

REPORT TO: CABINET

DATE: 25 FEBRUARY 2021

TITLE: HARLOW INVESTMENT FUND

PORTFOLIO HOLDER: COUNCILLOR MARK INGALL, LEADER OF THE COUNCIL

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This is a Key Decision
It is on the Forward Plan as Decision Number I012226
Call-in Procedures may apply
This decision will affect Toddbrook Ward.

RECOMMENDED that Cabinet agrees that:

- A** In principle that the Council will invest £5 million in the Harlow Town Centre Investment Fund.
- B** The Chief Executive, in consultation with the Leader of the Council, enters into an agreement to subscribe to purchase shares in the Harlow Investment Fund Limited Partnership and such other entities as may be required.
- C** The Chief Executive, in consultation with the Leader of the Council, will nominate a representative to the Board of the General Partner.
- D** Agreement of all operational matters and approval of the draft Board documents are delegated to the Chief Executive in consultation with the Leader of the Council.

REASON FOR DECISION

- A** To establish the Investment Fund, a proposed £50 million fund which will contribute to the development of a vibrant, safe, social and connected Town Centre for Harlow.

BACKGROUND

1. Harlow Council have collaborated with Homes England (HE), and Places for People (PfP) and Essex County Council (ECC) (the Parties), over the past 18 months, exploring opportunities to catalyse private sector development and unlock key town centre sites in order to secure the growth and regeneration required in Harlow Town Centre.
2. Through this work, it is apparent that whilst Harlow is a place of significant opportunity, low residential values and disorganised landholdings, in the town centre there have been barriers to attracting private investment. This in turn constrains the growth potential of the economy of the area. In these circumstances, public sector-led investment is needed to stimulate change.

ISSUES/PROPOSALS

Investment in the Fund

3. Having sought advice from independent legal and financial professionals, the Parties have concluded that the best ways to address the issues above would be through the creation of a revolving Investment Fund for Harlow Town Centre. This will address extant market failure, investing public sector capital to create a portfolio of property investments focused on sites with marginal and in some cases potentially negative viability. It will focus on those sites which are too complex for the private sector to develop or where the return profile is too limited to attract purely private sector investment, but development of which will create the conditions catalysing private investment and regeneration and deliver a financial return.
4. The Fund is seeking to attract £50 million of shareholder capital to be invested in development of residential-led mixed use development sites in Harlow Town Centre. The Parties have agreed, subject to Cabinet or Board approvals, to make the following investment commitments;
 - a) Homes England (£20 million) (40 percent equity);
 - b) Places for People (£20 million) (40 percent equity);
 - c) Harlow Council (£5 million) (10 percent equity); and
 - d) Essex County Council (£5 million) (10 percent equity).

Proposed Structure of the Fund

5. A Limited Partnership (LP) has been recommended by the advisers working with the Parties to date, as the most appropriate investment vehicle for the Fund. A limited partnership is not a legal entity but a relationship between partners and as such will be regulated by a partnership agreement. LPs consist of one or more 'limited partners' and a 'general partner'. Limited partners are essentially

silent investors in relation to the partnership's day to day management, as in order to enjoy limited liability status, they cannot take part in the management of or bind the partnership. The limited partners will consist of Harlow Council alongside HE, PFP and ECC.

6. The LP will appoint a 'General Partner' which will take the form of a company limited by shares created for the purpose. Each of the Parties will be a shareholder of the General Partner, purchasing £1 of shares for each percentage of their initial investment. Harlow Council will therefore have ten £1 shares. Holders of these shares will be under an obligation to lend money as limited partners in proportion with their shareholding – 10 percent for Harlow Council.
7. The Harlow Investment Fund has an equity requirement of £50 million. The Parties' equity will be subscribed and pooled at a General Partner level. Harlow Council will be expected to contribute the following:
 - a) Ten percent investment in the share capital would require a £10 subscription of shares (or the equivalent under an LLP) in the Harlow Investment Fund Limited Partnership (General Partner); and
 - b) A corresponding 10 percent share of the Loan Notes equalling £5 million.
8. The Fund will create project specific Special Purpose Vehicles (SPVs) through which development projects will be undertaken. The General Partner will then loan the money onto SPVs created for each company project SPV's through Loan Notes. The activities of the SPVs will be reported back to the Fund Board but the interface will be managed by a Commercial Manager and Development Manager who will advise on acquisitions, investments and operations of the Fund.
9. The equity return will be payable as dividends via the share equity and not via the Loan Notes.
10. Further detail on the structure and operation of the Fund is attached as Appendix 1 to the report, which was developed by the Parties, but led by HE with advice from technical experts/consultants.

Decision Making, Governance and Fund Management

11. Decisions regarding the running of the Fund will be taken at the Board of the General Partner and each of the Parties will appoint one director onto the Board. Reserved matters and shareholder reserved matter provisions will be used to ensure a requirement for unanimity for some decisions regardless of the investment of each of the Parties ensuring the interests of each party is safeguarded (attached as Appendix 3 to the report). Agreement will need to be reached regarding the selection of Harlow Council's director on the Board.

