77 homes across four sites. The initial developments are unlikely to offer the advanced items to prospective tenants, however the remaining items could become standard as part of the PRS offer from Merton Development Company.

The introduction of Wi-Fi and TV package deals as standard items saves time on management administration costs, and stops residents from sourcing their own solutions and thus making the building look untidy as different customers start to use different providers for different products e.g. Sky satellite dishes etc

This target market group, apart from young families, are sharers, whom will often be looking for equal sized bedrooms and ensuite facilities as part of the standard offer.

Competitors

Merton Development Company's key competitors are the 6% that are private limited companies and 5% which are charities and other public organisations such as registered providers who are now changing their business model to enable them to operate in the market rent part of the PRS market.

These main competitors are:

Be:here

About / Experience

- Established in early 2013, be:here is a principle subsidiary of Wilmott Dixon operating within its regeneration division. It represents its PRS business.

Rent strategy

- Be:here plans to create over 5,000 PRS homes over the next few years.

Development/purchase pipeline

- be:here has two schemes. It's fist scheme, East India in Tower Hamlets, offers 158 studio, 1 and 2 bed apartments and is due for completion in early 2015. It forms part of the multiphase Aberfeldy regeneration project. This development was undertaken with Poplar HARCA, who retains the freehold but has granted a 250-year leasehold on the land to M&G Investments. The latter are funding the development through be:here but the units will be let under the be:here brand. Poplar HARCA will be responsible as the landlord for the management of the tenancies, including all outgoings, maintenance and repairs during the lease term.
- More recently be:here has teamed up with Invesco Real Estate (IRE). The latter will acquire 118 PRS units for £32.5m in Hayes, West London, on behalf of a UK local authority pension fund. IRE's client will purchase the site's freehold from be:here and fund the development of the scheme. be:here will manage the units following completion in 2016.
- be:here in the process of acquiring further sites across London and at central locations in Manchester, Birmingham, Bristol and Leeds; each capable of accommodating single developments of 100 to 400 apartments.

Units in management -All schemes are currently in the development phase.

Indicative Rents – Their first properties are not due to be let until January 2015, but be: here anticipate a 1 bed studio at their East India scheme will be roughly £1000-1300 per month, and a 2 bed between £1500-1900 per month.

Target market & Services

"Flexible apartments, designed to work for singles, sharers and families"

Be: here is developing homes specifically designed for young professionals, targeting 'in-betweeners' who want to live in high quality homes close to their work but cannot afford to buy and don't qualify for social housing. Its services have been developed using feedback from this target group, including:

- Ample storage space, with additional secure storage available on-site to rent
- High-speed broadband, cable TV and telephone ready to use
- Sharers enjoy large, equal-sized bedrooms and a bathroom each
- Rent, rent increases and charges that are fair, reasonable and transparent
- Flexible communication methods - online, phone, text, email or on-site manager
- Flexible approach to tenancies
- Support finding a flat-mate
- Taking in parcels and dry cleaning

Finances

- Its model is predicated on sale and lease back financing, working on a “develop build and sell continuum”. As its income is brought in progressively over successive construction phases, its benefit to Wilmott Dixon will not be felt for a while.
- be:here’s agreement with M&G Investments on its East India scheme represents one of the first examples of institutional investment in the PRS. There is growing recognition among institutional funds of the PRS market’s investment potential.

Fizzy Living

About

- Fizzy Living, a commercial Subsidiary of Thames Valley Housing association (TVH), launched in early 2012 and has made a genuine effort to capture a modern brand position.

Rent Strategy

- Fizzy plans to buy 1,000 new build properties over three years. It buys blocks between 60 and 150 units, all to be let at market rents. Currently its preferred area of operation is London and the South East, but there are plans to take the product nationwide in the mid-term.
- In the future it will deliver mainly 2-3 bedroom units, with the bedrooms around the same size. They will be designed for sharers, which will reduce the cost of the tenancies.
- Plans are to re- invest income into social housing.TVH intends to hold onto the portfolio but the option of selling will be there; in the future it may consider selling it into a real estate investment trust.
- Their full portfolio will be managed and let by Fizzy

Development/purchase pipeline

- Fizzy’s fifth acquisition in Lewisham recently took place; acquiring 136 units. The acquisition takes their portfolio to 382 apartments and moves it closer to its target of 1,000 units.
- Fizzy has launched schemes in Epsom, Stepney Green and Canning Town.

Units in management (as at today) –They currently manage approximately 180 units.

Indicative Rents - A one bed flat in Poplar costs from £1,325 per month. A two bed from £1,560 per month, and three bed from £2,000 per month.

Target Market& Services

"Re-inventing renting"

Fizzy has marketed its product at aspirational young professionals, referred to as 'rentysomethings'. Its offer has been developed with this client group in mind, for instance:

- Each block has its own property manager called 'Bob', the equivalent of an American "super", who arranges access for repairs and takes deliveries
- Two weeks free rent is available on some schemes. They also offer discounts to tenants who accept longer term tenancies to increase retention
- A resident's gym and concierge free of charge
- Self-serve (rent statements available online etc.)
- Fizzy manages utility charges on behalf of tenants at some buildings, recharged at cost and there are no middlemen or agency fees
- Social media and IT to help tenants find flat mates and free WiFi for the life of the tenancy &Free TV set top box / Freeview channels

Finances

- Plans are to fund this £200m investment programme with £120m debt (from banks) and £80m equity, with £30 million of equity from TVH. Fizzy plans to attract a further £50 million of equity from institutions such as pension funds and smaller private investors. It will be grown into a £15 million-a-year turnover business.
- Fizzy has a forecasted internal rate of return of 15 per cent. In February 2013 Fizzy obtained £40 million of finance from Macquarie Capital. In March 2014 it secured £200m from Silver Arrow, an investment entity ultimately owned by the Abu Dhabi Investment Authority (ADIA).

Grainger plc.

About

- Grainger has been in operation since 1912 starting in Newcastle, and is the UK's largest listed specialist residential landlord and property manager. It manages a good portion of its property, but outsources much of its stock to RP partners, as it is unable to sustain a national management presence.

Rent Strategy

- A good part of its successful growth is based on property trading – buying when the market is low or adding value through investment and trading when property prices rise. For this reason the Grainger product is not a settled PRS product. It has to saleable to non-renters.

- Part of its current strategy consists of leading the residential market and creating new business opportunities, as well as maximising returns by actively managing assets and ensuring they are located in the best economic areas. Grainger are actively increasing the size of their market rented portfolio, as the business focuses on increasing their rental income.

Development/purchase pipeline

- Grainger are currently developing an array of mixed tenure schemes (e.g. 197 private units in Haringey due for completion in 2015).
- In terms of build to rent, they are currently active in the 'doughnut' zones around central London to acquire large-scale build to rent opportunities. Their first build to rent scheme is under construction in Barking.
- APG, the Dutch pension fund group, has recently invested in a £430m fund with Grainger, for developments amounting to 1,700 homes.
- Grainger are actively looking to expand their PRS portfolio in Newham, having already teamed up with Bouygues UK to begin work on a site in November 2014.

Units in management (as at today) – Across the UK Granger owns and manages 4,007 market rented assets that have a market value of £446 million.

Indicative Rents – unavailable

Target Market& Services

"For our tenants we are a local, responsible and professional landlord"

- Grainger provides a generic rental offer and doesn't appear to have a specific target market.
- Properties are usually let on a fixed term, usually on an annual basis, but they may also agree a minimum term of six months in some circumstances and periods of five years for some tenancy types.

Finances

- Grainger owns a significant portfolio of residential property assets across the United Kingdom and Germany worth c. £1.8bn as at 30 September 2013. In the UK, 60% of their assets are located in London and the South East. Their assets provide strong and resilient cash flows through sales and rental income.
- In fact, their net rents equate to £48.5m, the second largest source of their income after profits from sales (£77.7m). Historically, the types of assets they owned provided strong sales income and relatively lower rental income, but as they deliver on their strategy, focusing on the private rented sector, a greater proportion of revenue will come from rents.

Essential Living

About

- Essential Living is a developer and operator of private rental homes in the UK.
- Backed by long-term institutional capital, Essential Living intends to "rewrite the rules on rental" by becoming the UK's first buyer, developer and operator of rented homes.

Rent Strategy

- They aim to deliver 5,000 units of private rental stock over the next decade
- They build to rent but also renovate office buildings
- Essential Living's strategy is based on replicating the successful multi-family lettings sector in the U.S. through buying up land to develop rental homes. Essential Living will directly manage these units over the long term.

Development/purchase pipeline

- At present Essential Living have a pipeline of 1,500 homes across London.
- They are currently developing 345 units in Canary Wharf – ready in 2017, as well as 149 residential units in Bethnal green, available in 2016. They also have high profile developments such as London 360 in Elephant & Castle, The Helix in Docklands and 100 Avenue Road in Swiss Cottage.
- It has bought its seventh site in Greenwich, SE8 and will submit a planning application later this year for a new scheme with more than 200 flats in a 17-storey tower.

Units in management (as at today) – All schemes are currently in the development phase.

Indicative Rents – unavailable (schemes not due for completion until 2015)

Target Market& Services

"Our vision is to bring exceptional quality, sustainability and customer service to our residents."

Essential Living recognizes that most renters are young but that many are increasingly likely to have families, and that there has been increase in single parent households. They have developed their brand with this in mind. Their core values are responsibility, inclusivity and commitment. Solutions are also developed on four key factors: time, space, freedom and trust. They encourage community and offer long-term tenancies

Their offer includes:

- Rooftop communal terraces, storage rooms, cold room storage
- Fitness centres
- Residents' bike stores & landscaped communal terraces
- Crèches and children's play space
- Professional, round the clock onsite service
- Quality IT services
- Sites are no more than a 10-minute walk to transport links

Finances

- Essential Living is backed by Evergreen Real Estate Partners in association with M3 Capital Partners who have given $200m of equity. The latter manage U.S. institutional funds.
- They claim their funding stream enables them to quickly acquire land without needing to raise debt.

Get Living London (GLL)

About experience

Rent strategy

- Get Living London launched its first scheme in May 2013 and is committed to *being the market leader in private rental in London.*

Development/purchase pipeline

- Currently GLL own and manage a new site in East Village located in Stratford, which used to be part of the Olympic Park. East Village has the following amenities on its doorstep: Westfield, Stratford International Station, Chobham Academy, and 27 hectares parkland
- East Village contains 2,818 homes in 11 distinct developments Get London Living own 1,439 units, and occupancy began in 2013.
- GLL has not released details of any future developments, however it is apparent that they have not been shortlisted for Round 2 of the Build to Rent Fund.

Units in management

- In June 2014 GLL had 500 units in management.

Indicative Rents

- 1 bedroom apartment-furnished£355 pw
- 1 bedroom apartment-furnished£380 pw
- 2 bedroom apartment-unfurnished£405 pw
- 2 bedroom apartment-furnished£410 pw
- 2 bedroom apartment-unfurnished£410 pw
- 3 bedroom apartment-unfurnished£518 pw
- 3 bedroom apartment-furnished£540 pw
- There are no 4 bedroom homes currently available

Target market & Services

"A better way of renting"

- GLL offer 1, 2, 3 & 4 bedroom properties, furnished or unfurnished. Their target market, with 1 and 2-bedroom apartments aimed at young professionals and couples. 3 and 4-bedroom apartments/ townhouses are designed for sharers and families.

Their offer includes:

- Eco-friendly living in London – marketed as greener place to live e.g. water recycling
- Flexible tenancy agreements: choose from one, two or three-year terms.
- Ability to up or downsize within East Village with no extra fees to pay
- Quality management - their team is located nearby, next to Stratford International Station and are available 7 days a week. They also have an emergency response team, located at East Village, who are available 24/7.
- Take parcel deliveries for tenants when they're out, give information about the neighbourhood and forthcoming events.

Finances

- GLL is owned by Delancey and Qatari Diar as part of a joint partnership Qatari DiarDelancey

Merton Development Company’s Approach

The organised PRS market in London is very competitive with a very different product to traditional buy to let landlords. Merton Development Company’s approach will be to focus on high quality developments that are maintained and managed to a good standard.

Some of the main strengths of Merton’s Development Company will be:

Geography

The London Borough of Merton unlike other boroughs has a very under developed market for company run PRS. The company will start by focusing in the London Borough of Merton. Focusing locally to start with will allow the company to establish a branded product that is recognised for quality through reputation.

Finance

The LB Merton will finance the company at a commercial rate and enable the company to get established. The access to relatively low risk finance gives the company some shield against financial market pressures as the council is the guarantor of the loan. The company will only draw down finance as and when it’s needed to ensure no additional borrowing charges are incurred to the company or the council.

Mixed Developments

Merton Development Company will develop both residential and commercial property as part of its remit, this mix in tenures will allow the company on smaller sites to establish facilities new renters look for such as cafes, gyms, dry cleaners etc in the form of retail units on the ground floor.

Extended Tenure

Merton Development Company will offer longer tenancies then traditional landlords with more security for renters. The longer tenancies will come with fixed increases which will give the customer comfort of no unexpected increases in rent and gives the company an even cash flow with less bad debt and void periods.

Pipeline

The company will have access to the council’s pipeline of sites. The sites will be subject to viability testing and other council pressures on land, however having access to a pipeline that can be tested will allow the company to pursue only sites that are financially viable and reduces the risk the company would be exposed to if the company where to purchase a sites.

Merton Development Company's Development Strategy

Pipeline

Merton Development Company has agreed access to a pipeline of potential council sites in order to create a development pipeline for both housing and commercial purposes. The first tranche of sites selected will all require planning permission for housing, with commercial property where necessary, and will look to develop units across four medium sized sites in the first tranche.

Merton Development Company will also transfer other smaller sites and one off properties into the company. The smaller sites are a mixture of houses that are currently rented commercially through a third party arrangement, and small pieces of land available for a single house development. The company will let, manage and maintain these individual properties giving the council a better return then what they currently achieve.

