REPORT TO: **CORPORATE SERVICES SCRUTINY COMMITTEE**
Date of Meeting: **28 June 2018**

REPORT TO: **EXECUTIVE COMMITTEE**
Date of Meeting: **10 July 2018**

Report of: **Chief Executive & Growth Director**

Title: **Sustainable Financing Model for Exeter Infrastructure**

Is this a Key Decision?
* One that affects finances over £1m or significantly affects two or more wards. If this is a key decision then the item must be on the appropriate forward plan of key decisions.

Yes

Is this an Executive or Council Function?

Executive

1 What is the report about?

1.1 This report seeks support to explore a solution to structural challenges of building in the city through a new sustainable financing model that puts development outcomes back into the hands of the city's leaders so as to deliver the outcomes that the city has been asking for.

2 Recommendations

2.1 That officers commit support, time and energy into exploring the benefits, risks and mechanics of a collaboration in a City Development Fund as a means of financing and delivering future developments in the Greater Exeter region and within the city. Developments will embrace innovative solutions and a fresh approach to the procurement process to successfully compete with the scale and agility of private sector development funds.

2.2 That the City Council encourage other public sector institutions within the city to commit resources to exploring the proposal for a City Development Fund.

2.3 That the Fund would operate and be governed under the following four key principles: -

- Publicly owned: The Fund is owned and controlled by Exeter's public-sector institutions;
- Impact driven: The Fund has place-making as its ultimate goal. All developments are measured for success on the basis of long term impact, outcomes and social benefit;
- Professionally run: Experienced, world class team of fund and asset directors; and
- Locally retained profits: All excess profits from developments are kept

within the Fund and recycled back into Exeter developments.

3 Reasons for the recommendation

3.1 The existing development model for Exeter and many other UK cities is under strain and, arguably, broken. There is a fundamental divergence of development financiers' motivations and Exeter's eventual recipients of development outcomes. Short-term capital has a different agenda to the long-term legacy that the existing development model is supposed to leave for Exeter. In this way, Exeter now faces congestion and a lack of available and affordable housing, with planning locked and land value trapped. Arguably this is having a knock-on effect on many aspects of city living. The emergence of new digital platforms for transport and innovative urban design means that there is a great opportunity for Exeter to makes step changes to its master planning. However, this is only likely to be possible if step changes are made to the financing and delivery models that aid implementation.

3.2 The private sector currently finances the majority of development in Exeter. It therefore controls the timing and agenda of the city's developments, often cherry picking sites on a piecemeal basis and can fail to deliver a product that benefits in the wider sense. Large scale private sector developments are motivated by profit for shareholders external to Exeter. Arguably, place-making through tackling congestion, affordable housing and long-term well-being is not high enough on the agenda.

3.3 A city-controlled fund source can control the financing and delivery of projects and hence control the outcomes that genuinely deliver the impact that the city and its residents have been asking for, as well as realise profits for retention in the city.

3.4 A City Fund assumes that profits are retained in the city as opposed to the existing model that surrenders 20% developer profit to financial organisations unconnected with Exeter or the South West.

3.5 By providing a pooled source of finance and delivery for a city-wide plan, rather than taking sites forward piecemeal, the council and the rest of Exeter's public sector can maximise then strength of its own assets and deliver at a pace and a scale not yet possible in the existing model

3.6 A single source of finance and delivery reduces finance costs on a project to project basis

3.7 Exeter city is embarking on an ambitious programme of data-led, innovative urban transformation as part of its long term strategic plan. The programme needs a joined up, sustainable financing solution to ensure long term success and grant/subsidy-free success

4 What are the resource implications including non-financial resources

4.1 Non-financial resources include time and energy to support Exeter City Futures in the due diligence process required by Central government to secure grant funding for Fund set-up process

5 Section 151 Officer comments

5.1 There are no specific, additional financial implications created by this report. The Council should consider as part of its due diligence, the impact on the Council's Balance Sheet of transferring assets to a partly owned Company. Clearly, given the Council's current financial challenges, any implications for the General Fund budget must be identified. As the Company being considered will retain any profits, there will be either no, or limited, opportunity for financial benefit to be derived by the Council.

6 What are the legal aspects?

6.1 The Local Government Act 1972 s.111 enables the Council to do anything which is calculated to facilitate, or is conducive to or incidental to, the discharge of any other of its functions, whether involving expenditure, borrowing or lending money, or the acquisition or disposal of any rights or property.

6.2 The Local Government Act 2003 s.95 authorises local authorities to do for a commercial purpose anything which it is authorised to do for carrying on any of its ordinary functions (other than where it is under a statutory duty to provide that function) however, this power is only exercisable through a company.

6.3 The Localism Act 2011 s.1(1) introduced the "general power of competence" for local authorities " *to do anything that individuals may do*" including the power to do something for the benefit of the authority, its area, its residents or those present in its area. The generality of this power is not limited by the existence of any other power which might overlap (to any extent) this power.

6.4 The Localism Act 2011 s.4 (2) provides that where a local authority does things for a commercial purpose under this 'general power of competence' that function must be exercised through a company.

