

SLOUGH BOROUGH COUNCIL

REPORT TO: Council **DATE:** 22nd July 2021
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PART I
FOR DECISION

AGREEMENT OF VARIOUS FINANCIAL DECISIONS WITH REGARDS TO GRE5 TO PROCEED WITH ESSENTIAL REPLACEMENT CLADDING WORKS AT NOVA HOUSE

1. Purpose of Report

To provide an update to Council on the current status of Nova House and Ground Rents Estates 5 Ltd (“GRE 5 Ltd”) and to approve a variation to the Council’s Investment Strategy which will enable the Council to provide delegated authority to the Chief Executive to enter into a loan agreement with GRE5 Ltd and to provide a parent company guarantee to Slough Urban Renewal (“SUR LLP”) with respect to the rectification of cladding defects at Nova House.

2. Recommendation/Proposed Actions

The Council is requested to:

- a) approve the variation to the Council’s investment strategy, as set out in this paper, which will enable (b) and (c) to take place;
- b) provide delegated authority to the s151 Officer after consultation with the Chief Executive and the SRO for this programme (Executive Director - Transformation) to enter into a loan facility agreement with GRE5 for up to £7m (with an option to increase this by up to a further £3m – a maximum of £10m); and
- c) provide a parent company guarantee to SUR LLP in relation to development costs for the replacement of cladding at Nova House that are not funded by Homes England (“HE”).

3. The Slough Joint Wellbeing Strategy, the JSNA and the Five Year Plan

(a) Slough Joint Wellbeing Strategy Priorities

The original project was intended to ensure that the private housing block was brought up to standards to meet those required for private sector housing. The Council choose to do this via acquiring the shares in GRE5, as opposed to utilising its enforcement powers under the Housing Act 2004.

(b) Five Year Plan Outcomes

The project was intended to ensure that Nova House was brought up to standard to allow tenants to safely live in the property without the need for ongoing interim measures to address the fire risks evident from the defects in the building.

4. Background

Nova House is a block of 68 apartments in the town centre, converted from offices to residential accommodation in 2015. Following the Grenfell Tower fire on 14 June 2017 the cladding at Nova House failed two flammability tests and further survey work during the summer and autumn of 2017 revealed significant defects with the compartmentation within the building.

The Council decided to acquire the shares in GRE5, the company owning the freehold lease of Nova House, due to concerns about the capacity of GRE5 to undertake the substantial remediation works required and concerns about the safety of residents and the wider interests of the community. This was completed on 7 March 2018. The Council also appointed directors to the company board at that time. In doing so, the Council committed to, and remains committed to, resolving the dangerous Aluminium Composite Material (“ACM”) cladding issue present on the building.

When the decision was taken to acquire Nova House, the scope of works and costs of the project were unknown although it was anticipated that costs may be up to a maximum of £10m. This included a provision for legal and other advisory costs to pursue a legal claim to recover costs incurred. The financial risks associated with the Council’s decision to acquire GRE5 were outlined at the time of the original decision.

It should be noted that GRE5’s core activities are the collection of ground rent, freehold extensions and management of some services at Nova House. Its income and costs are approximately £20,000 per annum and it has very limited options in terms of raising finance as it has minimal assets and value.

Interim fire safety measures were put in place, and continue to be in place, in the building to ensure the safety of residents, pending the completion of remediation works. These have included a high-quality heat detector system, the presence of a 24 hour waking watch and immediate evacuation procedures in the event of fire.

GRE5 commissioned investigations to identify the extent of the fire and safety related issues at Nova House. This has culminated in a scope of works that has now been agreed between the lead contractor and GRE5. A draft Development

Agreement (“DA”) has been produced to deliver the scope of works and a financial solution is required to ensure that these critical works can take place. The Council has continued to provide technical support throughout.