The company will take a pragmatic approach to providing additional services such as gyms, cafes, retail space within developments to ensure the rent prices can be set competitively and customers get a good deal. The focus will be on the quality of the internal furnishings of the properties to ensure the units are comfortable and contain all modern fixtures.

Affordable Housing

Merton Development Company Ltd will comply with the council's affordable housing policy, subject to the planning requirements to demonstrate viability, however PRS development schemes do not offer an immediate cash return. PRS developments hold more risk and debt for longer, and the company is likely to go through two property cycles during the 30 year period that borrowing it is currently modelled on, therefore the way in which its assessed at planning stage needs to be reviewed and any affordable housing carefully negotiated to ensure viability of the company is maintained.

The company will sell any units developed for affordable housing to registered providers and will not retain any social or affordable housing within its business model. The retention of affordable housing puts the company at risk to current government legislation around the right to buy and any further changes. It's the intention that the company will operate on a purely commercial footing and only offer discounts where as part of any incentives where, market conditions require.

Market Sale

Merton Development Company Ltd may sell a proportion of the units in some developments to boost the company's balance sheet by paying debt down quicker.If the opportunity presents itself in the market where the company can sell properties off at peak values, this will be considered and presented to the council on a development by development basis.

Development Pipeline

The tables below show the medium and small sites that the company could have access to.

Merton Development Company Pipeline – Medium sites pipeline			
Sites	Status	PRS/Affordable	Units
Raleigh Gardens	Pre Planning	PRS	22
Land at Canons	Pre Planning	PRS	22
Elm Nursery Car Park	Pre Planning	PRS	24
Farm Road Church	Pre Planning	PRS	9
West Barnes Library	Pre Planning	Affordable	21
Wilson Avenue Shops	Pre Planning	Affordable	20
Worsford House	Pre Planning	PRS	60
		Total	**178**

Merton Development Company - Small Sites Pipeline			
Kenilworth Road	Pre Planning	PRS	2
Land at Westside Common	Pre Planning	Sale	1
		Total	**3**

The first four sites have been modelled and will cost approximately £11.8 million to construct out based on current market costs. Construction inflation has risen in the last 18 months, this will need to be considered further and reviewed once prices are returned through the procurement process, as the financial model has estimated values that the properties can be built for per square foot, if these fall outside of the current envelope, the model will need to be reviewed and revisions made as appropriate.

Future sites

The below is a list of other larger sites that the Company could have first refusal on as future development sites.

Merton Development Company Pipeline - Future Sites			
Sites	Status	PRS/Affordable	Units
Morden Regeneration	Pre Planning	PRS	600-800
Leatherhead	Pre Planning	PRS	250
Chaucer centre	Pre Planning	PRS	40
Kenley Railway Car Park	Pre Planning	PRS	20
		Total	910-1110

The council also has a large portfolio of commercial sites (light industrial) in the western part of the borough located in Wimbledon. This site sits adjacent to the railway line and has huge potential to be redeveloped in to alternative uses such as high quality serviced office space similar to developments like prologis science parks that house hubs for high tech start ups and internet companies like Amazon.

High Quality Management

Merton Development Company Ltd is committed to providing a high quality management service to all customers. Merton Development Company's objectives are to take rental products to the next level, ensuring that customers are happy with the service and the word spreads quickly across our target market. The company will select a strong local agent through a competitive selection process, to manage the lettings process ensuring that all customers are vetted and the product is not compromised by poor processes from the outset.

The Agents responsibility will be:

- Lettings
- Negotiations
- Tenancy management
- Block management administration

As the company progresses, these may be changed and additional duties may be passed over to the agent after their track record has been proven.

Rents/Tenancies

The company is yet to agree a rental policy for the company, however rents are set at market rates in the model and increased only by inflation each year which is likely to be the stance the company takes to ensure customers get a fair and transparent rental product. The rents included in the business plan are estimates based on advice provided by BPP Regeneration.

Affordable rents will be something that will be passed over to registered providers as the company will not retain affordable properties.

Rentals will be set at market levels at their specific locations by the managing agents, based on existing rental levels, based on location, the below is expected;

- High value rental: Wimbledon
- Medium value rental: Morden/Colliers Wood
- Low to medium value rental: Mitcham

Merton Development Company will offer longer tenancies then what traditional landlords offer with less volatility on price increases and rental periods. Merton Development Company will be an exemplar landlord and ensure all customers have assured shorthold tenancy contracts for the specified period and notice periods that allow the tenant enough time to move. Merton Development Company may offer incentives for prospective tenants and tenants coming up for renewal.

Built to Last

Merton Development Company's mission is to develop a robust and sustainable PRS product which will require a higher specification during construction, ensuring that products purchased and installed are built to last and stand the test of time. The layout of the built product will be designed in a way that maximises the use of space without requiring further modification later on.

Sales

Merton Development Company's business model is based on developing a long term rental product. Sales may be built into the viability model to ensure more debt is paid earlier so the company is under less strain from debt recharges and produces a dividend earlier. However changes in the market may also require the company to sell some units in positive and negative market changes.

- Positive- if the market peaks and the opportunity presents itself for a dividend to be given back to the shareholder.
- Negative - or the market slumps and the sale of one or two units are required to ensure cash flow of the company is protected.

Asset management strategy

Merton Development Company’s asset management strategy is to maintain the stock to a good standard to ensure tenants are kept happy, the assets are always in an attractive condition and up to date with the most modern features to attract renters. To retain its exemplar landlord status, the company will do via its retained managing agents, by:

- A highly responsive repairs and maintenance service allowing customers to report online and having a repairs response line active for the longest period of the day possible.
- Planned preventative maintenance, ensuring facilities do not fall below an acceptable level before being serviced, this also avoids higher costs further down the line when the product fails.
- Annual inspections of properties to ensure the terms of the tenancy agreement are being adhered to, to spot early any condition issues and breeches of tenancy.

Governance

Merton Development Company will be structured in a way that allows flexible and agile decision making to ensure the company can take advantage of market opportunities.

The company will consist of three directors to start with, as recommended by the South London Legal Partnership (SLLP) legal team. As the company grows the company will have the flexibility to add additional directors.

The Board of Directors will initially meet monthly to discuss matters arising from the company.

As the sole share holder the council will set up a shareholder sub-committee through the cabinet process to discuss shareholder matters. The sub-committee will nominate a shareholder representative who will then represent the council at board meetings to ensure that the company is on target to deliver the anticipated returns to the council.

All Major financial and resourcing decisions will require sign off by the council's shareholder sub-committee or shareholder representative. A list of the key decisions is captured as reserved matters in the company's shareholder agreement.

Resourcing

The company will have part time seconded employees from the council to start with to get the company and projects up and running providing strong project management, financial and design and planning skills. Professional skills we be brought in on an ad hoc basis. The company will have a service level agreement with the council to provide support services, such as financial, IT and legal. Once the initial scheme is up and running and further sites are agreed, additional time will be required to manage the existing portfolio and to work up the next tranche of sites.

Finances

Introduction

The financial model utilised by Merton Development Company, has been constructed using Price Waterhouse Coopers (PWC) housing model. PWC have supplied Models to various other councils and are now the market leader for financial advice around wholly owned council housing/property company set ups in the country. The inputs to the model have been supplied by the council's independent regeneration surveyors BPP Regeneration Ltd.

Further information and additional financial tables can be found at the back in Appendix 1.

BPP Regeneration reviewed the existing information that was compiled together previously with other advisors and internal staff. They also visited the sites to check the original assumptions that were made. The site visits resulted in a reduction in the numbers of units assumed at each site to be cautious as some of the sites are very difficult construction sites where higher densities may be difficult to achieve due to the layout of the site. Once the sites have been fully designed it may be possible to achieve some additional units.

The first financial estimates below are based on the first four sites. The first four sites below produce 77 units:

- Raleigh Gardens (22)
- Elm Nursery Car Park (24)
- Land at Cannons (22)
- Farm Road Church (9)

The model is based on a 30 year loan period with the sale of any affordable housing units going to registered providers.

Below are the various funding tables showing the loan required, interest and debt repayments, cash flow from the company to the council and a sales and income position the modelling is based on.

Financial Tables

Table 1: LAPC Balance Sheet Years 1 to 5

	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**
	£000s	£000s	£000s	£000s	£000s
Land	8,190	4,074	0	0	0
Cash	(0)	(0)	(0)	(0)	(0)
Capitalised interest	20	272	851	668	682
WIP/Stock	136	3,379	4,567	0	0
Investment properties	337	9,295	19,097	19,097	19,097
Corporation tax creditor	0	0	0	0	0
Long term loan	(640)	(7,373)	(13,966)	(10,301)	(10,315)
Equity cash element	155	1,775	3,256	3,256	3,256
Equity land element	8,190	8,190	8,190	8,190	8,190
P&L Reserve	(301)	(318)	(897)	(1,982)	(1,982)

Table 2: LAPC Balance Sheet - in 5 year periods

	Year 5	**Year 10**	**Year 15**	**Year 20**	**Year 25**	**Year 30**
	£000s	£000s	£000s	£000s	£000s	£000s
Land	0	0	0	0	0	0
Cash	(0)	33	54	(0)	(0)	9,328
Capitalised interest	682	682	682	682	682	(0)
WIP/Stock	0	0	0	0	0	0
Investment properties	19,097	19,097	19,097	19,097	19,097	0
Corporation tax creditor	0	(33)	(89)	(169)	(281)	(9,328)
Long term loan	(10,315)	(9,881)	(8,298)	(5,540)	(905)	0
Equity cash element	3,256	3,256	3,256	3,256	3,256	3,256
Equity land element	8,190	8,190	8,190	8,190	8,190	8,190
P&L Reserve	(1,982)	(1,548)	0	2,624	7,147	(11,446)

Table 3: LAPC Income and Expenditure - Years 1 to 5

	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**
	£000s	£000s	£000s	£000s	£000s
Profit/(Loss) on sales	(200)	0	(1,001)	(800)	0
Net rental income	(101)	(17)	422	622	655
Net Interest/(Cost)	0	0	0	(908)	(655)
Interest income on surplus cash balance	0	0	0	0	0
Profit/(Loss) before tax	(301)	(17)	(579)	(1,086)	0
Corporation tax	0	0	0	0	0
Profit/(Loss) after tax	(301)	(17)	(579)	(1,086)	0
Dividends	0	0	0	0	0

Table 4: LAPC Income and Expenditure Impact in 5 Year Periods

	Years 1-5	**Years 6-10**	**Years 11-15**	**Years 16-20**	**Years 21-25**	**Years 26-30**
	£000s	£000s	£000s	£000s	£000s	£000s
Profit/(Loss) on sales	(2,000)	0	0	0	0	51,126
Net rental income	1,581	3,838	4,949	6,350	8,110	10,343
Net Interest/(Cost)	(1,563)	(3,319)	(3,042)	(2,373)	(1,257)	(59)
Interest income on surplus cash balance	0	0	1	0	0	0
Profit/(Loss) before tax	(1,982)	518	1,908	3,977	6,853	61,410
Corporation tax	0	(85)	(324)	(676)	(1,165)	(10,687)
Profit/(Loss) after tax	(1,982)	434	1,583	3,301	5,688	50,723
Dividends	0	0	(35)	(676)	(1,165)	(69,316)

Table 5: LBM Income and Expenditure - Years 1 to 5

	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**
	£000s	£000s	£000s	£000s	£000s
Investment income	0	0	0	0	0
Interest payable	(13)	(158)	(416)	(550)	(419)
Interest receivable	20	252	672	908	670
Net I&E Surplus (excl MRP)	8	95	256	358	251

Table 6: LBM Income and Expenditure - In 5 year periods

	Years 1-5	**Years 6-10**	**Years 11-15**	**Years 16-20**	**Years 21-25**	**Years 26-30**
	£000s	£000s	£000s	£000s	£000s	£000s
Investment income	0	(0)	35	676	1,165	57,870
Interest payable	(1,554)	(1,951)	(1,581)	(964)	(161)	0
Interest receivable	2,521	3,319	3,042	2,373	1,257	59
Net I&E Surplus (excl MRP)	967	1,368	1,497	2,085	2,262	57,929

Sites

Farm Rd Church (9 Units)

Canons Leisure Centre (22 Units)

Raleigh Gardens (22 Units)

Risk Register

Risk ID	Risk Title	Risk Description	Likelihood	Impact	Risk Score	Mitigation Actions
1	**Deterioration of Relationship With Council**	It is anticipated that there will be challenges within the relationship between the company and the council. Whilst the shareholder agreement offers the company a good deal of autonomy it also retains key decisions for the Shareholder, which incentives the company to resolve any difficulties.	2	4	8	The management of the relationship will need to be reviewed particularly when key appointments are made.
2	**Collapse of the Residential Property Market**	The property market is susceptible to fluctuations. The risk is that the value of the company's portfolio will fall while the market is at a low.	2	2	4	The company is a long term venture and would expect to survive any fluctuations in the market. However, were market rent levels to fall substantially, the company could take a view on sales to ride the downturn or seek a greater subsidy input from LBM to utilize a greater proportion of properties at affordable rents.