12. Councillors will be involved in the setting of the investment criteria. The investment criteria will be reviewed on an annual basis.
13. A suitably qualified person(s) will be appointed to act as Commercial Manager and Development Manager on behalf of the Parties. They will be responsible for identifying opportunity sites and developing proposal papers for approval in line with investment criteria set by the board and delivered as part of an annual investment plan.
14. The Commercial Manager and Development Manager will be asked to identify sites which meet the criteria of the Fund overall, and to minimise risk to the investors through the decisions they make on behalf of the fund. They will report to and be accountable to the Board of the General Partner.
15. Following establishment of the Fund the Commercial and Development Managers will financially appraise and test viability of each project as part of delivery of an annual investment plan for agreement by the parties.

Returns on Investment/Fund Expectations

16. It is planned that all funding will be assigned from 2021 financial year onwards and returns are expected to be realised as initial development sites are completed and sold. It is proposed a longer-term return will be achieved through re-investment of the proceeds of sale.
17. The Parties have set a series of investment criteria, against which eligible projects will be tested, with these set out at appendix 2. Initial work has suggested that as part of a £50 million capitalisation of an investment fund, Harlow Council's investment will:
 - a) Directly leverage £45 million of funding from HE, PfP and ECC;
 - b) Enhance the quality of the town centre, creating a mixed community through direct delivery and promotion of better designed, sustainable and higher quality homes, services and the built environment;
 - c) Directly enable the development of new homes and secure affordable homes across all tenures across Harlow;
 - d) Catalyse and provide confidence in the successful delivery of the planned Harlow Gilston Garden Town.
18. By investing, Harlow will be taking a commercial risk. Whilst this is considered as an investment proposal aiming to deliver regeneration of Harlow Town Centre, a priority growth location for Harlow Council, it is also planned that investment will generate a return, but this is not the key driver for the project.

Risk

19. Like any investment, there are risks that the projects supported by the Harlow Investment Fund will not advance or, if they do, will not generate a return on investment. The aim is that the Fund takes a blended approach to investments with some of the investments generating a larger return which much more than offsets those projects which deliver a low return or fail to deliver a return on investment at all. The key risks are:

a) Risk that overall, the fund fails to generate returns: If this happened Harlow Council would be unable to capitalise the investment and would have to find revenue to fund it, thereby creating a budget pressure.

i) This will be mitigated to some extent by:

- The Parties taking proper advice from suitably qualified experts in the form of commercial managers appointed by the fund prior to making investment decisions;
- Prior to establishing the fund, the Parties will sought input from legal, commercial and economic experts;
- To ring-fence risk and, if required to enable the leveraging of debt, the Fund will create project SPVs through which projects will be undertaken;
- Harlow Council will have a nominee on the board of the General Partner with oversight of and delegated decision on approving the investment plan; and
- The investment model assumes that there will be a blended approach to investments and that some will not generate a return however others will generate a larger surplus and that overall, the fund will generate a positive return in line with an established Internal Rate of Return (IRR) threshold.

b) Risk that Harlow Council's position is undermined by conflicts of interests with partner investors or that its position on the board is undermined:

- i) This risk cannot entirely be mitigated but three of the four partners are public sector organisations who seek to act in the public interest, and we will ensure that the constitution of the partnership and associated agreements provide reasonable protection to Harlow Council;
- ii) The shareholders have worked together over the course of over a year and a half to negotiate and agree a set of investment principles prior to establishment of the fund ensuring priorities and interests are aligned; and

- iii) The partners individually have aligning corporate priorities and strategic objectives which give confidence that conflicts are unlikely and where they may exist there are protocols in place to mitigate the impacts of these.
- c) Risk that projects fail to receive planning permission is a risk in any development, but care will be taken as part of the development appraisal process to select sites and development which are likely to be approved in principle by the local planning authority.

Investment Criteria

20. To ensure that investments are only made in the strongest cases, the Parties have taken steps to ensure that only the strongest and/or most impactful projects are funded. This includes:
- a) Developing seven criteria for project investment, attached as Appendix 2 to the report;
 - b) Appointing Commercial and Development managers with appropriate expertise and experience to advise the fund on investment proposals; and
 - c) Drawing up an investment plan to be reviewed annually.
21. In preparation of the fund exemplar projects to test the operation of the fund and the likely returns profiles available in Harlow from a range of sites has been developed.

Exiting the Fund

22. The participation of HE in the fund is restricted by law to where there is market failure. Therefore, once the fund has achieved its purpose and dealt with market failure, HE will be required to withdraw its investment. It is likely that HE will exit the Fund on completion of all investments or after a period of seven years. At the end of this period it is anticipated that the partners have the following options:
- a) HE's equity stake in the Fund is acquired by an external entity acceptable to the remaining partners, probably following a competitive marketing exercise undertaken by HE;
 - b) Other partners acquire the value of HE's equity at fair market value; and
 - c) The winding up of the Fund and distribution of proceeds in accordance with the agreed cascade in the agreement between the partners.

