Committee:	Cabinet	**Date:**	
Title:	Aspire (CRP) Ltd – Request for Funding	Wednesday, 23 August 2023	
Portfolio Holder:	Councillor Hargreaves, Portfolio Holder for Finance and the Economy		
Report Author:	Jody Etherington, Director of Finance, Revenues and Benefits JEtherington@uttlesford.gov.uk	**Key decision:** Yes	

Summary

1. The Council has been approached by its wholly owned subsidiary, Aspire (CRP) Ltd, with a request for loan funding to the value of £21,060,000.

2. The purpose of the loan is to fund new development at Chesterford Research Park, namely the building of a new unit for letting (Building 800), and phase 1 of an on-site solar farm.

3. This report considers the implications of providing such funding, including the financial returns for the Council and Aspire, the recommended loan terms and interest rate to be applied, compliance with statutory requirements, sources of finance, and the implications on the Council's access to the Public Works Loan Board (PWLB).

4. The loan is forecast to provide a significant positive return to the Council over a number of years. Furthermore, should the Council decide not to proceed, there is a risk that the value of Aspire's existing stake in Chesterford Research Park will be adversely affected. For these reasons, it is recommended that the Council proceed with the loan as requested.

Recommendations

5. Cabinet is recommended to:

    a. approve a new loan facility of up to £21,060,000 be made available to Aspire (CRP) Ltd, to be drawn down in tranches over a period of up to 2 years, subject to Full Council agreeing to make funding available for this purpose;

    b. note the implications of making the loan on the Council's access to Public Works Loan Board, as set out in paragraphs 50 to 57; and

    c. delegate authority to the Director of Finance, Revenues & Benefits (in consultation with the Portfolio Holder for Finance and the Economy and the Council's external treasury advisers) to agree the final terms of the loan facility, including the interest rate to be charged (such rate to be no less than 7.5%).

Financial Implications

6. The financial implications are set out at paragraphs 42 to 49 and Appendix A.

Background Papers

7. The following papers were referred to by the author in the preparation of this report and are available for inspection from the author of the report.

    - Letter from the Board of Aspire (CRP) Ltd – request for additional funding for further development at Chesterford Research Park
    - Arlingclose Report – Aspire Interest Rate Report August 2023 (Draft)

Impact

8.

Communication/Consultation	None prior to this Cabinet report as this is responding to a specific request from Aspire (CRP) Ltd
Community Safety	None
Equalities	None
Health and Safety	None – Aspire (CRP) Ltd is a passive investor in Chesterford Research Park and is not therefore directly responsible for health and safety matters
Human Rights/Legal Implications	The legal form of any new loan agreement will mirror previous agreements entered into with Aspire (CRP) Ltd
Sustainability	The request for funding is partly to finance an on-site solar farm, which will greatly enhance the Park's sustainability credentials
Ward-specific impacts	The Park is located in the Littlebury, Chesterford and Wenden Lofts Ward
Workforce/Workplace	None

Background

9. In December 2016, Full Council gave its approval for the acquisition of a 50% share in Chesterford Research Park, through the Council's wholly owned subsidiary, Aspire (CRP) Ltd (referred to throughout this report as 'Aspire').

10. In order to fund this acquisition, a 50-year maturity loan of £47.5 million was made by the Council to Aspire at a fixed rate of 4%.

11. At the time of acquisition, the development of the park was still in the first of three planned phases, with outline planning consent in place for a further 21 units to be built. The Council recognised and supported the principal that additional borrowing would be required in the future to enable the park to develop further.

12. Since this time, 7 additional loans have been advanced to Aspire totalling £13.3 million. These have been for small scale development and improvements to existing assets on the site. The loans are on a mixture of terms and durations depending upon their purpose. As at the date of this report, the total principal amount outstanding on all loans is £59.6 million.

13. Aspire have now approach the Council seeking funding for the first large scale development on the site since its acquisition – namely the development of a new unit for letting (Building 800), and a solar farm for the purposes of providing an on-site renewable energy provision.

14. The total funding being sought is £21,060,000, to be drawn down in tranches over a period of up to 2 years.

Nature of Investments

15. This report does not directly address the viability or risks associated with the underlying investment in the Park by Aspire. These matters are for discussion by the Investment Board, which will meet on 21 August 2023. The Chair of the Investment Board will be in a position to update Cabinet on these discussions at the meeting at which this report is considered.

16. Nevertheless, before agreeing to any funding request, it is important that the Council carries out its own due diligence to ensure that the risks and rewards of any loan made to Aspire are fully considered.