3	**Loss of London as a World City**	London's residential property market is closely related to London as a world city therefore the loss of London as a city would greatly impact the company.	1	4	4	London's growth is key to the growth of the UK economy and therefore its global status is a matter of national priority.
4	**Severe Decline in Demand for Rental Properties**	Over recent years, there has been a shift in tenure patterns. Owner occupation has been in decline while renting has increased. It is possible that the market may see a reversal of this state.	2	4	8	In severe circumstances, the company can mitigate financial losses through a number of measures including converting properties to shared ownership and/or outright sale, and leasing properties to housing associations, LBM and/or other London councils.
5	**Skill Deficit of Local Authority Property Company (LAPC) Staff**	Skill Deficit of the company Staff will leave it unable to compete.	2	4	8	The company will develop a competitive pay commensurate with those offered by private sector competitors. Skills development will be a key objective of the company
6	**Failure to Secure Planning Consent**	There may be a failure to secure planning consent for viable schemes.	2	3	6	The company will work in partnership with LB Merton planners in order that pressures and priorities on both sides are understood.
7	**Cash Flow Crisis**	The company is a rental business, therefore it may suffer from issues that arise as a result of the slow influx of rental income.	3	3	9	Conversion of market rent properties to outright market sale to bridge cash flow difficulties
8	**Failure to Stay True to Mission**	A failure to stay true to their mission may lead to loss of community confidence, damage to reputation.	2	2	4	Always stay on top of market trends within PRS and target audience

9	**Tranche 2 Schemes Become Unviable**	It is possible that some sites can no longer be built on as a result of unknown elements. This is a greater concern if it occurs to multiple sites as opposed to single sites.	**3**	**2**	**6**	Monitor sites and ensure that there are alternative plans for the portfolio.
10	**Collapse of Contracts**	It is possible that the company may fall out of contract with architects, planners or constructors. This would result in loss of time and will affect progress.	**1**	**2**	**2**	Strong project management. Maintain constant communication with all teams in order to ensure that concerns are addressed before they become problematic.
11	**Changes in Policy**	Changes may occur to policy relating to private rented accommodation which would alter the organisation's mission.	**1**	**4**	**4**	Stay abreast of the political situation and ensure the companies interests are considered before any decisions are made.
12	**Fail of Loan Covenants**	The company may fall fail of loan covenants. This would put it in default so the loan would need to be paid back.	**2**	**4**	**8**	Renegotiate the loan.
13	**Deterioration of Stock Value**	The value of the stock may fall below long term value ratio. This would become an impairment to the accounts, as well as to the council's accounts.	**2**	**4**	**8**	Need to be constantly conscious of rental and sales values .
14	**Inability to Meet Viability Targets**	Mid-way through the development, a scheme may be unable to meet the assumed viability model.	**2**	**4**	**8**	Properties could be sold, however assistance from the council may be required.
15	**Working Capital**	Prior to funding approval, increasing working capital requirements which exceed LBM budget would lead to a reduction of activity on projects.	**4**	**4**	**16**	Working capital facility is set at a minimum of £4m. A recovery strategy has been implemented to maintain the solvency of the company

16	**Increasing Construction Costs**	Estimated construction costs may increase during the pre-construction stage. This will also result in an increase in the pre-construction professional fees.	**3**	**4**	**12**	Development of a robust cost control mechanism, with Gateway approval points for authorisation

[V.28/09/2016] **DATED** **2016**

SHAREHOLDER AGREEMENT

between

THE MAYOR AND BURGESSES OF THE LONDON BOROUGH OF MERTON

and

[LAPC LTD]

CONTENTS

CLAUSE

SCHEDULE

THIS AGREEMENT is dated [ ] 2016.

PARTIES

(1) **THE MAYOR AND BURGESSES OF THE LONDON BOROUGH OF MERTON**, of Civic Centre, London Road, Morden, SM4 5DX (**the COUNCIL**).

(2) **[LAPC LIMITED]** incorporated and registered in England and Wales with company number [NUMBER] whose registered office is at [REGISTERED OFFICE ADDRESS] (**LAPC**).

BACKGROUND

(A) LAPC is a newly formed company incorporated in England and Wales on [ ] and has one ordinary share of £1 in issue, which is registered in the name of and the beneficial ownership of the Council.

(B) LAPC has been established for the purpose of making profit by way of building or acquiring housing and commercial units for either sale or rental at full market rates (in relation to housing units on assured shorthold tenancies) (with affordable housing as required by the local planning authority conditions).

(C) LAPC shall carry on business in accordance with the terms and conditions of this Agreement.

(D) THE COUNCIL shall exercise its rights as shareholder in relation to LAPC in accordance with the terms and conditions of this Agreement.

AGREED TERMS

1. INTERPRETATION

1.1 The definitions and rules of interpretation in this clause apply in this Agreement.

Act: the Companies Act 2006.

Adequate Procedures: adequate procedures, as referred to in section 7(2) of the Bribery Act 2010 and any guidance issued by the Secretary of State under section 9 of the Bribery Act 2010.

Articles: the articles of association of [LAPC] in agreed form to be adopted on or prior to Completion as amended or superseded from time to time.

Associated Person: a person (including an employee or agent) who performs services for or on behalf of [LAPC].

Board: the board of Directors of the [LAPC] as constituted from time to time.

Business: has the meaning given in clause 2.

Business Day: any day other than a Saturday, Sunday or public holiday in England when banks in London are open for business.

Business Plan: has the meaning given in clause 10.

Chairman: means the Council Director appointed by the Council to preside over a meeting of the Directors.

Completion: the completion of the formation of [LAPC].

Confidential Information: means any information or data in whatever form disclosed, which by its nature is confidential or which the disclosing party acting reasonably states in writing to the receiving party is to be regarded as confidential, or which the disclosing party acting reasonably has marked 'confidential' (including, without limitation, information concerning the business, affairs, customers, clients or suppliers of a party, financial information, or marketing or development or work force plans and information, and information relating to services or products) but which is not personal data (as defined in the Data Protection Act 1998), pursuant to an FOIA or EIRs request, or information which is published as a result of government policy in relation to transparency.

Council Director: any Director appointed to the Board by the Council, excluding any Independent Director.

Director: a director of [LAPC], including a managing Director or chief executive or other chief officer of [LAPC].

EIRs: the Environmental Information Regulations 2004 (SI 2004/3391) together with any guidance and/or codes of practice issued by the Information Commissioner or relevant government department in relation to such regulations.

Encumbrance: any interest or equity of any person (including any right to acquire, option or right of pre-emption) or any mortgage, charge, pledge, lien, assignment, hypothecation, security interest, title retention or any other security agreement or arrangement.

Executive Director: means a Director that is also an employee of [LAPC].

Finance Agreement: a finance agreement to be entered into by [LAPC] and the Council on or about the date of this Agreement and any other funding and security documentation which is entered into by the Council and [LAPC] pursuant to which the Council shall provide funding to [LAPC].

Financial Year: in relation to [LAPC], means its accounting reference period of 12 months ending on the date given in clause 3.1(g)~~3.1(h)~~ or such other date as [LAPC] may determine in accordance with section 392 of the Act but, in the first year in which [LAPC] is formed, means the period starting with the day [LACH] is formed and ending on the date given in clause 3.1(g)~~3.1(h)~~, subject to the Act.

FOIA: the Freedom of Information Act 2000, and any subordinate legislation made under that act from time to time, together with any guidance and/or codes of practice issued by the Information Commissioner or relevant government department in relation to such legislation.

Independent Director: a Director that is not an Executive Director or an employee, officer or member of the Council.

Intellectual Property Rights/IPR: any and all patents, inventions, trademarks, logos, service marks, domain names, registered designs, utility models, copyright, moral rights, rights in design, know-how, confidential information and all or any other intellectual or individual property rights whether or not registered or capable of registration and whether now or in the future residing in the U.K. or any other part of the world together with all or any goodwill and accrued rights of action.

Land Transfer Agreements: agreements to be entered into by the [LAPC] and the Council, the first agreement to be signed on or about the date of this Agreement pursuant to which the Council will transfer land to [LAPC] as part of its equity investment in LAPC.

Procurement Law: means all U.K. and European law relevant to public procurement activities including, without limitation the Public Contracts Regulations 2015 (SI 102/2015), the Treaty on the Functioning of the European Union, the Directive 2014/24/EU and all other relevant legislation, case law, guidance and codes of practice with which the Council is bound to comply (or any updates, re-enactments or replacements).

Remuneration Policy: a policy adopted by the [LAPC] (following receipt of Council written approval) in relation to the provision of remuneration (including salary, bonus, the provision of benefits-in-kind or otherwise) for its employees, officers and consultants.

Reserved Matters: the matters listed in Schedule 1.

Subsidiary: has the meaning given in section 1159 of the Act.

Support Agreement: the agreement pursuant to which the Council provides support services to [LAPC], to be entered into by LAPC and the Council in agreed form.

Support Services: the support services to be provided by the Council to [LAPC] as set out in the Support Agreement.

1.2 Clause, Schedule and paragraph headings shall not affect the interpretation of this Agreement.

1.3 Unless otherwise stated to the contrary, references to clauses and Schedules are to clauses of and Schedules to this Agreement and references to paragraphs are to paragraphs of the relevant Schedule.

1.4 The Schedules form part of this Agreement and shall have effect as if set out in full in the body of this Agreement. Any reference to this Agreement includes the Schedules.

1.5 A reference to this Agreement or to any other agreement or document referred to in this Agreement is a reference to this Agreement or such other agreement or document as varied or novated in accordance with its terms from time to time.

1.6 Unless the context otherwise requires, words in the singular shall include the plural and in the plural shall include the singular.

1.7 Unless the context otherwise requires, a reference to one gender shall include a reference to the other genders.

1.8 A person includes a natural person, corporate or unincorporated body (whether or not having separate legal personality).

1.9 A reference to any party shall include that party's successors and permitted assigns.

1.10 Unless otherwise stated to the contrary, a reference to writing or written includes email and faxes.

1.11 In construing this Agreement, the ejusdem generis rule does not apply and the interpretation of general words following the terms including, include, in particular, for example or any similar expression shall be construed as illustrative and shall not limit the sense of the words, description, definition, phrase or term preceding those terms.

1.12 Where the context permits, other and otherwise are illustrative and shall not limit the sense of the words preceding them.

1.13 References to a document in “agreed form” are to that document in the form agreed by the parties and initialled by them or on their behalf for identification.

1.14 A reference to a statute or statutory provision is a reference to it as amended, consolidated, extended or re-enacted from time to time (whether made before or after the date of this Agreement).

1.15 A reference to a statute or statutory provision shall include all statutory instruments and subordinate legislation (as defined in section 21(1) of the Interpretation Act 1978) or orders made from time to time under that statute or statutory provision (whether made before or after the date of this Agreement).

1.16 A reference to a statutory or regulatory body shall include its successors and any substituted body.

1.17 Any obligation on a party not to do something includes an obligation not to allow that thing to be done.

1.18 Unless the context requires otherwise, words and expressions defined in the Articles shall have the same meaning when used in this Agreement.

2. Business of [LAPC]

2.1 The business of [LAPC] is:

(a) to operate as a commercial company;

(b) primarily to build and acquire housing and commercial units for either sale or to be rented at full market rates (in relation to housing units on assured shorthold tenancies) (with affordable housing only as required by local planning authority conditions) .

together with any activities reasonably incidental to the above (“**Business”**).

2.2 The principle place of business of and for management of [LAPC] shall be within the London Borough of Merton, unless otherwise agreed in writing by the Council.

2.3 In order to maximise the potential of successful lettings/sales of the homes to potential tenants/owners the Company shall ensure that the homes are available to a modern standard and are well managed and maintained.

2.4 [LAPC] shall circulate a draft Remuneration Policy to the Council on or before [ ] 2016 (or such later date as shall be agreed between the parties). The Council shall use reasonable endeavours to respond to confirm whether it has approved the Remuneration Policy within twenty (20)]Business Days of its receipt

2.5 Following approval of the Remuneration Policy by the Council the [LAPC] shall comply with the Remuneration Policy in making remuneration payments to all personnel, including consultants, architects and others, who are entitled to receive remuneration payments from the [LAPC].

3. Completion

3.1 At Completion the parties shall procure that such [shareholder resolution] and board meetings of [LAPC] are held as may be necessary to:

(a) adopt the Articles in agreed form;

(b) give the Directors the authority to allot the Council its share[s] in accordance with clause 3.2;

(c) appoint:

(i) Fiona Thomsen and Paul Dale Council Directors; and

(ii) James McGinlay as Executive Director;

Comment [ss1]: Paul I have a note re ‘Paul McGarry’ but am unsure where his name should be included. Please will you advise.

(d) resolve that the registered office of [LAPC] shall be the Council's address at the heading of this Agreement;

(e) appoint PwC as the auditors of [LAPC];

(f) appoint [NAME] as the principal bankers to [LAPC]; and

(g) resolve that [LAPC's] Financial Year shall end on 31st March in each year.

Comment [sb2]: Awaiting confirmation from Paul as to the Council's Bankers

3.2 At Completion:

(a) [LAPC] shall issue credited as fully paid one (1) share to the Council and enter the Council in the register of members of [LAPC] as the holder of such share and issue a share certificate to the Council in respect of such share;

(b) in consideration for the issue to the Council of its share, the Council shall:

(i) pay £1 to [LAPC];

(ii) enter into the Finance Agreement;

(iii) enter into one or more Land Transfer Agreement(s);

(iv) provide Support Services to [LAPC] in accordance with the terms of the Support Agreement.

3.3 At Completion the parties shall adopt the Business Plan for the Financial Year in which [LAPC] is formedin agreed form. The Business Plan shall be revised annually, three calendar months before the end of the relevant Financial Year.

3.4 At Completion the parties shall procure that the following agreements are executed in the agreed form:

(a) the Support Agreement;

(b) the Finance Agreement;

(c) the Land Transfer Agreement;

(d) [the Secondment Agreement];

(e) the Directors' Service Agreements.

3.5 The parties waive, or agree to procure the waiver of, any rights or restrictions which may exist in the Articles or otherwise which may prevent the allotment and issue of the share in [LAPC] pursuant to clause 3.2.

4. MATTERS REQUIRING CONSENT OF THE COUNCIL

[LAPC] shall not, without the prior written approval of the Council, carry out any of the Reserved Matters.

5. DIRECTORS AND MANAGEMENT

5.1 The Board has responsibility for the supervision and management of [LAPC] and its Business, subject to clause 4.

5.2 Without prejudice to the generality of the foregoing, the Directors will determine the general policies of the Company and the manner in which the Business is to be carried out, subject to the Business Plan, to the Reserved Matters (requiring Council consent pursuant to clause 4) and to any other express provisions of this Agreement. In particular, but without limitation to the generality of the foregoing, the Directors shall exercise all voting rights and other powers of control available to them in relation to [LAPC] so as to procure (in so far as they are able in the exercise of such rights and power) that, at all times during the term of this Agreement, the Company shall:

(a) carry on and conduct its business and affairs in a proper and efficient manner, for its own benefit and in accordance with the Business Plan and with good business practices; and

(b) transact all its business on arm's length terms.