23. At the end of the 7-year initial operating period Harlow Council will have the option to:
- a) Continue, potentially with the addition of a private sector entity should HE exercise their right to leave the Fund and should the remaining partners not wish to acquire HE's ownership;
 - b) Harlow Council offers sale of its shares in the Harlow Investment Fund Limited Partnership to other shareholders (at fair market value); and
 - c) Shareholders to agree to a formal winding up of the Harlow Investment Fund Limited Partnership Company and distribution of the proceeds in line with the agreed dividends in return for the share equity.

Options

24. Option 1: Do not invest

- a) This would result in Harlow Council forgoing the opportunity to generate a capital return from investments that are made in the Town Centre which may improve the Council's financial position. Not investing would also limit or constrain the growth opportunity in Harlow, potentially impacting the viability or impact of future council investments in the Town Centre. Not investing would however avoid the risk of having to write off the investment should the fund fail to deliver on the planned priorities.

25. Option 2: Develop an alternative Investment model

- a) This would seek an alternative way of investing capital funding to that proposed in this report. In designing the fund, a range of investment structures including a legal partnership and direct investment in projects have been considered. These models have been discounted on the basis that whilst simpler to establish in the short-term they would not be recognised by the private sector as an optimal investment vehicle requiring the fund to be restructured when seeking to attract private capital. Given that the aim of the fund is to attract private sector investment, developing an alternative investment model would have complexities around changing the design and operation of the fund and its investments.

26. Option 3: Support Harlow Councils involvement in a Limited Partnership development fund and subscribe £5 million investment (Recommended Option)

- a) This would see Harlow Council investing £5 million, which will seek to leverage a return on investment and create potential economic growth and regeneration benefits for Harlow and the wider areas.

Financial Issues for Consideration

27. Harlow Council's maximum investment will be £5 million and this will be used as equity to make interventions in specific land and property assets in Harlow Town Centre, delivering residential led mixed-use schemes that align to the Investment Fund's priorities and help to accelerate and otherwise support the delivery of the Harlow Town Centre Masterplan. Harlow Council's investment represents a 10 percent equity stake.

Legal Issues for Consideration

28. The proposed investment is for ten £1 shares in the General Partner, giving 10 percent of the voting rights. The Council would therefore be a minority shareholder however will have decision-making through shareholder protections set out in the shareholder agreement.
29. Unless the company engages in wrongful or fraudulent trading, the Council's financial risk in relation to the Investment Fund will be limited to £5 million. It is important to note that the Fund will be making investments that carry a degree of risk and there is no guarantee of any return. It is possible that Harlow Council could lose the entire value of its investment. Equally Harlow Council has the possibility of earning a significant return on its investment.
30. Section 12 of the Local Government Act 2003 gives the Council the power to invest for (a) any purpose relevant to its functions under any enactment (b) the purposes of the prudent management of its affairs. In doing so it is not restricted to investment via a limited company and it is permitted to invest via a limited partnership in this context.
31. Harlow Council has sought advice to ensure that its investment in the Fund is compliant with the rules on state aid. As investments will be made on market terms utilising the LP structure, it is assessed that state aid is not applicable to the Council's investment. If as the Fund evolves and investment cannot be made on market terms, or if grant funding is required then further work will need to be done in order to assess compliance at the time. The Cabinet will appreciate that the future of state aid following the end of the EU transition period is as yet unclear.
32. The current discussions have been at a high level only with no detailed drafting on the documents which would form the constitution of the Harlow Investment Fund Limited Partnership or on any proposed shareholder agreement.

IMPLICATIONS

Environment and Planning (Includes Sustainability)

Participation in the Harlow Investment Fund will enable Harlow Council to better achieve its place-making and regeneration aspirations as set out in the adopted Local Plan and emerging Town Centre Masterplan. Public Sector intervention in the

town centre will help to counter the trend of opportunistic piecemeal development that has been seen in recent years.

Author: Andrew Bramidge, Head of Environment and Planning

Finance (Includes ICT, and Property and Facilities)

As set out in the report –provision has been agreed for the Council’s contribution as part of the reports agreed at the January Cabinet and Council.

Author: Simon Freeman, Head of Finance and Property and Deputy to the Chief Executive

Housing

As outlined in the report.

Author: Andrew Murray, Head of Housing

Community Wellbeing (Includes Equalities and Social Inclusion)

The establishment of this fund will provide a mechanism or funding major regeneration projects in Harlow Town Centre, and help bring about the step change required.

Author: Jane Greer, Head of Community Wellbeing

Governance (Includes HR)

The legal implications are set out in para 28-32 above and have been subject to external legal advice. Governance arrangements are set out in the Appendix. Section 1 of the Localism Act 2011 provides authorities with a General Power of Competence in addition to those of Section 12 of the Local Government Act 2003 to allow such investment opportunities

Author: Simon Hill, Head of Governance

Appendices

Appendix 1 – Structure overview

Appendix 2 – Investment criteria

Appendix 3 – Board decisions and reserved matters

Background Papers

None.

Glossary of terms/abbreviations used

ECC – Essex County Council

IRR – Internal Rate of Return

HE – Homes England

LP – Limited Partnership

PfP – Places for People

SPV – Special Purpose Vehicle