7 Monitoring Officer's comments

Given the legislation outlined in paragraph 6 above, the Council does have the power to commit resources and generally collaborate with others in setting up and running a City Development Fund as a means of financing and delivering future developments in the Greater Exeter region, although the fund itself must be owned by a separate company to satisfy the requirements of the Localism Act 2011.

That company, in turn, must be clearly accountable, governed and controlled in accordance with the four key principles set out in paragraph 2.3 above.

8 Report details

8.1 Exeter strives to be seen as one of the world's most sustainable cities. In doing so it has set out a bold vision for the future that aligns with the UK industrial strategy. For 2018, the Council has set out three strategic priority areas to be addressed over the next two decades:-

- Healthy active citizens
- Reduced congestion and enhanced mobility
- Building better housing and neighbourhoods

8.2 To achieve this, huge investment is require, on new public mobility solutions, dense unit housing, new energy networks, city centre remodelling and new transport infrastructure that connects jobs to housing in the greater Exeter region.

The Challenge

8.3 The Greater Exeter region is set to deliver up to 50,000 houses over the next 20 years with its new strategic plan. This will see approximately £10bn of private money and £2bn of public funds invested in the region. Based on current trends, this new housing will be delivered on green field sites outside the City using existing trunk road infrastructure and, unless solutions are found, will bring increased pressure on affordable housing, employment, the environment and our transport network. This is beginning to leave planning locked and land value trapped.

8.4 There is a significant amount of evidence nationally that points to rising social exclusion in our Cities, poorly managed urban growth leads to a growing divide between those individuals who are able to benefit from the opportunities offered by growth and those individuals who are not.

Ownership and control: the private sector agenda

8.5 The private sector development market tends to select projects based on short term profitability rather than outcomes that benefit the long-term prosperity of the city. The developers' accountability is to its shareholders and yet the accountability of the products they create is to the citizens of Exeter. This divergence means that the city will struggle to achieve its preferred outcomes if the development strategy is forced by private sector financing. If left to the private sector alone in the next 10 years, sites that could deliver social impact and ease congestion will be picked off by large scale developers and designed for profits instead. In other words business as usual.

8.6 Large-scale developers in the city enjoy profits in the region of 20% on capital spend. These profits are commensurate with the risk associated with financing a development project. Typically, the profit from these financing arrangements leaves the city to pay shareholders external to Exeter. This means that large chunks of value in typical developments are leaving the region and are lost.

Value in the delivery process: public sector assets and development projects

8.7 The public sector in Exeter has many assets and strategic sites operating in relative silos. If these assets and sites were brought together under a single development program and fund structure, the aggregate asset pool would create greater financial power and borrowing capacity to deliver larger scale developments at pace. This means that the existing asset base at the council is not operating as efficiently as it could be: a pooled approach can maximise and optimise returns.

8.8 Publicly financed developments are subject to restrictive planning and procurement procedures that deliver projects too slowly to both compete with the private sector agility and deliver the Council's ambition for housing, the economy and the environment. Piecemeal projects take too long to get started. A more ambitious aggregate approach is needed.

8.9 Silo developments also result in high top and tail costs. Too much of the development of value in a typical project is lost to financial and legal advisers, refinancing costs mid project and other ‘on-costs’ associated with the pre-project due diligence within the public sector operating frameworks. This happens repeatedly and on a project by project basis. A pool approach to the city’s developments would reduce top and tail costs and deliver more returns for the city

<u>Options to meet these challenges</u>

8.10 *Do nothing*: if the city does nothing to address the private sector agenda and conflicting congestion and affordable housing needs, the challenges described above will remain. Additionally, sites will continue to come forward by the private sector and development will continue anyway. This will see further congestion, further pressure on affordable housing and further development profit leaving the city. The council cannot control its own destiny if it does not intervene in some way.

8.11 *Sell land:* selling land will recognise a capital receipt, with which the council can potentially reinvest to generate revenue elsewhere. However, this strategy results in a loss of land value uplift and development profits, loss of strategy/control over a site and, hence, loss of control of the outcomes associated with development.

8.12 *Joint-venture e.g. The Haringey Delivery Vehicle model:* joint ventures with the private sector are a good way of ringing in the finance and expertise. However, the public perception of these types of vehicles is under strain given the perceived loss of control. This perception is no fallacy. While a joint-venture can be owned 50/50 between public and private sector, the reality is that the private sector brings all of the additional development finance and much of the development strategy and logistics. This results in, ultimately, implicit private control of the development and invariably social outcomes suffer. Only with its own complete control can the public sector guarantee delivery of its outcomes.

8.13 *DevCo*: the development company, owned and controlled by the council is an excellent way of delivering outcomes required by the city, particularly given its work to date in linking with the HRA stock. However, a single development company delivering piecemeal projects in the hundreds of units does not tackle the scale of housing required over the next twenty years, nor does it deliver on the big infrastructure transformation required for the city to ease congestion. Access to funding via PWLB is limited to both financial criteria and the speed at which applications can be written and submitted. A DevCo will make a significant contribution to house building but will not have the scale to deliver a transformational agenda.