5.3 Subject to clause 5.5~~5.4~~, the Council may appoint a Director and remove a Director, by giving notice in writing to [LAPC], and to the Director being removed, in the case of removal of a Director. Such appointment or removal shall take effect on the date on which the notice is given.

Comment [ss3]: This means the Council appoints/removes any director (i.e. including executive director, MD/chief executive), subject to 5.4 which provides for joint appointment of the independent director

5.4 In the event that the number of directors is reduced to one (1) and such director is not the Executive Director the Council shall be entitled to appoint an Executive Director to be the managing director

5.5 The parties shall agree on the appointment the Independent Director.

5.6 The Council shall indemnify and keep indemnified [LAPC] against any claim connected with the removal by the Council of any Director from office.

5.7 Unless the Council shall determine otherwise, there shall be a minimum number of three (3) Directors on the Board made up of two (2) Council Directors and an Executive Director.

5.8 The post of Chairman shall be held by a Council Director. The Chairman shall have a casting vote. If the Chairman for the time being is unable to attend or to vote on any matter at any meeting of the Board, the Chairman shall be entitled to appoint another Council Director to act as Chairman at the meeting or in relation to that matter and such person shall have the casting vote.

5.9 Unless agreed otherwise, the parties intend there to be a meeting of Directors at least four (4) times each year, with a period of not more than twelve (12) weeks between any two meetings.

5.10 The parties shall use their respective reasonable endeavours to ensure that any meeting of the Board (or meeting of a committee of the Board) has the requisite quorum.

5.11 [LAPC] shall be entitled to reimburse any Independent Director his or her reasonable expenses arising in connection with his/her role as Independent Director.

6. FINANCE FOR LAPC AND LAND

6.1 The parties shall procure that [LAPC] arranges a loan facility for its initial working capital (**Facility**) from the Council (or such bank or financial institution as the Board shall select if it offers more favourable terms (**Bank**)). The amount of the Facility shall be £[AMOUNT] and shall be on the terms set out in the Finance Agreement.

Comment [ss4]: To be completed when figure is available

6.2 Unless set out otherwise in the Finance Agreement, there is no obligation on the Council to provide any further finance to [LAPC] but if it does so this shall be on the same terms as set out in the Finance Agreement unless the parties agree otherwise in writing.

6.3 If [LAPC] requires any additional loan facility, this may be financed, as far as is practicable, from external funding and on such terms as agreed between the Board, the Council and the relevant third parties. The parties agree that any security required in relation to such external funding shall, if possible, be provided by [LAPC].

6.4 Any loan facility to be provided by a Bank or other third party shall be provided on the basis that the Bank or other third party will not acquire the right to participate in the share capital of [LAPC] or otherwise in [LAPC's] business.

6.5 The parties shall enter into such Land Transfer Agreements as are considered appropriate from time to time. If [LAPC] wishes to enter into any agreements for the acquisition of land (whether freehold or leasehold) from any third party, it shall:

(a) prepare a business case setting out the rationale and supporting arguments for acquiring the land;

(b) not, without the prior agreement of the Council, enter into any agreement to acquire the land where the acquisition price is in excess of £[1,000,000 (one million pounds)] or such other lower or higher figure as the Council may from time to time agree;

(c) irrespective of the acquisition price, retain and make available for inspection by the Council, any business case prepared pursuant to clause (a).

7. COMPLIANCE WITH PROCUREMENT LAW

7.1 [LAPC] shall in carrying out any relevant procurement exercise, comply with all Procurement Law and shall, upon request, provide evidence to the Council of such compliance.

7.2 Without prejudice to clause 7.1, [LAPC] shall permit the Council at any time to monitor any procurement exercise to which Procurement Law applies (or which the Council reasonably considers may apply).

8. RESTRICTIONS ON THE PARTIES

8.1 Neither party shall, during the times specified below, offer employment to, enter into a contract for the services of, or attempt to solicit or seek to entice away from the other party any individual who is at the time of the offer or attempt, a Director, officer or employee [holding an executive or managerial position] with the other party or procure or facilitate the making of any such offer or attempt by any other person. The times during which the restrictions apply are:

(a) any time when the Council is a shareholder; and

(b) for a period of twelve (12) months after the Council ceases to be a shareholder in [LAPC].

9. ANTI-CORRUPTION

9.1 LAPC undertakes to the Council that:

(a) it will not, and will procure that all Associated Persons do not, in the course of the operation of the Business, engage in any activity, practice or conduct which would constitute an offence under sections 1, 2 or 6 of the Bribery Act 2010;

(b) it has and will maintain in place Adequate Procedures designed to prevent any Associated Person from undertaking any conduct that would give rise to an offence under section 7 of the Bribery Act 2010; and

(c) from time to time, at the reasonable request of the Council, it will confirm in writing that it has complied with its undertakings under clause 9.1(a) and clause 9.1(b) and will provide any information reasonably requested by the Council in support of such compliance.

10. BUSINESS PLAN

10.1 The Business Plan is an annual business plan (unless otherwise agreed by the Council) for [LAPC] prepared by the Board and it shall include in relation to the Financial Year to which it relates:

(a) a cashflow statement giving:

(i) an estimate of the working capital requirements; and

(ii) an indication of the amount (if any) that it is considered prudent to retain, for the purpose of meeting those requirements, out of those profits of the previous Financial Year that are available for distribution to the Council as shareholder;

(b) a monthly projected profit and loss account;

(c) an operating budget (including capital expenditure requirements) and balance sheet forecast;

(d) a management report setting out:

(i) business objectives for the year;

(ii) Land Transfer Agreements and Finance Agreements proposed to be entered into; and

(iii) proposals for acquisition of any land (freehold or leasehold) from any third party; and

(e) a financial report which shall include an analysis of the estimated results of [LAPC] for the previous Financial Year compared with the Business Plan for that year, identifying variations in sales, revenues, costs and other material items.

10.2 The Business Plan for the Financial Year in which [LAPC] is formed shall be that identified in clause 3.3.

10.3 The Business Plan for every other Financial Year shall, subject to clause 10.4, be:

(a) prepared by the Board and circulated to the Council at least twenty eight (90) Business Days before the end of the preceding Financial Year;

(b) approved or commented upon by the Council as soon as reasonably possible and in any event the Council shall use reasonable endeavours to approve/comment within ten (20) Business Days of receipt;

(c) updated by the Board if required to reflect any comments provided by the Council pursuant to clause (b) within five (5) Business Days of receipt of any comments from the Council; and

(d) adopted by the Board following approval by the Council.

10.4 Where the Business Plan includes a proposal to enter into a Land Transfer Agreement, Finance Agreement or incur capital borrowing above £1 million pounds, the Business Plan shall be circulated to the Council at least 30

Business Days before the end of the preceding Financial Year and the timescale for approval or comment by the Council set out in clauses 10.3(b) shall be increased by ten (10) Business Days.

10.5 For the avoidance of doubt, no Business Plan shall be adopted, varied or replace without the prior written approval of the Council.

10.6 For the any period when a proposed Business Plan circulated pursuant to clause 10.3(a) has not been approved by the Council and adopted by the Board in accordance with this Agreement, the relevant existing Business Plan shall continue to be the Business Plan of the Company.

11. ACCOUNTING AND OTHER INFORMATION

11.1 [LAPC] shall at all times maintain effective and appropriate control systems in relation to its financial, accounting and record-keeping functions. Without prejudice to the generality of the foregoing, [LAPC] shall at all times maintain accurate and complete accounting and other financial records including all corporation tax computations and related documents and correspondence with HM Revenue & Customs in accordance with the requirements of all applicable laws and generally accepted accounting principles applicable in the United Kingdom.

11.2 The Council and its authorised representatives shall be allowed access at all reasonable times to examine the books, accounts, documents and records of [LAPC] and to discuss [LAPC's] affairs, finances and accounts with its Directors and senior management and the Company shall permit such persons to discuss such matters with the Council and its authorised representatives. The Council and its authorised representatives shall be entitled to make copies of such books, accounts, documents and records as it/they consider appropriate.

11.3 [LAPC] shall supply the Council with the financial and other information necessary to keep the Council informed about how effectively the Business is performing and in particular shall supply the Council with:

(a) a copy of each year's Business Plan for approval in accordance with clause 10.3;

(b) a copy of each business case prepared pursuant to clause 6.5(a);

(c) a copy of the audited accounts of [LAPC] prepared in accordance with the laws applicable in and the accounting standards, principles and practices generally accepted in the United Kingdom, within two (2) months of the end of the year to which the audited accounts relate;

(d) monthly management accounts of [LAPC] to be supplied within ten (10) Business Days of the end of the month to which they relate and the accounts shall include a profit and loss account, a balance sheet and a cashflow statement and such other information as the Council may reasonably require; and

(e) a copy of a report prepared by [LAPC] in respect of each Financial Year, demonstrating the implementation by [LAPC] of Adequate Procedures, such report to be provided within forty (40) Business Days of the end of the Financial Year to which it relates.

11.4 [LAPC] shall, as soon as possible, comply with any request made by the Council, to provide any documents, information and correspondence necessary to enable the Council to comply with filing, elections, returns or any other requirements of HM Revenue & Customs or of any other revenue or tax authority.

11.5 The Company shall not carry out any activity which would render the holding of shares by the Council unlawful provided that where a proposed change of law would render such shareholding unlawful shall use its reasonable endeavours to take such steps as are necessary to allow it to continue lawfully to hold its shares.

11.6 The Company shall, if it requires any approval, consent or licence for the carrying on of its Business in the manner in which it is from time to time carried on or proposed to be carried on, use all reasonable endeavours to obtain and maintain the same in full force and effect.

11.7 The Company shall not breach nor cause the Council to be in breach of the Local Authorities (Companies) Order 1995.

12. DIVIDEND POLICY

12.1 Any decision relating to the distribution or otherwise of a dividend shall be a Reserved Matter.

13. NOT USED

14. ISSUE OF FURTHER SHARES

Any decision relating to the issue of any shares or other equity securities (within the meaning of section 560(1) of the Act) shall be a Reserved Matter.

15. INTELLECTUAL PROPERTY

15.1 The Council shall retain ownership of all IPR arising from the operation of the Business by [LAPC].

15.2 The Council grants to [LAPC] a fully paid up, non-exclusive, royalty-free, non-transferable licence to use the IPR for the term of this Agreement.

15.3 [LAPC] shall promptly, at the Council's request, do (or procure the doing of) all such acts and things and execute (or procure the execution of) all such documents as the Council may from time to time require for the purpose of securing for the Council all its rights, title and interest in and to the IPR.

16. TERMINATION AND LIQUIDATION

16.1 Subject to clause 16.2, this Agreement shall terminate:

(a) upon written agreement of the parties in accordance with the agreed terms; or

(b) when the Council ceases to hold any shares in [LAPC];

(c) when a resolution is passed by the Council or creditors, or an order is made by a court or other competent body or person instituting a process that shall lead to [LAPC] being wound up and its assets being distributed among [LAPC's] creditors, shareholder or other contributors.

16.2 On termination of this Agreement, the following clauses shall continue in force:

Comment [ss5]: To be reviewed and completed immediately prior to finalisation of Agreement.

(a) Clause 1 (Interpretation);

(b) Clause 7 (Restrictions on Parties);

(c) Clause **Error! Reference source not found.**~~13~~ (Tax Matters);

(d) this clause;

(e) Clause 18 (Confidentiality);

(f) Clause 22 (Assignment and Other Dealings);

(g) Clause 23 (Entire Agreement);

(h) Clause 25 (Variation and Waiver);

(i) Clause 26 (Costs);

(j) Clause 27 (No Partnership or Agency);

(k) Clause 28 (Notices);

(l) Clause 29 (Severance);

(m) Clause 34 (Inadequacy of Damages);

(n) Clause 35 (Governing Law and Jurisdiction); [and **OR**.]

(o) [INCLUDE ANY OTHER RELEVANT PROVISIONS.

16.3 Termination of this Agreement shall not affect any rights, remedies, obligations or liabilities of the parties that have accrued up to the date of termination, including the right to claim damages in respect of any breach of the agreement which existed at or before the date of termination.

16.4 Where, following an event referred to in clause 16.1(c), [LAPC] is to be wound up and its assets distributed, the parties shall endeavour to ensure that, before dissolution:

(a) all existing contracts of [LAPC] are performed to the extent that there are sufficient resources;

(b) [LAPC] shall not enter into any new contractual obligations;

(c) [LAPC's] assets are distributed as soon as practical; and

(d) any assets transferred to [LAPC] pursuant to any relevant agreement shall be returned to the Council or dealt with as the Council directs.

17. STATUS OF THE AGREEMENT

17.1 Each party shall, to the extent that it is able to do so, exercise all its voting rights and other powers in relation to [LAPC] to procure that the provisions of this Agreement are properly and promptly observed and given full force and effect according to the spirit and intention of this Agreement.

17.2 If there is an inconsistency between any of the provisions of this Agreement and the provisions of the Articles, the provisions of this Agreement shall prevail as between the parties.

17.3 The parties shall, when necessary, exercise their powers of voting and any other rights and powers they have to amend, waive or suspend a conflicting provision in the Articles to the extent necessary to permit [LAPC] and its Business to be administered as provided in this Agreement.

18. CONFIDENTIALITY, FOIA AND EIRS

18.1 In this clause, Confidential Information excludes the information in clause 18.2.

18.2 Information is not Confidential Information if:

(a) it is or becomes generally available to the public (other than as a result of its disclosure in breach of this Agreement); or

(b) either party can establish to the reasonable satisfaction of the other party that it found out the information from a person not connected with the other party and that such person is not under any obligation of confidence in respect of the information; or

(c) either party can establish to the reasonable satisfaction of the other party that the information was known to the first party before the date of this Agreement and that it was not under any obligation of confidence in respect of the information; or

(d) the parties agree in writing that it is not confidential.