17. The proposed investment in the Park can be split into two parts, as follows:-

<u>Building 800</u>

18. The proposed development of Building 800 provides for a multi-state, fully fitted lab building, created to satisfy demand from second stage Life Science companies who are moving from incubator hubs or small suite accommodation as their research expands.

19. The project appraisal prepared by the Park's Development Manager allows for total development costs of £51.1 million (including the notional value of the

land upon which the building will sit), with an estimated net development value upon completion of £59.3 million, representing a development profit of £8.2 million. Expected rental value of the building is anticipated to be £3.2 million.

20. An alternative appraisal prepared by the Park's independent valuers, CBRE, estimates development costs of £51.2 million, with an estimated net development value of £57.6 million, i.e. a slightly lower development profit of £6.4 million. Nevertheless, this still helps to provide independent assurance as to the profitability of the planned development. Expected rental value is again estimated at £3.2 million.

21. After removing the notional value of the land already held by the Park, Aspire's 50% share of the development costs is estimated at £18,821,200. The main contractor will be appointed on a fixed price design and build contract, which will significantly reduce the risk of price variability.

<u>Solar Farm</u>

22. The request for funding of the solar farm is for phase 1 of a two phase project, covering some development of the farm itself, alongside infrastructure upgrade works to the private electrical ring to enable the use by core buildings of the electricity generated. Phase 1 will include a total panel area of c. 1,500 sqm.

23. The value of Aspire's share of the investment in phase 1 is estimated at £2,238,800. Aspire have estimated the payback period to be approximately 8.5 years. However, given the inherent volatility of income from energy generation, no income has been assumed for the purposes of this report, in the interests of prudence. Even without this model, the loan requested will deliver a positive return to the Council overall, as set out at paragraphs 42 to 49 below.

Loan Terms

24. Previous loans to Aspire have been made at fixed rates between 4.0% and 4.5% – the latest of which was advanced in August 2021. However, the past 12 months have seen significant increases in interest rates, which has impacted the cost at which the Council can borrow.

25. When setting the interest rate on subsidiary loans there are a number of factors to consider. The rate charged needs to result in a viable investment for both the Council and its subsidiary, as well as for the group as a whole. In addition, it must reflect a fair commercial rate, otherwise there is a risk of issues relating to state subsidy (if the rate is too low) or corporation tax (if the rate is too high). As such, the Council has engaged its treasury management advisers, Arlingclose, to advise on a range of acceptable rates, taking into account the other terms of the loan.

26. It is proposed that the main terms of the loan (except interest rate) be broadly consistent with the original loan made to Aspire for the acquisition of the Park, namely:-

a. the loan shall be secured on the assets of Aspire as a whole (i.e. not just the individual building being financed);

b. the loan shall be a maturity loan with a duration of 50 years from the date of first drawdown, to reflect its primary purpose in financing a new building which will have a useful life of at least 50 years;

c. the loan shall be repayable in full upon demand by the Council.

27. In addition, Aspire have requested an initial interest free period from the point of first drawdown until 31 March 2025, in order to allow time for construction and occupation, and taking into account and rent-free periods which may be offered to tenants. Arlingclose have confirmed that such a request is not unusual for this type of funding, and this initial interest-free period will be reflected in a higher rate charged for the remaining duration of the loan.

28. In determining a reasonable commercial interest rate to charge, Arlingclose have reviewed the creditworthiness of Aspire (in the absence of a formal credit rating), and have estimated a likely Moody's rating of Baa3. Taking this into account, Arlingclose have proposed a minimum commercial loan rate of 5.15% – although this rate does not take into account any profit margin for the Council, nor the impact of the initial interest-free period above.

29. Taking all factors into account, it is therefore proposed that the final fixed-term loan rate should be set no lower than 7.50%, which is equivalent to 2.25% above the current Bank of England base rate. For comparison, the original acquisition loan was made at 4.00% when the Bank of England base rate was 0.25%, i.e. a margin of 3.75%.

30. The advice from Arlingclose is still in draft form at the time of writing this report, and is due to be finalised shortly. Cabinet is therefore recommended to delegate authority for agreeing the final rate to the Director of Finance, Revenues and Benefits, in consultation with the Portfolio Holder of Finance and the Economy, taking into account appropriate professional advice from Arlingclose.

Statutory Compliance

<u>Prudential Code</u>

31. Under local government finance regulations, the making of loans from capital purposes is classified as capital expenditure, and therefore the Council is required to have due regard to the CIPFA Prudential Code.