8.14 *City Development Fund:* the city can pool some of its unused assets into a fund, against which it can borrow significant sums for comprehensive infrastructure development at scale. Critically, this strategy ensures that the city retains ownership and control of both its assets and the development strategy, thereby controlling the outcomes. This takes the positive principles of the DevCo and allows it to scale up its ambition.

<u>City Development Fund</u>

8.15 This report proposes exploring further due diligence for the formation of a city development fund:-

- The fund is owned and controlled by Exeter's public sector institutions
- The fund is capitalised by a spread of public sector property assets
- The fund raises further capital against its asset base via a traditional debt facility
- The fund creates delivery Special Purpose Vehicles for specific projects and finances them via a single gateway. It acts as the Exeter infrastructure bank and delivery portal for the region's demanding development pipeline

Key benefits:

8.16

- The fund controls the financing of projects and hence control the outcomes that genuinely deliver the impact that the city and its residents have been asking for
- Developer profits are captured by the council rather than by private developers and hence value is retained in the city
- A single source of finance and delivery reduces finance and other costs on a project to project basis
- Profits from, say, traditional high-end housing developments are recycled into projects that provide greater social benefits such as social housing schemes and public and green space infrastructure.
- Projects are delivered at the pace and scale akin to private sector development funds
- Fostering of innovation, entrepreneurship, Business and skills within the city
- The council can control its own development destiny.

Fund Principles:

8.17 The city development fund would operate on the basis of the following key draft principles:-

Publically Owned

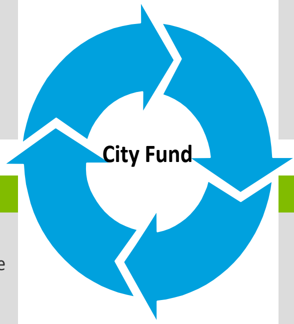
The City Fund is owned and controlled outright by the public sector

- Greater Exeter City institutions
  - City Council, regional councils
  - University, NHS Trust
- Homes England
- Joint Governance over professional teams

Professionally Run

Experienced, world class team of fund and asset directors

- Individual recruitment campaign from existing successful private sector infrastructure funds
- Master developer and architect capability
- PMO capability
- Legal capability



Impact driven

Place-making is the ultimate goal

- All developments measured for success on the basis of impact, outcomes and social benefit
  - Affordable housing
  - Sustainable transport
  - Connectivity and mobility
  - Reduced congestion

Locally retained profits

All profits from developments are kept within the fund and recycled back into Greater Exeter developments

- Ownership by Exeter's public sector institutions ensures recycling of profits into local impact projects in the future
- The fund pays dividends to its public sector shareholders to bolster revenue budgets

9 How does the decision contribute to the Council's Corporate Plan?

9.1 Building neighbourhoods is a key strategic aim and supporting measures to address congestion and health outcomes are the other strategic aims.

10 What risks are there and how can they be reduced?

10.1 The key risks are associated with the development process; changes in market conditions for housing, property prices can fall and rental markets can collapse. Policy and legal constraints on the operation of the fund; some of the key strategic assets may also be in the long term scope of the proposed city council's development company; and may also have income considerations for the city council, for example obvious assets may currently be used as surface car parks. The city Council could fail to raise the upfront funding from Government to create the fund and provide the required capacity to establish the fund. Other public stakeholders may not wish to bring forward assets and the fund would be solely reliant on the city council. The purpose of seeking members' approval to explore this proposal is to fully test the legal, financial and organisational risks associated with the innovative approach. The fact that it is innovative and is not happening elsewhere suggests there will be risks that will only unearth through dialogue with others. Through this exploratory stage risk workshops will be undertaken with officers and consultants to draw out all the risks and to establish the mitigation measures.

11 What is the impact of the decision on equality and diversity; health and wellbeing; safeguarding children, young people and vulnerable adults, community safety and the environment?

11.1 The purpose of creating a sustainable development fund is to ensure that the development process within the city better serves the wider outcomes for the city. It is clear that the current development model falls short in meeting the wider societal objectives around equality, health and well-being etc. Developers are only obliged to meet planning policy tests and to contribute to the community infrastructure levy. The wider outcomes of health and well-being, inclusive growth etc are policy objectives that are framed by planning policy. The limitations of the development model are all too apparent, hence the need to find a different model to address these outcomes. The level of control over the development because of the access to finance is a key component in aligning the development with our wider city objectives. The outcomes of a sustainable development fund for the city should be to improve these outcomes.

12 Are there any other options?

12.1 The city council does not have to create a development fund, the creation of a development company is a positive step in itself to aid direct delivery of development. The proposed sustainable development fund would be the first of its kind in the UK. The City Council could simply do nothing and continue with the current models of delivery that puts the onus on the private sector, or enters into joint ventures with the private sector.

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Local Government (Access to Information) Act 1972 (as amended)
Background papers used in compiling this report:-
None

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