18.3 Each party shall at all times keep confidential (and [use all reasonable endeavours to] ensure that its employees, agents, subsidiaries, and the employees and agents of such subsidiaries shall keep confidential) any Confidential Information and shall not use such Confidential Information except for the purpose of exercising or performing its rights and obligations under or in connection with this Agreement, and shall not disclose such Confidential Information except:

(a) to a party's professional advisers where such disclosure is for a purpose related to the operation of this Agreement; or

(b) with the written consent of the party that the information relates to; or

(c) as may be required by law or by the rules of any recognised stock exchange, or governmental or other regulatory authority or by a court or other authority of competent jurisdiction, including pursuant to the FOIA or EIRs; or

(d) a party may, provided it has reasonable grounds to believe that the other party is involved in activity that may constitute a criminal offence under the Bribery Act 2010, disclose Confidential Information to the Serious Fraud Office without first informing the other party of such disclosure; or

(e) to any tax authority to the extent reasonably required for the purposes of the tax affairs of the party concerned [or any party connected with that party].

18.4 Each party shall inform (and shall use all reasonable endeavours to procure that any connected party shall inform) any officer, employee or agent or any professional adviser advising it in relation to the matters referred to in this Agreement, or to whom it provides Confidential Information, that such information is confidential and shall require them:

(a) to keep it confidential; and

(b) not to disclose it to any third party (other than those persons to whom it has already been disclosed in accordance with the terms of this Agreement).

18.5 On termination of this Agreement, each party shall (and shall use all reasonable endeavours to procure that its subsidiaries, and its officers and employees and those of its subsidiaries shall):

(a) return to the other party all documents and materials (and any copies) containing, reflecting, incorporating or based on the other party's Confidential Information; and

(b) erase all the other party's Confidential Information from computer and communications systems and devices used by it, including such systems and data storage services provided by third parties (to the extent technically and legally practicable),

provided that a recipient party may retain documents and materials containing, reflecting, incorporating or based on the other party's Confidential Information to the extent required by law or any applicable governmental or regulatory authority.

18.6 The provisions of this clause 18 shall continue to apply after termination of this Agreement for any cause.

Freedom of Information and Environmental Information Regulations

18.7 Each party acknowledges that the other party is subject to the requirements of the FOIA and the EIRs and each party shall assist and co-operate with the other party to enable that other party to comply with its obligations under the FOIA and the EIRs. This shall include complying with any timescales set by the relevant party for providing information and/or assistance and providing all such information and/or assistance as the relevant party shall request to enable the relevant party to comply with its obligations under the FOIA and the EIRs.

18.8 Where a party (the “Recipient”) receives a request for information in relation to information which it is holding on behalf of the other party in relation to this Agreement, it shall:

(a) transfer the request for information to the other party as soon as practicable after receipt and in any event within two (2) Business Days of receiving a request for information;

(b) provide the other party with a copy of all information in its possession or power in the form that the other party requires within ten (10) Business Days (or such longer period as the other party may specify) of the other party requesting that information; and

(c) provide all necessary assistance as is reasonably requested by the other party to enable it to respond to a request for information within the time for compliance set out in the FOIA or the EIRs.

18.9 The parties acknowledge that (notwithstanding the provisions of clause 18.3 and notwithstanding any information designated as Confidential Information by a party) the Recipient may, acting in accordance with the Department of

Constitutional Affairs' Code of Practice on the Discharge of Functions of Public Authorities under part I of the Freedom of Information Act 2000, be obliged under the FOIA or the Environmental Information Regulations to disclose Information concerning the other Party:

(a) in certain circumstances without consulting with the other Party; or

(b) following consultation with the other Party and having taken their views into account.

19. DATA PROTECTION

19.1 The parties undertake to comply with the provisions of the Data Protection Act 1998 in so far as the same relates to any subject matter of this Agreement.

20. ANNOUNCEMENTS

20.1 Subject to clause 20.2 and clause 20.3, neither party shall make, or permit any person to make, any public announcement, communication or circular (**announcement**) concerning this Agreement without the prior written consent of the other party [(such consent not to be unreasonably withheld or delayed)]. The parties shall consult together on the timing, contents and manner of release of any announcement.

20.2 Where an announcement is required by law or any governmental or regulatory authority (including, without limitation, any relevant securities exchange), or by any court or other authority of competent jurisdiction, the party required to make the announcement shall promptly notify the other party. The party concerned shall make all reasonable attempts to agree the contents of the announcement before making it.

20.3 On the signing of this Agreement the parties shall issue a joint announcement about the formation of [LAPC] in agreed form.

21. WARRANTIES

21.1 Each party warrants and represents to the other that, at the date of this Agreement, [LAPC] has not carried on any business, has no assets or liabilities, has no employees and is not a party to any contracts except as necessary to comply with clause 2.4.

21.2 Each party warrants and represents to the other party that:

(a) it has full power and authority and has obtained all necessary authorities and consents to enter into and perform its obligations under this Agreement and such other agreements and arrangements referred to in this Agreement; and

(b) the signing of this Agreement and the performance of its obligations under this Agreement and the other agreements and arrangements referred to in this Agreement will not result in a breach of any other agreement or arrangement to which it is a party, nor give rise to any right of termination of any other agreement or arrangement to which it is a party.

22. ASSIGNMENT AND OTHER DEALINGS

22.1 Neither party shall assign, transfer, mortgage, charge, sub-contract, declare a trust over or deal in any other manner with any or all of its rights and obligations under this Agreement (or any other document referred to in it) without the prior written consent of the other party [(such consent not to be unreasonably withheld or delayed)].

22.2 Each party confirms that it is acting on its own behalf and not for the benefit of any other person.

23. DISPUTE RESOLUTION

23.1 The parties shall endeavour to resolve a dispute arising in connection with this Agreement by referring the dispute for resolution to internal representatives of the parties and escalating as appropriate to relevant senior officers. If such persons are unable to resolve the dispute either party may request mediation by serving a notice for mediation ("Mediation Notice") on the other party and sending a copy to the Centre for Effective Dispute Resolution (CEDR) or to such alternative mediator as the parties may agree. Unless otherwise agreed between the parties, the mediator will be nominated by CEDR. The mediation will start not later than ten (10) Business Days after the date of the Mediation Notice, and the costs of such mediation shall be borne in such proportions as the mediator may determine to be fair and reasonable in all the circumstances or if the mediator makes no such determination by the parties in equal proportions.

23.2 No party may commence any court proceedings/arbitration in relation to any dispute arising out of this Agreement until the dispute resolution process provided for in this clause 23 has ended or the other party has failed to participate in the dispute resolution process, provided that the right to issue proceedings is not prejudiced by a delay.

24. ENTIRE AGREEMENT

24.1 This Agreement (together with any documents referred to in it) constitutes the entire agreement between the parties and supersedes and extinguishes all previous discussions, correspondence, negotiations, drafts, agreements, promises, assurances, warranties, representations, arrangements and understandings between them, whether written or oral, relating to its subject matter.

24.2 Each party acknowledges that in entering into this Agreement (and any documents referred to in it), it does not rely on, and shall have no remedies in respect of, any statement, representation, assurance or warranty (whether made innocently or negligently) that is not set out in this Agreement or those documents.

25. VARIATION AND WAIVER

25.1 No variation of this Agreement shall be effective unless it is in writing and signed by the parties (or their authorised representatives). In the context of this clause, writing does not include email.

25.2 A waiver of any right or remedy under this Agreement or by law is only effective if it is given in writing and is signed by the person waiving such right or remedy. Any such waiver shall apply only to the circumstances for which it is given and shall not be deemed a waiver of any subsequent breach or default.

25.3 A failure or delay by any person to exercise any right or remedy provided under this Agreement or by law shall not constitute a waiver of that or any other right or remedy, nor shall it prevent or restrict any further exercise of that or any other right or remedy.

25.4 No single or partial exercise of any right or remedy provided under this Agreement or by law shall prevent or restrict the further exercise of that or any other right or remedy.

25.5 A person that waives any right or remedy provided under this Agreement or by law in relation to one person, or takes or fails to take any action against that person, does not affect its rights or remedies in relation to any other person.

26. COSTS

Except as expressly provided in this Agreement, each party shall pay its own costs and expenses incurred in connection with the negotiation, preparation, execution and performance of this Agreement (and any documents referred to in it).

27. NO PARTNERSHIP OR AGENCY

Nothing in this Agreement is intended to, or shall be deemed to, establish any partnership between the parties or constitute any party the agent of another party.

28. NOTICES

28.1 A notice given to a party under or in connection with this Agreement:

(a) shall be in writing and in English;

(b) shall be signed by or on behalf of the party giving it;

(c) shall be sent to the relevant party for the attention of the contact and to the address, fax number or email address specified in clause 28.2, or such other address, fax number, email address or person as that party may notify to the other in accordance with the provisions of this clause 28; and

(d) shall be:

(i) delivered by hand; or

(ii) sent by fax; or

(iii) sent by pre-paid first class post, recorded delivery or special delivery; or

(iv) sent by email provided that the subject heading of the email must be stated as a notice being sent pursuant to this Agreement and the email must be tagged as "high importance" (or similar); and

(e) unless proved otherwise is deemed received as set out in clause 28.4.

28.2 The addresses and fax numbers for service of notices are:

(a) Council:

(i) address: Civic Centre, London Road, Morden, SM4 5DX]

(ii) for the attention of: Chris Lee, Director of Environment and Regeneration

(iii) fax number: [NUMBER]

(iv) email address: [EMAIL ADDRESS];

(b) [LAPC]:

(i) address: [ADDRESS]

(ii) for the attention of: [NAME]

(iii) fax number: [NUMBER]

(iv) email address: [EMAIL ADDRESS].

28.3 A party may change its details for service of notices as specified in clause 28.2 by giving notice to the other party, provided that the address for service is an address in the United Kingdom following any change. Any change notified pursuant to this clause shall take effect at 9.00 am on the later of:

(a) the date (if any) specified in the notice as the effective date for the change; or

(b) five (5) Business Days after deemed receipt of the notice.

28.4 Delivery of a notice is deemed to have taken place (provided that all other requirements in this clause have been satisfied):

(a) if delivered by hand, on signature of a delivery receipt; or

(b) if sent by fax, at the time of transmission provided the sender has received a successful transmission report; or

(c) if sent by pre-paid first class post, recorded delivery or special delivery to an address in the United Kingdom, at 9.00 am on the second Business Day after posting; or

(d) if sent by email, one (1) hour after the notice was sent; and

(e) if deemed receipt under the previous paragraphs of this clause 28.4 is not within business hours (meaning 9.00 am to 5.30 pm on a Business Day), at 9.00 am on the next Business Day.

28.5 To prove service, it is sufficient to prove that:

(a) if delivered by hand the notice was delivered to the correct address; or

(b) if sent by fax, a transmission report was received confirming that the notice was successfully transmitted to the correct fax number; or

(c) if sent by post, the envelope containing the notice was properly addressed, paid for and posted; or

(d) if sent by email, the notice was properly addressed (as described in clause 28.1(d)(iv) and sent to the email address of the recipient.

28.6 This clause 28 does not apply to the service of any proceedings or other documents in any legal action or, where applicable, method of dispute resolution.

29. SEVERANCE

29.1 If any provision or part-provision of this Agreement is or becomes invalid, illegal or unenforceable, it shall be deemed modified to the minimum extent necessary to make it valid, legal and enforceable. If such modification is not possible, the relevant provision or part-provision shall be deemed deleted. Any modification to or deletion of a provision or part-provision under this clause shall not affect the validity and enforceability of the rest of this Agreement.

29.2 If one party gives notice to the other of the possibility that any provision or part-provision of this Agreement is invalid, illegal or unenforceable or if it is agreed or determined to be the case, the parties shall negotiate in good faith to amend such provision so that, as amended, it is legal, valid and enforceable, and, to the greatest extent possible, achieves the intended commercial result of the original provision.

30. AGREEMENT SURVIVES COMPLETION

This Agreement (other than obligations that have already been fully performed) remains in full force after Completion.

31. THIRD PARTY RIGHTS

31.1 A person who is not a party to this Agreement shall not have any rights under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Agreement.

31.2 The rights of the parties to terminate, rescind or agree any variation, waiver or settlement under this Agreement are not subject to the consent of any person.

32. COUNTERPARTS

32.1 This Agreement may be executed in any number of counterparts, each of which when executed shall constitute a duplicate original, but all the counterparts shall together constitute the one agreement.

32.2 Transmission of an executed counterpart of this Agreement (but for the avoidance of doubt not just a signature page) by:

(a) fax; or

(b) email (in PDF, JPEG or other agreed format),

shall take effect as delivery of an executed counterpart of this Agreement. If either method of delivery is adopted, without prejudice to the validity of the agreement thus made, each party shall provide the other with the original of such counterpart as soon as reasonably possible thereafter.

32.3 No counterpart shall be effective until each party has executed at least one counterpart.

33. RIGHTS AND REMEDIES

The rights and remedies provided under this Agreement are in addition to, and not exclusive of, any rights or remedies provided by law.

34. INADEQUACY OF DAMAGES

Without prejudice to any other rights or remedies that a party may have, each party acknowledges and agrees that damages alone would not be an adequate remedy for any breach of the terms of clause 7 or clause 18 by that party. Accordingly, the other party shall be entitled to the remedies of injunction, specific performance or other equitable relief for any threatened or actual breach of the terms of clause 7 or clause 18 of this Agreement.

35. GOVERNING LAW AND JURISDICTION

35.1 This Agreement and any dispute or claim arising out of or in connection with it or its subject matter or formation (including non-contractual disputes or claims) shall be governed by and construed in accordance with the law of England and Wales.

35.2 Each party irrevocably agrees that the courts of England and Wales shall have exclusive jurisdiction to settle any dispute or claim that arises out of or in connection with this Agreement or its subject matter or formation (including non-contractual disputes or claims).