5. Other Implications

(a) Financial

Original Cost Estimates and Loan Facility Agreement

On 21 January 2019, the Cabinet was asked to approve a £7m loan facility to GRE5 with the option of providing a further loan of £3m, if required, subject to the delegated authority of the s151 officer. At that time, £10m was expected to cover all costs required to rectify the fire and safety defects and pursue a legal claim to recover a proportion of these costs. The Cabinet accepted that GRE5’s ability to repay this loan was dependent upon the outcome of the legal claim and the ability to recover monies from leaseholders. This has been a significant financial risk from the outset and continues to remain a key risk.

Following a recent review of the Council’s arrangements in place re GRE5, it has been identified that although a loan facility agreement was drafted and agreed by the then s151 officer, it was not signed and executed. In addition, monies have not been drawdown by GRE5 and the Council does not recognise a loan on its balance sheet. An alternative arrangement was implemented which has seen the Council processing and paying GRE5’s invoices for works and services associated with Nova House (waking watch costs, fire and safety works, investigations, legal and insurance advisors) following approval of invoices by GRE5 Directors. These costs have been included in the Council’s capital programme as a “GRE5 Fire and Safety Programme” (with an assumed budget of £7m). These issues need to be addressed to ensure that appropriate arrangements are established for GRE5 and the Council with regards to accounting for costs, loans and liability recognition in the appropriate entities and ensuring that there is an agreed funding strategy to successfully deliver the works required at Nova House.

In addition, the Cabinet did not have the powers to approve the loan facility with GRE5. Loans can only be approved in accordance with the Council’s Investment Strategy (“IS”) and all loans require full Council approval. As such, a variation to the Council’s IS is required to enable the Council to legally enter into a loan facility agreement with GRE5. Appendix 1 sets out the variation to the IS which will enable the Council to approve the loan facility with GRE5.

It is recommended that the original loan that was approved by Cabinet should now be approved by full Council (£7m plus an option for an additional £3m) and that this should then be executed by officers. In additional, appropriate accounting records should be maintained by the Council and GRE5 which are transparent and accurate with regards to costs, loans and liabilities of both parties.

The financial, technical and other support services to be provided by the Council to GRE5 should be clearly set out in a Service Level Agreement (“SLA”) to include regular cost management and reporting, board and performance management reporting, risk management and governance requirements. As part of a wider review of the Council’s companies, a GRE5 Action Plan will be developed.

Development Agreement, Grant Funding and Parent Company Guarantee

GRE5 has now proposed a programme of works to rectify the main defects. A draft DA has been agreed which relates to the main works programme (predominantly cladding replacement and immediate associated works). A follow-on phase of work is also expected to be required to address other non-cladding fire safety issues for which GRE5 is responsible for.

The DA will be between GRE5 and SUR as lead contractor, with the use of additional sub-contractors. These works can be carried out without an evacuation of the building. Table 1 provides details of all costs.

GRE5 has been successful in recently securing a substantial grant from The Ministry of Housing, Communities and Local Government (“MHCLG”)/Homes England (“HE”) to contribute towards the costs of ACM cladding replacement works. The Grant Funding Agreement (“GFA”) will be between MHCLG, HE, GRE5 and SUR and will only fund costs that are deemed to be “eligible” (focused on core cladding works). It should be noted that it is not permissible for the Council to be a party to this agreement; this is with the freehold leaseholder (and not its shareholder).

HE requires SUR to be a party to the GFA (in its role as lead contractor) and SUR will be liable to deliver the full works programme under the DA. SUR has requested that the Council provide a parent company guarantee (“PCG”) to effectively underwrite the costs that not funded by HE within the DA. Under the terms of the Council’s IS, the Council does not have the authority to enter into such guarantees. The funding gap on the DA is currently estimated to be £2.5m (see Table 1 – total DA costs of £10.3m less HE funding of £7.8m).

Current Status and Financial Position

Based upon estimates as at the end of June 2021, total costs are now expected to be in the region of £18.8m with current expected funding of £14.8m, resulting in a funding shortfall of £4m. This has increased by £0.5m compared to the June Cabinet report due to additional DA costs due to a delayed start to the project and additional team/governance resource to provide robust management and governance arrangements. A funding gap of £4m is based upon the provision of a Council loan of £7m only, HE funding of £7.8m and does not include any potential monies recoverable from the insurance claim or leaseholders. See Table 1.