This Agreement has been entered into on the date stated at the beginning of it.

Schedule 1 Matters reserved for shareholder approval

1. Altering in any respect the Articles or the rights attaching to any of the shares in [LAPC] (except as provided in clause 17.3 of the agreement).

2. Permitting the registration of any person as a member of [LAPC] other than the Council.

3. Increasing the amount of [LAPC]'s issued share capital, granting any option or other interest (in the form of convertible securities or in any other form) over or in its share capital, redeeming or purchasing any of its own shares or effecting any other reorganisation of its share capital.

4. Incurring expenditure or entering into any arrangement, contract or transaction in excess of:

    (a) other than in relation to any land acquisition, £500,000 (five hundred thousand pounds);

    (b) in relation to any land acquisition, £[1,000,000 (one million pounds)unless otherwise agreed.

5. Issuing any loan capital in [LAPC] or entering into any commitment with any person with respect to the issue of any loan capital.

6. Making any borrowing [other than [the initial loan for working capital purposes from its bankers in the ordinary and usual course of business.

7. Applying for the listing or trading of any shares or debt securities on any stock exchange or market.

8. Passing any resolution for its winding up or presenting any petition for its administration (unless it has become insolvent).

9. Altering the name of [LAPC] or its registered office.

10. Adopting or amending the Business Plan in respect of each Financial Year.

11. Changing the nature of [LAPC]'s Business or commencing any new business by [LAPC] which is not ancillary or incidental to the Business.

12. Forming any Subsidiary or acquiring shares in any other company or participating in any partnership or joint venture (incorporated or not).

13. Amalgamating or merging with any other company or business undertaking.

14. Making any acquisition or disposal by [LAPC] of any material asset(s) otherwise than in the ordinary course of business.

15. Creating or granting any Encumbrance over the whole or any part of the Business, undertaking or assets of [LAPC] or over any shares in [LAPC] or agreeing to do so other than liens arising in the ordinary course of business or any charge arising by the operation or purported operation of title retention clauses and in the ordinary course of business.

16. Making any loan (otherwise than by way of deposit with a bank or other institution the normal business of which includes the acceptance of deposits or in the ordinary course of business) or granting any credit (other than in the normal course of trading) or giving any guarantee (other than in the normal course of trading) or indemnity.

17. Altering any mandate given to [LAPC]'s bankers relating to any matter concerning the operation of [LAPC]'s bank accounts other than by the substitution of any person nominated as a signatory by the party entitled to make such nomination.

18. Appointing any agent or other intermediary to conduct any of [LAPC]'s Business.

19. Giving notice of termination of any arrangements, contracts or transactions which are material in the nature of [LAPC]'s Business, or materially varying any such arrangements, contracts or transactions.

20. Adopting or amending any standard terms of business (including prices) on which [LAPC] is prepared to provide goods or services to third parties.

21. Granting any rights (by licence or otherwise) in or over any intellectual property owned or used by [LAPC].

22. Factoring or assigning any of the book debts of [LAPC].

23. Changing the auditors of [LAPC] or its Financial Year end.

24. Making or permitting to be made any change in the accounting policies and principles adopted by [LAPC] in the preparation of its audited and management accounts except as may be required to ensure compliance with relevant accounting standards under the Act or any other generally accepted accounting principles in the United Kingdom.

25. Dealing with any surpluses of [LAPC].

26. Making any decision relating to the distribution or otherwise of a dividend.

27. Establishing or amending any profit-sharing, share option, bonus or other incentive scheme of any nature for Directors or employees.

28. Establishing or amending any pension scheme or granting any pension rights to any Director, officer, employee, former Director, officer or employee, or any member of any such person's family.

29. Dismissing any officer or employee in circumstances in which [LAPC] incurs or agrees to bear redundancy or other costs in excess of £30,000 (thirty thousand pounds) in total.

30. Appointing or dismissing any Director or Chairman.

31. Amending the Remuneration Policy.

32. Agreeing to remunerate (by payment of fees, the provision of benefits-in-kind or otherwise) any officer of, or consultant to, [LAPC] at a rate in excess of £100,000 (one hundred thousand pounds) per annum or increasing the remuneration of any such person to a rate in excess of £100,000 (one hundred thousand pounds) per annum.

33. Agreeing to remunerate (by payment of fees, the provision of benefits-in-kind or otherwise) any Independent Director.

34. Entering into or varying any contract of employment providing for the payment of remuneration (including pension and other benefits) in excess of a rate of £100,000 (one hundred thousand pounds) per annum or increasing the remuneration of any staff (including pension and other benefits) to a rate in excess £100,000 (one hundred thousand pounds) per annum.

35. Instituting, settling or compromising any [material] legal proceedings (other than debt recovery proceedings in the ordinary course of business) instituted or threatened against [LAPC] or submitting to arbitration or alternative dispute resolution any dispute involving [LAPC].

36. Making any agreement with any revenue or tax authorities or making any claim, disclaimer, election or consent for tax purposes in relation to [LAPC] or its business.

37. Purchasing any housing or commercial unit(s) or land which is situated outside of the Council's administrative area.

Schedule 2 Deed of adherence

Comment [ss6]: If required – see comment at definition

AS WITNESS the hands of the parties or their duly authorised representatives the day and year first written above

Executed as a deed by affixing the	)
common seal of	)
THE LONDON BOROUGH OF	)
MERTON	)
	)
In the presence of:	)

……………………….
Authorised signatory

Executed as a deed by	)
[**LAPC**]	)
acting by ……………..	)
	)…………………………..
	Director
	……………………………
	Director/Secretary

Sites	Capacity	Availability	Dependencies	Planning	Market Position			Rag
Large Sites					Prs	Sale	AH	
Abbotsbury	600	2018-2022	HZ/GLA/CHMP/TfL	√ SPD/LDP	√	√	√	
Leatherhead	250	2019-2024	Appeal at Mole Valley	√ Application	√	√	√	
Civic Wings	70	2020-2024	Morden Regen/Leases	√ Morden SPD	√	√	√	
Medium Development sites								
Hallowfield Way	14	2016-2019	SITA/Leases/ownership	√ Application	-	-		
Wilson avenue shops	15	2019-2021	Leases/VP/Acquisition	√ Application	-	√	√	
West Barnes Library	21	2015-2017	-	√ Application	√	√	√	
CWCC	20	2016-2019	CC Audit/Lib/GP/Decant	√ Application	√	√	√	
Kenley Railway	20	2018-2022	P decant/MΘ/hz	√ Morden SPD	√	√	√	
P3	60	2019-2021	FW masterplan/Alt	√ application	√	√	√	
Total								
Potential School sites								
Chaucer Centre	40	2018-2020	Asset Review/Decant Q4's	√ Application	-	√	√	
Whatley Avenue MAE	20	2016-2019	MAE/Schools/Free sch/Mrt	√ Application	√	√	√	
Worsfold House	55	2016-2018	Schools/Grenfell Lease	√ Application	-	√	√	
Smaller Development Sites								
Kenilworth Road	2	2016-2019	Asset review Q4's	√ Application	√	√	√	
Land at Westside Common	1	2016-17		√ Application	√			

Overall Total	**1188**

Property Company Sites

									Additional Units (Actual)
Elm Nursery	24 Units	2016-2018	-	√ Application	-	√	√		24 Units
Raleigh Gardens	22 Units	2017-2019	St Marks P lease and refurb	√ Application	-	√	√		22 Units
Land at Canons	22 Units	2017-2020	HLF M'Plan	√ Cons area	-	√	√		22 Units
Farm Road Church	9 Units	2016-2018	Community use/Church lease/VP	√ Application	-	√	√		9 Units
Tranche 1 Total	**77 Units**							**Total**	**77 Units**

This page is intentionally left blank

[V.28/09/2016] SCHEDULE 1 Regulation 2

ARTICLES FOR PRIVATE COMPANIES LIMITED BY SHARES

INDEX TO THE ARTICLES

PART 1
INTERPRETATION AND LIMITATION OF LIABILITY

PART 2
DIRECTORS
DIRECTORS' POWERS AND RESPONSIBILITIES

DECISION-MAKING BY DIRECTORS

APPOINTMENT OF DIRECTORS

PART 3
SHARES AND DISTRIBUTIONS
SHARES

PART 1

INTERPRETATION AND LIMITATION OF LIABILITY

Defined terms

1. In the articles, unless the context requires otherwise—

"articles" means the company's articles of association;

"bankruptcy" includes individual insolvency proceedings in a jurisdiction other than England and Wales or Northern Ireland which have an effect similar to that of bankruptcy;

"chairman" has the meaning given in article 12;

"chairman of the meeting" has the meaning given in article 39;

"Companies Acts" means the Companies Acts (as defined in section 2 of the Companies Act 2006), in so far as they apply to the company;

"Council" means the Mayor and Burgesses of the London Borough of Merton

"Council director" means a director appointed by the Council excluding any Independent Director

"Director" means a director of the company, and includes any person occupying the position of director, by whatever name called;

"distribution recipient" has the meaning given in article 31;

"document" includes, unless otherwise specified, any document sent or supplied in electronic form;

"electronic form" has the meaning given in section 1168 of the Companies Act 2006;

"Executive Director" means a Director that is also an employee of the Company

"fully paid" in relation to a share, means that the nominal value and any premium to be paid to the company in respect of that share have been paid to the company;

"hard copy form" has the meaning given in section 1168 of the Companies Act 2006;

"holder" in relation to shares means the person whose name is entered in the register of members as the holder of the shares;

"instrument" means a document in hard copy form;

"Officer of the Council" means an officer who is an employee of the Council

"ordinary resolution" has the meaning given in section 282 of the Companies Act 2006;

"paid" means paid or credited as paid;

"participate", in relation to a directors' meeting, has the meaning given in article 10;

"proxy notice" has the meaning given in article 45;

"shareholder" means a person who is the holder of a share;

"shares" means shares in the company;

"special resolution" has the meaning given in section 283 of the Companies Act 2006;

"subsidiary" has the meaning given in section 1159 of the Companies Act 2006;

"transmittee" means a person entitled to a share by reason of the death or bankruptcy of a shareholder or otherwise by operation of law; and

"writing" means the representation or reproduction of words, symbols or other information in a visible form by any method or combination of methods, whether sent or supplied in electronic form or otherwise.

Unless the context otherwise requires, other words or expressions contained in these articles bear the same meaning as in the Companies Act 2006 as in force on the date when these articles become binding on the company.

Liability of members

2. The liability of the members is limited to the amount, if any, unpaid on the shares held by them.

PART 2

DIRECTORS

DIRECTORS' POWERS AND RESPONSIBILITIES

Directors' general authority

3. Subject to the articles, the directors are responsible for the management of the company's business, for which purpose they may exercise all the powers of the company.

Shareholders' reserve power

4.—(1) The shareholders may, by special resolution, direct the directors to take, or refrain from taking, specified action.

(2) No such special resolution invalidates anything which the directors have done before the passing of the resolution.

Directors may delegate

5.—(1) Subject to the articles, the directors may delegate any of the powers which are conferred on them under the articles—

(a) to such person or committee;

(b) by such means (including by power of attorney);

(c) to such an extent;

(d) in relation to such matters or territories; and

(e) on such terms and conditions;

as they think fit.

(2) If the directors so specify, any such delegation may authorise further delegation of the directors' powers by any person to whom they are delegated.

(3) The directors may revoke any delegation in whole or part, or alter its terms and conditions.

Committees

6.—(1) Committees to which the directors delegate any of their powers must follow procedures which are based as far as they are applicable on those provisions of the articles which govern the taking of decisions by directors.

(2) The directors may make rules of procedure for all or any committees, which prevail over rules derived from the articles if they are not consistent with them.

(3) Where a provision of the articles refers to the exercise of a power, authority or discretion by the Directors and that power, authority or discretion has been delegated by the Directors to a Committee, the provision shall be construed as permitting the exercise of the power, authority or discretion by the Committee

DECISION-MAKING BY DIRECTORS

Directors to take decisions collectively

7.—(1) The general rule about decision-making by directors is that any decision of the directors must be either a majority decision at a meeting or a decision taken inaccordance with article 8.

(2) If—

(a) the company only has one director, and

(b) no provision of the articles requires it to have more than one director,

the general rule does not apply, and the director may take decisions without regard to any of the provisions of the articles relating to directors' decision-making.

Unanimous decisions

8.—(1) A decision of the directors is taken in accordance with this article when all eligible directors indicate to each other by any means that they share a common view on a matter.

(2) Such a decision may take the form of a resolution in writing, copies of which have been signed by each eligible director or to which each eligible director has otherwise indicated agreement in writing.

(3) References in this article to eligible directors are to directors who would have been entitled to vote on the matter had it been proposed as a resolution at a directors' meeting.
(4) A decision may not be taken in accordance with this article if the eligible directors would not have formed a quorum at such a meeting.

Calling a directors' meeting

9.—(1) Any director may call a directors' meeting by giving notice of the meeting to the directors or by authorising the company secretary (if any) to give such notice.
(2) Notice of any directors' meeting must indicate—

(a) its proposed date and time;

(b) where it is to take place; and

(c) if it is anticipated that directors participating in the meeting will not be in the same place, how it is proposed that they should communicate with each other during the meeting.

(3) Notice of a directors' meeting must be given to each director, but need not be in writing.
(4) Notice of a directors' meeting need not be given to directors who waive their entitlement to notice of that meeting, by giving notice to that effect to the company not more than 7 days after the date on which the meeting is held. Where such notice is given after the meeting has been held, that does not affect the validity of the meeting, or of any business conducted at it.

Participation in directors' meetings

10.—(1) Subject to the articles, directors participate in a directors' meeting, or part of a directors' meeting, when—

(a) the meeting has been called and takes place in accordance with the articles, and

(b) they can each communicate to the others any information or opinions they have on any particular item of the business of the meeting.

(2) In determining whether directors are participating in a directors' meeting, it is irrelevant where any director is or how they communicate with each other.
(3) If all the directors participating in a meeting are not in the same place, they may decide that the meeting is to be treated as taking place wherever any of them is.

Quorum for directors' meetings

11.—(1) At a directors' meeting, unless a quorum is participating, no proposal is to be voted on, except a proposal to call another meeting.
(2) The quorum for directors' meetings may be fixed from time to time by a decision of the directors, but it must never be less than two (made up of at least one Council director and at least one executive director), and unless otherwise fixed it is two.
(3) If the total number of directors for the time being is less than the quorum required, the directors must not take any decision other than a decision to call a general meeting so as to enable the shareholders to appoint further directors.
(4) A directors' meeting shall not be quorate if the number of executive directors and independent directors attending a meeting or participating in a vote at a meeting exceeds the number of Council directors attending or participating in a vote.

Chairing of directors' meetings

12.—(1) The directors may appoint a director to chair their meetings.
(2) The person so appointed for the time being is known as the chairman.
(3) The directors may terminate the chairman's appointment at any time.
(4) If the chairman is not participating in a directors' meeting within ten minutes of the time at which it was to start, the participating directors must appoint one of themselves to chair it.

Casting vote

13.—(1) If the numbers of votes for and against a proposal are equal, the chairman or other director chairing the meeting has a casting vote.

(2) Any person appointed in accordance with article 12(4) in place of the Chairman shall not have the casting vote in the circumstances described in 13 (1).

(3) Article 13.1 will not apply if, in accordance with the articles, the chairman or other director is not to be counted as participating in the decision-making process for quorum or voting purposes.

Conflicts of interest

14.—(1) If a proposed decision of the directors is concerned with an actual or proposed transaction or arrangement with the company in which a director is interested, that director is not to be counted as participating in the decision-making process for quorum or voting purposes.
(2) But if paragraph (3) applies, a director who is interested in an actual or proposed transaction or arrangement with the company is to be counted as participating in the decision-making process for quorum and voting purposes.
(3) This paragraph applies when—
 (a) the company by ordinary resolution disapplies the provision of the articles which would otherwise prevent a director from being counted as participating in the decision-making process;
 (b) the director's interest cannot reasonably be regarded as likely to give rise to a conflict of interest; or
 (c) the director's conflict of interest arises from a permitted cause.
(4) For the purposes of this article, the following are permitted causes—
 (a) a guarantee given, or to be given, by or to a director in respect of an obligation incurred by or on behalf of the company or any of its subsidiaries;
 (b) subscription, or an agreement to subscribe, for shares or other securities of the company or any of its subsidiaries, or to underwrite, sub-underwrite, or guarantee subscription for any such shares or securities; and
 (c) arrangements pursuant to which benefits are made available to employees and directors or former employees and directors of the company or any of its subsidiaries which do not provide special benefits for directors or former directors.

(5) For the purposes of this article, references to proposed decisions and decision-making processes include any directors’ meeting or part of a directors’ meeting.
(6) Subject to paragraph (7), if a question arises at a meeting of directors or of a committee of directors as to the right of a director to participate in the meeting (or part of the meeting) for voting or quorum purposes, the question may, before the conclusion of the meeting, be referred to the chairman whose ruling in relation to any director other than the chairman is to be final and conclusive.
(7) If any question as to the right to participate in the meeting (or part of the meeting) should arise in respect of the chairman, the question is to be decided by a decision of the directors at that meeting, for which purpose the chairman is not to be counted as participating in the meeting (or that part of the meeting) for voting or quorum purposes.

Authorisation of directors' conflicts of interest

(8) For the purposes of section 175 of the Companies Act, shareholders shall have the power to authorise any matter which would or might otherwise constitute or give rise to a breach by a director of the duty to avoid conflicts of interest set out in that section of the Companies Act. Any reference in these articles to a conflict of interest includes a conflict of interest and duty and a conflict of duties.

(9) Unless otherwise determined by the shareholders, any authorisation of a matter under article 14.8 shall extend to any actual or potential conflict of interest of the director in question and any other interested director (together the "Interested Directors") which may reasonably be expected to arise out of the matter so authorised.

(10) Any authorisation of a matter under article 14.8 shall be on such terms and/or conditions as the shareholders may determine, whether at the time such authorisation is given or subsequently and may be varied or terminated by the shareholders at any time. Such terms or conditions may include (without limitation) terms and conditions as to the duration, renewal and/or revocation of the authorisation, and/or the exclusion of the Interested Directors from all information and discussion of the matter in question. A director shall comply with any obligations imposed on him by the shareholders pursuant to any such authorisation.

(11) A director, notwithstanding his office, may be a director or other officer of, employed by, a member of or otherwise interested (including by the holding of shares) in, the Council or in a shareholder who has appointed him as a director of the Company, or any other member of such shareholder's group, or an employee of another local authority placed at the disposal of the Council [pursuant to section 113 of the Local Government Act 1972], and no authorisation under article 14.8 shall be necessary in respect of any such interest.

(12) Any director shall be entitled from time to time to disclose to a shareholder that appointed that director such information concerning the business and affairs of the company as he shall at his discretion see fit.

(13) If a director receives or has received any information otherwise than by virtue of his position as a director of the company and in respect of which he owes a duty of confidentiality to another person, the director is under no obligation to:

14.13(1) disclose any such information to the company, the directors or any other director or employee of the company; or

14.13(2) use or apply any such information in connection with the performance of his duties as a director;

provided that to the extent that such duty of confidentiality arises out of a situation or relationship which would or might otherwise constitute or give rise to a breach by the director of the duty to avoid conflicts of interest set out in section 175 of the Companies Act, this article shall apply only if such situation or relationship has been authorised by the shareholders under article 14(8).

(14) A director shall not, save as otherwise agreed by him, be accountable to the company for any benefit which he (or a person connected with him) derives from any matter authorised by the directors under article 14.8 and any contract, transaction or arrangement relating thereto shall not be liable to be avoided on the grounds of any such benefit."

Records of decisions to be kept

15. The directors must ensure that the company keeps a record, in writing, for at least 10 years from the date of the decision recorded, of every unanimous or majority decision taken by the directors.

Directors' discretion to make further rules

16. Subject to the articles, the directors may make any rule which they think fit about how they take decisions, and about how such rules are to be recorded or communicated to directors.

APPOINTMENT OF DIRECTORS

Methods of appointing directors

17.—(1) Any person who is willing to act as a director, and is permitted by law to do so, may be appointed to be a director by ordinary resolution.
(2) Notwithstanding any other provision of these articles, the holder or holders of a majority in nominal value of the issued ordinary shares in the capital of the company may, for as long as it is a member of the company, at any time and from time to time:

(a) appoint any person to be a director (provided that any such appointment does not cause the number of directors to exceed a number fixed by or in accordance with these articles as the maximum number of directors); or

(b) remove any director from office,

and every such appointment or removal shall be effected by notice in writing to the company and shall take effect immediately (or on such later date, if any, specified in the notice). Any such notice of appointment or removal may consist of several documents in similar form, each signed by or on behalf of one or more holders.

(3) For the purposes of paragraph (2), where 2 or more shareholders die in circumstances rendering it uncertain who was the last to die, a younger shareholder is deemed to have survived an older shareholder.

Termination of director's appointment

18. A person ceases to be a director as soon as—

(a) that person ceases to be a director by virtue of any provision of the Companies Act 2006 or is prohibited from being a director by law;
(b) a bankruptcy order is made against that person;
(c) a composition is made with that person's creditors generally in satisfaction of that person's debts;
(d) a registered medical practitioner who is treating that person gives a written opinion to the company stating that that person has become physically or mentally incapable of acting as a director and may remain so for more than three months;
(e) notification is received by the company from the director that the director is resigning from office, and such resignation has taken effect in accordance with its terms.
(f) that a person ceases to be an Officer of the Council.
(g) the Company receives written notice to that effect from the Council.

Directors' remuneration

19.—(1) Directors may undertake any services for the company that the directors decide.
(2) Directors are entitled to remuneration as agreed by the board of directors and the agreed remuneration policy—

(a) for their services to the company as directors, and
(b) for any other service which they undertake for the company.

(3) Subject to the articles, a director's remuneration may—

(a) take any form, and
(b) include any arrangements in connection with the payment of a pension, allowance or gratuity, or any death, sickness or disability benefits, to or in respect of that director.

(4) Unless the directors decide otherwise, directors' remuneration accrues from day to day.
(5) Unless the directors decide otherwise, directors are not accountable to the company for any remuneration which they receive as directors or other officers or employees of the company's subsidiaries or of any other body corporate in which the company is interested.

Directors' expenses

20. The company may pay any reasonable expenses which the directors properly incur in connection with their attendance at—

(a) meetings of directors or committees of directors,

(b) general meetings, or

(c) separate meetings of the holders of any class of shares or of debentures of the company, or otherwise in connection with the exercise of their powers and the discharge of their responsibilities in relation to the company.

PART 3

SHARES AND DISTRIBUTIONS

SHARES

All shares to be fully paid up

21.—(1) No share is to be issued for less than the aggregate of its nominal value and any premium to be paid to the company in consideration for its issue.
(2) This does not apply to shares taken on the formation of the company by the subscribers to the company's memorandum.

Powers to issue different classes of share

22.—(1) Subject to the articles, but without prejudice to the rights attached to any existing share, the company may issue shares with such rights or restrictions as may be determined by ordinary resolution.
(2) The company may issue shares which are to be redeemed, or are liable to be redeemed at the option of the company or the holder, and the directors may determine the terms, conditions and manner of redemption of any such shares.

Company not bound by less than absolute interests

23. Except as required by law, no person is to be recognised by the company as holding any share upon any trust, and except as otherwise required by law or the articles, the company is not in any way to be bound by or recognise any interest in a share other than the holder's absolute ownership of it and all the rights attaching to it.

Share certificates

24.—(1) The company must issue each shareholder, free of charge, with one or more certificates in respect of the shares which that shareholder holds.
(2) Every certificate must specify—

(a) in respect of how many shares, of what class, it is issued;

(b) the nominal value of those shares;

(c) that the shares are fully paid; and

(d) any distinguishing numbers assigned to them.
(3) No certificate may be issued in respect of shares of more than one class.
(4) If more than one person holds a share, only one certificate may be issued in respect of it.
(5) Certificates must—
(a) have affixed to them the company's common seal, or
(b) be otherwise executed in accordance with the Companies Acts.

Replacement share certificates

25.—(1) If a certificate issued in respect of a shareholder's shares is—
(a) damaged or defaced, or
(b) said to be lost, stolen or destroyed, that shareholder is entitled to be issued with a replacement certificate in respect of the same shares.
(2) A shareholder exercising the right to be issued with such a replacement certificate—

(a) may at the same time exercise the right to be issued with a single certificate or separate certificates;
(b) must return the certificate which is to be replaced to the company if it is damaged or defaced; and
(c) must comply with such conditions as to evidence, indemnity and the payment of a reasonable fee as the directors decide.

Share transfers

26.—(1) Shares may be transferred by means of an instrument of transfer in any usual form or any other form approved by the directors, which is executed by or on behalf of the transferor.
(2) No fee may be charged for registering any instrument of transfer or other document relating to or affecting the title to any share.
(3) The company may retain any instrument of transfer which is registered.
(4) The transferor remains the holder of a share until the transferee's name is entered in the register of members as holder of it.

Transmission of shares

27.—(1) If title to a share passes to a transmittee, the company may only recognise the transmittee as having any title to that share.

(2) A transmittee who produces such evidence of entitlement to shares as the directors may properly require—
(a) may, subject to the articles, choose either to become the holder of those shares or to have them transferred to another person, and
(b) subject to the articles, and pending any transfer of the shares to another person, has the same rights as the holder had.
(3) But transmittees do not have the right to attend or vote at a general meeting, or agree to a proposed written resolution, in respect of shares to which they are entitled,

by reason of the holder’s death or bankruptcy or otherwise, unless they become the holders of those shares.

Exercise of transmittees’ rights

28.—(1) Transmittees who wish to become the holders of shares to which they have become entitled must notify the company in writing of that wish.
(2) If the transmittee wishes to have a share transferred to another person, the transmittee must execute an instrument of transfer in respect of it.
(3) Any transfer made or executed under this article is to be treated as if it were made or executed by the person from whom the transmittee has derived rights in respect of the share, and as if the event which gave rise to the transmission had not occurred.

Transmittees bound by prior notices

29. If a notice is given to a shareholder in respect of shares and a transmittee is entitled to those shares, the transmittee is bound by the notice if it was given to the shareholder before the transmittee’s name has been entered in the register of members.

DIVIDENDS AND OTHER DISTRIBUTIONS

Procedure for declaring dividends

30.—(1) The company may by ordinary resolution declare dividends, and the directors may decide to pay interim dividends.
(2) A dividend must not be declared unless the directors have made a recommendation as to its amount. Such a dividend must not exceed the amount recommended by the directors.
(3) No dividend may be declared or paid unless it is in accordance with shareholders’ respective rights.
(4) Unless the shareholders’ resolution to declare or directors’ decision to pay a dividend, or the terms on which shares are issued, specify otherwise, it must be paid by reference to each shareholder’s holding of shares on the date of the resolution or decision to declare or pay it.
(5) If the company’s share capital is divided into different classes, no interim dividend may be paid on shares carrying deferred or non-preferred rights if, at the time of payment, any preferential dividend is in arrear.
(6) The directors may pay at intervals any dividend payable at a fixed rate if it appears to them that the profits available for distribution justify the payment.
(7) If the directors act in good faith, they do not incur any liability to the holders of shares conferring preferred rights for any loss they may suffer by the lawful payment of an interim dividend on shares with deferred or non-preferred rights.