The net funding shortfall is £1.9m if the additional (phase 2) fire and safety works are excluded (estimated costs of £2.1m as set out in Table 1). The immediate development works (cladding rectification as part of the DA) and core operating costs are affordable within the total Council loan facility (of up to £10m). Although it should be noted that the repayment of the Council’s loan remains uncertain and is at risk. The repayment of the Council’s loan is dependent upon a successful legal claim and the recovery of monies from leaseholders.

The costs and funding position as stated in this paper will change as work continues on this. In addition, the sector continues to be in dialogue with the Government to consider options to address the issues faced by leaseholders, including financing. Any changes in this respect may have an impact upon the financing strategy and financial risks faced by GRE5 and the Council.

Table 1: GRE5 financial summary as at the end of June 2021

	Costs £'000
Nova House Costs	
Costs up to 1/4/21	3,400.00
Development Agreement - main cladding works contract	10,300.00
Future operating costs	2,100.00
Additional team/NED costs	900.00
Total estimated costs	16,700.00
Potential additional fire and safety works	2,100.00
Potential estimated costs	18,800.00
Funding	
Council loan	7,000.00
Homes England funding	7,800.00
Total expected funding	14,800.00
Current funding shortfall - based upon total costs	4,000.00
Funding shortfall - excluding additional works	1,900.00

It should be noted that:

- Dialogue continues with Homes England/MHCLG and although £7.8m of funding has been confirmed in writing, this may be revised upwards by a further £1m which will reduce the financial exposure to the Council/GRE5;
- Table 1 is based upon a £7m Council loan only – there would still be a small funding shortfall if a loan of up to £10m was provided (see below);
- Development Agreement costs remain subject to change – current estimate is £10.3m and delays to starting on site will increase the total cost. Scaffolding is in place and costs continue to be incurred;
- Future operating costs include waking watch costs, minor works and ongoing substantial legal advice on the insurance claim. Waking watch costs may be recovered from leaseholders although GRE5 has not started proceedings to enforce this – the timing of proceedings is being considered as part of an overall strategy for leaseholder engagement;
- Future fire and safety works (phase 2) continue to be investigated and are likely to increase from this cost estimate – currently £2.1m. Works delivered as part of the Development Agreement may identify further works required;
- The Council is considering resourcing and governance arrangements for GRE5 as the company enters a significant phase where it will be required to deliver the essential cladding works, consider other defects, enter into legal proceedings, manage its finances during a period of significant costs and uncertainty, enter into proceedings with leaseholders for potential recovery of waking watch and other costs. Additional team support and non-executive director resource will be required and are included in Table 1;
- The legal claim against the warranty provider (Allianz) is complex and ongoing.
- Additional loan finance, over and above the £7m plus £3m loan option as set out in this paper, is not required at this stage. However, Cabinet will be updated on ongoing developments that may change the risk profile associated with GRE5 including any future requirement to consider additional financing;
- This analysis excludes interest payable which will be required to comply with Stade Aid requirements; and

- GRE5 has limited assets and very limited options in terms of obtaining additional finance. As GRE5's 100% shareholder, this is an issue the Council will need to address and could potentially add to the Council's financial pressures this year and in subsequent years.

As part of the Council's review of GRE5, a range of governance, management, financial and reporting changes will be required to reflect good practice and the scale and risk of ongoing activities. This will include a review of ongoing statutory requirements, an updated risk strategy and risk management plan, and establishment of a new GRE5 team. A plan is being developed as part of the action plan in response to the s114.

(b) Risk Management

The main risks for the Council in relation to Nova House are financial and are fully covered in the finance implications. GRE5 as the freeholder has responsibility for maintenance responsibilities under the leases, however this does not provide an obligation on the Council, as the sole shareholder, to provide a specific level of funding. As in most residential leases, whilst the maintenance responsibilities for structural issues lie with the freeholder, the cost of these are chargeable via service charges, subject to compliance with statutory consultation and other obligations. GRE5 have taken appropriate advice from professionals to support the board of directors with compliance with its statutory responsibilities.

As sole shareholder, the Council is responsible for appointing directors to the company board. The Council will be reviewing the company's governance arrangements alongside a wider review of companies' governance and this may include a skills audit and options to appoint independent non-executive directors. The Chief Executive has delegated authority to make such appointments.

GRE5 maintains a risk management plan which will be considered as part of the overall review of GRE5 and the development of an Action Plan.

(c) Human Rights Act and Other Legal Implications

Regulatory compliance

GRE5 is responsible for regulatory compliance of the Nova House site and has worked closely with key regulators: RBFRS, SBC Building Control and Housing Regulation.

In November 2018, MHCLG issued guidance to local authorities in relation to their Housing Act 2004 duties. This specifically addressed the profile for the hazard of fire in relation to cladding systems on high rise residential buildings. The guidance clarifies that the 2004 Act permits the inspection and rating of the common parts as separate residential premises and that this includes the exterior of the building and internal common parts of each floor and that consideration should also be given to balcony areas and terraces, service risers and ducting.

The guidance confirms that the fire authority also holds responsibility for fire hazards under the Fire Safety Order and it is recommended that there be a local protocol on the liaison between the Council and the fire and rescue authority, including the need

for the Council in its enforcement role, to consult with the fire and rescue authority in advance of any action, except in an emergency situation.

The guidance confirms that interim measures such as waking watches should not be considered in the hazard assessment but will be relevant to decisions on what action should be taken in response to an assessment.

If, following assessment, a local housing authority identifies a Category 1 hazard, it has a duty to use the provisions of the 2004 Act. If the hazard is identified as a Category 2 hazard, it has the power to take action and the guidance makes it clear that in this situation, it will be necessary to show how its discretion has been used.

To date, the Council, in its enforcement role, has not conducted a formal assessment of Nova House. Instead, it has worked with the fire and rescue authority and the freeholder to seek to advise on the most appropriate works to respond to the defects identified. The Council's duties as enforcement body remain the same regardless of whether it is the shareholder of the freehold company, as Nova House remains a private sector housing block.

If the Council assessed the building as having a Category 1 hazard and served an improvement notice, this would place responsibility on the building owners and/or leaseholders to take appropriate action. There is a right of appeal against relevant notices, and this can be used by the recipient if they believe they are not the responsible person. Failure to comply with a notice gives the Council the right to do works in default and charge these back to the responsible person.

Fiduciary duty and value for money

The Council owes a fiduciary duty to its taxpayers, as well as a best value duty to make arrangements to secure continuous improvement in the way its functions are exercised, having regard to a combination of economy, efficiency and effectiveness.

The fiduciary duty requires that the Council has regard to the interests of its taxpayers and to balance this against the aims of a policy decision. This duty is particularly relevant at a time when the Council is having to make difficult decisions around revenue and capital spending.

Many of the planned works to cover compartmentalisation works are not covered by the HE grant, which solely covered eligible ACM cladding works. It may be difficult for the Council to cover works over and above that which is strictly necessary to remove the imminent danger. It may also be difficult for the Council to justify funding works subject to recovery from the warranty provider. The benefits of these works are likely to increase the value of the leasehold flats, but unlikely to increase the value of the freehold land to any great extent. For this reason, the Council's longer term strategy is being considered to ensure that is clear on all options.

Procurement

GRE5 submitted a procurement strategy to the Council in July 2020 which identified SUR as the preferred lead contractor. This enabled procurement of Morgan Sindall Construction and a cladding subcontractor, both of which were also being used on the nearby Hotel project. Construction projects across the country have been affected by the pandemic and proximity and availability of teams was recognised as

a critical factor to manage risk of infection and secure contractors to undertake essential works. This approach was approved by the Council on the 31 July 2020.