Payment of dividends and other distributions

31.—(1) Where a dividend or other sum which is a distribution is payable in respect of a share, it must be paid by one or more of the following means—

(a) transfer to a bank or building society account specified by the distribution recipient either in writing or as the directors may otherwise decide;

(b) sending a cheque made payable to the distribution recipient by post to the distribution recipient at the distribution recipient's registered address (if the distribution recipient is a holder of the share), or (in any other case) to an address specified by the distribution recipient either in writing or as the directors may otherwise decide;

(c) sending a cheque made payable to such person by post to such person at such address as the distribution recipient has specified either in writing or as the directors may otherwise decide; or

(d) any other means of payment as the directors agree with the distribution recipient either in writing or by such other means as the directors decide.

(2) In the articles, "the distribution recipient" means, in respect of a share in respect of which a dividend or other sum is payable—

(a) the holder of the share; or

(b) if the share has two or more joint holders, whichever of them is named first in the register of members; or

(c) if the holder is no longer entitled to the share by reason of death or bankruptcy, or

otherwise by operation of law, the transmittee.

No interest on distributions

32. The company may not pay interest on any dividend or other sum payable in respect of a share unless otherwise provided by—

(a) the terms on which the share was issued, or

(b) the provisions of another agreement between the holder of that share and the company.

Unclaimed distributions

33.—(1) All dividends or other sums which are—

(a) payable in respect of shares, and

(b) unclaimed after having been declared or become payable,

may be invested or otherwise made use of by the directors for the benefit of the company until claimed.

(2) The payment of any such dividend or other sum into a separate account does not make the company a trustee in respect of it.

(3) If—

(a) twelve years have passed from the date on which a dividend or other sum became due for payment, and

(b) the distribution recipient has not claimed it,

the distribution recipient is no longer entitled to that dividend or other sum and it ceases to remain owing by the company.

Non-cash distributions

34.—(1) Subject to the terms of issue of the share in question, the company may, by ordinary resolution on the recommendation of the directors, decide to pay all or part of a dividend or other distribution payable in respect of a share by transferring non-cash assets of equivalent value (including, without limitation, shares or other securities in any company).
(2) For the purposes of paying a non-cash distribution, the directors may make whatever arrangements they think fit, including, where any difficulty arises regarding the distribution—

(a) fixing the value of any assets;
(b) paying cash to any distribution recipient on the basis of that value in order to adjust the rights of recipients; and
(c) vesting any assets in trustees.

Waiver of distributions

35. Distribution recipients may waive their entitlement to a dividend or other distribution
payable in respect of a share by giving the company notice in writing to that effect, but if—
(a) the share has more than one holder, or
(b) more than one person is entitled to the share, whether by reason of the death or
bankruptcy of one or more joint holders, or otherwise,
the notice is not effective unless it is expressed to be given, and signed, by all the holders or persons otherwise entitled to the share.

CAPITALISATION OF PROFITS

Authority to capitalise and appropriation of capitalised sums

36.—(1) Subject to the articles, the directors may, if they are so authorised by an ordinary resolution—
(a) decide to capitalise any profits of the company (whether or not they are available for distribution) which are not required for paying a preferential dividend, or any sum standing to the credit of the company's share premium account or capital redemption reserve; and
(b) appropriate any sum which they so decide to capitalise (a "capitalised sum") to the persons who would have been entitled to it if it were distributed by way of dividend (the "persons entitled") and in the same proportions.
(2) Capitalised sums must be applied—
(a) on behalf of the persons entitled, and
(b) in the same proportions as a dividend would have been distributed to them.
(3) Any capitalised sum may be applied in paying up new shares of a nominal amount equal to the capitalised sum which are then allotted credited as fully paid to the persons entitled or as they may direct.

(4) A capitalised sum which was appropriated from profits available for distribution may be applied in paying up new debentures of the company which are then allotted credited as fully paid to the persons entitled or as they may direct.
(5) Subject to the articles the directors may—

(a) apply capitalised sums in accordance with paragraphs (3) and (4) partly in one way and partly in another;
(b) make such arrangements as they think fit to deal with shares or debentures becoming distributable in fractions under this article (including the issuing of fractional certificates or the making of cash payments); and
(c) authorise any person to enter into an agreement with the company on behalf of all the persons entitled which is binding on them in respect of the allotment of shares and debentures to them under this article.

PART 4

DECISION-MAKING BY SHAREHOLDERS

ORGANISATION OF GENERAL MEETINGS

Attendance and speaking at general meetings

37.—(1) A person is able to exercise the right to speak at a general meeting when that person is in a position to communicate to all those attending the meeting, during the meeting, any information or opinions which that person has on the business of the meeting.
(2) A person is able to exercise the right to vote at a general meeting when—

(a) that person is able to vote, during the meeting, on resolutions put to the vote at the meeting, and
(b) that person's vote can be taken into account in determining whether or not such resolutions are passed at the same time as the votes of all the other persons attending the meeting.

(3) The directors may make whatever arrangements they consider appropriate to enable those attending a general meeting to exercise their rights to speak or vote at it.
(4) In determining attendance at a general meeting, it is immaterial whether any two or more members attending it are in the same place as each other.
(5) Two or more persons who are not in the same place as each other attend a general meeting if their circumstances are such that if they have (or were to have) rights to speak and vote at that meeting, they are (or would be) able to exercise them.

Quorum for general meetings

38. No business other than the appointment of the chairman of the meeting is to be transacted at a general meeting if the persons attending it do not constitute a quorum.

Chairing general meetings

39.—(1) If the directors have appointed a chairman, the chairman shall chair general meetings if present and willing to do so.

(2) If the directors have not appointed a chairman, or if the chairman is unwilling to chair the meeting or is not present within ten minutes of the time at which a meeting was due to start—

(a) the directors present, or

(b) (if no directors are present), the meeting,

must appoint a director or shareholder to chair the meeting, and the appointment of the chairman of the meeting must be the first business of the meeting.

(3) The person chairing a meeting in accordance with this article is referred to as "the chairman of the meeting".

Attendance and speaking by directors and non-shareholders

40.—(1) Directors may attend and speak at general meetings, whether or not they are shareholders.

(2) The chairman of the meeting may permit other persons who are not—

(a) shareholders of the company, or

(b) otherwise entitled to exercise the rights of shareholders in relation to general meetings,

to attend and speak at a general meeting.

Adjournment

41.—(1) If the persons attending a general meeting within half an hour of the time at which the meeting was due to start do not constitute a quorum, or if during a meeting a quorum ceases to be present, the chairman of the meeting must adjourn it.

(2) The chairman of the meeting may adjourn a general meeting at which a quorum is present if—

(a) the meeting consents to an adjournment, or

(b) it appears to the chairman of the meeting that an adjournment is necessary to protect the safety of any person attending the meeting or ensure that the business of the meeting is conducted in an orderly manner.

(3) The chairman of the meeting must adjourn a general meeting if directed to do so by the meeting.

(4) When adjourning a general meeting, the chairman of the meeting must—

(a) either specify the time and place to which it is adjourned or state that it is to continue at a time and place to be fixed by the directors, and

(b) have regard to any directions as to the time and place of any adjournment which have been given by the meeting.

(5) If the continuation of an adjourned meeting is to take place more than 14 days after it was adjourned, the company must give at least 7 clear days' notice of it (that is, excluding the day of the adjourned meeting and the day on which the notice is given)—

(a) to the same persons to whom notice of the company's general meetings is required to be given, and

(b) containing the same information which such notice is required to contain.

(6) No business may be transacted at an adjourned general meeting which could not properly have been transacted at the meeting if the adjournment had not taken place.

VOTING AT GENERAL MEETINGS

Voting: general

42. A resolution put to the vote of a general meeting must be decided on a show of hands unless a poll is duly demanded in accordance with the articles.

Errors and disputes

43.—(1) No objection may be raised to the qualification of any person voting at a general
meeting except at the meeting or adjourned meeting at which the vote objected to is tendered, and every vote not disallowed at the meeting is valid.
(2) Any such objection must be referred to the chairman of the meeting, whose decision is final.

Poll votes

44.—(1) A poll on a resolution may be demanded—
(a) in advance of the general meeting where it is to be put to the vote, or
(b) at a general meeting, either before a show of hands on that resolution or immediately after the result of a show of hands on that resolution is declared.
(2) A poll may be demanded by—
(a) the chairman of the meeting;
(b) the directors;
(c) two or more persons having the right to vote on the resolution; or
(d) a person or persons representing not less than one tenth of the total voting rights of all the shareholders having the right to vote on the resolution.
(3) A demand for a poll may be withdrawn if—
(a) the poll has not yet been taken, and
(b) the chairman of the meeting consents to the withdrawal.
(4) Polls must be taken immediately and in such manner as the chairman of the meeting directs.

Content of proxy notices

45.—(1) Proxies may only validly be appointed by a notice in writing (a **"proxy notice")**
which—
(a) states the name and address of the shareholder appointing the proxy;
(b) identifies the person appointed to be that shareholder's proxy and the general meeting in relation to which that person is appointed;

(c) is signed by or on behalf of the shareholder appointing the proxy, or is authenticated in such manner as the directors may determine; and

(d) is delivered to the company in accordance with the articles and any instructions contained in the notice of the general meeting to which they relate.

(2) The company may require proxy notices to be delivered in a particular form, and may specify different forms for different purposes.

(3) Proxy notices may specify how the proxy appointed under them is to vote (or that the proxy is to abstain from voting) on one or more resolutions.

(4) Unless a proxy notice indicates otherwise, it must be treated as—

(a) allowing the person appointed under it as a proxy discretion as to how to vote on any ancillary or procedural resolutions put to the meeting, and

(b) appointing that person as a proxy in relation to any adjournment of the general meeting to which it relates as well as the meeting itself.

Delivery of proxy notices

46.—(1) A person who is entitled to attend, speak or vote (either on a show of hands or on a poll) at a general meeting remains so entitled in respect of that meeting or any adjournment of it, even though a valid proxy notice has been delivered to the company by or on behalf of that person.

(2) An appointment under a proxy notice may be revoked by delivering to the company a notice in writing given by or on behalf of the person by whom or on whose behalf the proxy notice was given.

(3) A notice revoking a proxy appointment only takes effect if it is delivered before the start of the meeting or adjourned meeting to which it relates.

(4) If a proxy notice is not executed by the person appointing the proxy, it must be accompanied by written evidence of the authority of the person who executed it to execute it on the appointor’s behalf.

Amendments to resolutions

47.—(1) An ordinary resolution to be proposed at a general meeting may be amended by ordinary resolution if—

(a) notice of the proposed amendment is given to the company in writing by a person entitled to vote at the general meeting at which it is to be proposed not less than 48 hours before the meeting is to take place (or such later time as the chairman of the meeting may determine), and

(b) the proposed amendment does not, in the reasonable opinion of the chairman of the meeting, materially alter the scope of the resolution.

(2) A special resolution to be proposed at a general meeting may be amended by ordinary resolution, if—

(a) the chairman of the meeting proposes the amendment at the general meeting at which the resolution is to be proposed, and

(b) the amendment does not go beyond what is necessary to correct a grammatical or other non-substantive error in the resolution.

(3) If the chairman of the meeting, acting in good faith, wrongly decides that an amendment to a resolution is out of order, the chairman’s error does not invalidate the vote on that resolution.

PART 5

ADMINISTRATIVE ARRANGEMENTS

Means of communication to be used

48.—(1) Subject to the articles, anything sent or supplied by or to the company under the articles may be sent or supplied in any way in which the Companies Act 2006 provides for documents or information which are authorised or required by any provision of that Act to be sent or supplied by or to the company.
(2) Subject to the articles, any notice or document to be sent or supplied to a director in
connection with the taking of decisions by directors may also be sent or supplied by the means by which that director has asked to be sent or supplied with such notices or documents for the time being.
(3) A director may agree with the company that notices or documents sent to that director in a particular way are to be deemed to have been received within a specified time of their being sent, and for the specified time to be less than 48 hours.

Company seals

49.—(1) Any common seal may only be used by the authority of the directors.
(2) The directors may decide by what means and in what form any common seal is to be used.
(3) Unless otherwise decided by the directors, if the company has a common seal and it is affixed to a document, the document must also be signed by at least one authorised person in the presence of a witness who attests the signature.
(4) For the purposes of this article, an authorised person is—

(a) any director of the company;
(b) the company secretary (if any); or
(c) any person authorised by the directors for the purpose of signing documents to which the common seal is applied.

No right to inspect accounts and other records

50. The Council shall be entitled to inspect any of the company's accounting or other records or documents upon request..

Provision for employees on cessation of business

51. The directors may decide to make provision for the benefit of persons employed or formerly employed by the company or any of its subsidiaries (other than a director or former director or shadow director) in connection with the cessation or transfer to any person of the whole or part of the undertaking of the company or that subsidiary.

52. Objects

The Company's objects are unrestricted. The Company will review alternative housing tenures, such as homelessness, subject to viability.

DIRECTORS' INDEMNITY AND INSURANCE

Indemnity

53.—(1) Subject to paragraph (2), a relevant director of the Company or an associated company may be indemnified out of the Company's assets against—

(a) any liability incurred by that director in connection with any negligence, default, breach of duty or breach of trust in relation to the Company or an associated company,

(b) any liability incurred by that director in connection with the activities of the Company or an associated company in its capacity as a trustee of an occupational pension scheme (as defined in section 235(6) of the Companies Act 2006),

(c) any other liability incurred by that director as an officer of the Company or an associated company.

(2) This article does not authorise any indemnity which would be prohibited or rendered void by any provision of the Companies Acts or by any other provision of law.

(3) In this article—

(a) companies are associated if one is a subsidiary of the other or both are subsidiaries of the same body corporate, and

(b) a "relevant director" means any director or former director of the company or an associated company.

Insurance

54.—(1) The directors may decide to purchase and maintain insurance, at the expense of the company, for the benefit of any relevant director in respect of any relevant loss.

(2) In this article—

(a) a "relevant director" means any director or former director of the company or an associated company,

(b) a "relevant loss" means any loss or liability which has been or may be incurred by a relevant director in connection with that director's duties or powers in relation to the company, any associated company or any pension fund or employees' share scheme of the company or associated company, and

(c) companies are associated if one is a subsidiary of the other or both are subsidiaries of the same body corporate.

This page is intentionally left blank