GRE5 applied for grant funding from HE for the removal and replacement of the combustible ACM cladding on the basis of a cost plan submitted by Morgan Sindall Construction in January 2020. This application has been subjected to external review by Cushman and Wakefield to verify value for money and fair market rates. This was an essential prerequisite for any funding agreement and HE required an independent market verification which it is satisfied with.

(d) Equalities Impact Assessment

There are no identified needs for an EIA at this juncture.

(e) Workforce

There are no workforce implications at this juncture, although it is recognised that significant additional Council and external resource will be required to successfully deliver this project, pursue the legal claim and provide critical governance and management to this complex project.

(f) Property

No other matters to note other than specific issues related to Nova House.

(g) Carbon Emissions and Energy Costs

There are no carbon emissions and energy cost implications at this juncture.

6. Supporting Information

No additional supporting information.

7. Comments of Other Committees

An update was provided to Cabinet in June 2021 setting out the decisions requires by Full Council and actions.

8. Conclusion

GRE5 has implemented and maintained a range of measures to fulfil its statutory and regulatory obligations and protect the residents of Nova House. It has made significant progress in agreeing a programme of works to replace the defect cladding at Nova House and in securing a positive outcome with HE for grant funding to reduce the Council's exposure to financial risk. However, full Council approval was not obtained for the original loan to GRE5 and changes to the IS are required to enable this to take place. In addition, there is now a requirement for a PCG which will require further changes to the IS and require approval by full Council.

A programme of changes will be implemented to strengthen the governance, management, financial and reporting arrangements within GRE5 and between the Council and GRE5.

Appendices

Appendix 1 - Variation to Investment Strategy

Appendix 1 Variation to Investment Strategy

The Council approved an Investment Strategy in March 2021 as part of the budget setting process. Paragraph 3 of the Investment Strategy gives authority for loans to be advanced to third parties. However the third parties to whom loans can be advanced under the current Investment Strategy are limited to James Elliman Homes and Slough Urban Renewal Old Library LLP for sums not exceeding £65.9m and £13.558m respectively.

The main part of this paper refers to the need for the Council to:

- regularise the approval for a loan agreement with GRE5 up to value of £7m, with an option to increase by a further £3m if required, to fund costs associated with the removal and repair of cladding from Nova House; and
- provide a parent company guarantee in respect of Slough Urban Renewal LLP for development costs not funded by Homes England as set out within the Development Agreement (unfunded costs are currently estimated to be £2.5m although dialogue continues with Homes England to increase the level of grant funding which will reduce the level of unfunded costs).

The wording of the current Investment Strategy does not permit either, because the wording of the current Investment Strategy only permits loans to two named third parties and does not envisage provision of any guarantees.

The Investment Strategy can be varied in year. Paragraph 17 of the Statutory Guidance on Local Government Investments (3rd edition) published by MHCLG in 2018 requires that:

Where a local authority proposes to make a material change to its [Investment] Strategy during the year a revised Strategy should be presented to full council or equivalent for approval before the change is implemented.

Given that the loan to be advanced is a material sum and the provision of guarantees is a significant change, then under the above Guidance this would require a full revision to the Investment Strategy, which is planned for later this summer.

In view of the urgency for completing the loan agreement with GRE5, Council approval is sought for a variation to the Investment Strategy to replace the current section 3 of the Investment Strategy with the following:

The Council will allow loans and guarantees to be made to organisations for any purpose relevant to its functions under any enactment. The Council will undertake due diligence checks to confirm the borrower's creditworthiness before any sums are advanced and will obtain appropriate levels of security or third party guarantees for loans advanced. In exceptional circumstances where security or third party guarantees cannot be provided, the Council would be required to justify its decision. The Council would expect a return commensurate with the type, risk and duration of the loan. A limit of £100 million for this type of investment is proposed with a duration commensurate with the life of the asset and Council's cash flow requirements. All loans will need to be in line with the Council's Scheme of Delegation and Key Decision thresholds levels.