32. The Prudential Code was last updated in 2021, and there is now a general prohibition on local authorities borrowing to finance capital expenditure where the primary purpose is for commercial yield. Authorities will existing commercial land and property are, however, expressly permitted to invest in maximising its value.

33. The investment appraisals referenced in paragraphs 19 to 20 above provide evidence that the making of this loan would increase the value of the Aspire's

share of the Park by a greater amount than the sums invested, which clearly demonstrates compliance with the Prudential Code.

34. Furthermore, the Council has sought professional advice from Cushman & Wakefield (who advised on the original acquisition) as to the impact should the Council choose not to proceed with this investment. The terms of the joint venture mean that, in this case, the other partner could proceed alone, which would dilute the Council's 50% holding in the whole Park. Specifically, Cushman & Wakefield have advised that:-

    "Where minority stakes are offered to the market the potential buyer audience is smaller, the liquidity of the stake diminishes and there is often a negative pricing implication although the quantum of such is difficult to determine as no two JVs are alike. Therefore, in conclusion, in order to protect the value of UDC's interest in CRP we would advise that any future developments and conducted in line with the JV agreement, on a 50:50 basis with Aviva, thus ensuring an equal shareholding with your JV partner."

35. The above provides further justification for proceeding with the investment under the 'maximising value' provisions of the Prudential Code.

<u>Minimum Revenue Provision</u>

36. Under the Council's Minimum Revenue Provision (MRP) policy, last approved by Full Council in February 2023, the Council charges MRP on all capital loans to subsidiaries on an annuity basis over the life of the loan.

37. It should be noted that this approach is more prudent than that currently required by statutory MRP guidance, which doesn't explicitly require local authorities to charge MRP on capital loans. The government has consulted on introducing such a requirement, but has not to date confirmed whether or not this will go ahead or from which date it will be effective. The Council has chosen to adopt this approach before it is mandated in the interests of prudence, and this has been taking into account in modelling the impact of the proposed loan on the finances of the Council and the group.

Sources of Finance

38. The Council will need to undertake new external borrowing in order to finance the loan to Aspire. It is proposed that this be done in two phases.

39. Firstly, during the construction and occupation phase, borrowing will be undertaken on the local authority market. This will consist primarily of short-term borrowing, although borrowing durations of up to 3 years may be taken if available.

40. Whilst short-term borrowing rates are currently slightly higher than long-term rates, this approach will allow the Council flexibility to match external borrowing with cashflow requirements, for example if there is a delay to construction which results in later than anticipated drawdown by Aspire. Since Arlingclose are currently forecasting short-term rates to start falling in around a

year’s time, a secondary benefit will be the ability to take advantage of lower refinancing rates later in the construction phase.

41. Once occupation is complete, the Council will seek to refinance the borrowing in the longer-term. The default starting assumption is that the duration of borrowing will be set to match the duration of the loan to Aspire in order to eliminate any interest rate risk to the Council – however advice will be sought from Arlingclose nearer the time, and an alternative strategy may be adopted if conditions dictate. All external borrowing will always be undertaken in line with the Treasury Management Strategy approved by Full Council each year.

Financial Modelling

42. As set out above, it is not the purpose of this report to provide a detailed financial appraisal of the underlying investment by Aspire in the Park. However, in order to demonstrate that the additional borrowing is prudent, a basic cashflow model has been developed for both the Council and Aspire.

43. The key assumptions used in this model are as follows:-

    a. Rental income – starting at £3.2 million as supported by CBRE appraisal, with 5-yearly increases set at 2% per annum compounded (a relatively prudent assumption based upon the terms of a number of existing tenants at the Park).

    b. Borrowing costs – based on rates available today, adjusted for future borrowing using the latest interest rate forecasts provided by Arlingclose.

    c. Loan rate – 7.5% (the minimum to be agreed as set out above).

44. The model has been extended to cover a 50 year occupation period to ensure that it accounts for the full repayment of MRP. This demonstrates positive net cashflow for Aspire in each year of the loan, with the exception of 2026/27 when there is a relatively small deficit of £251,000 as a result of an anticipated rent-free period. It is expected that Aspire will be able to cover this shortfall from rental profits relating to other buildings.

45. For the Council, there is an initial total net cost of £2.3 million in the first three years (2023/24 to 2025/26), due to the fact that the Council will incur external borrowing costs whilst not receiving interest income from Aspire during the interest-free period. It is proposed that these costs are covered from the commercial asset reserve, which currently stands at £4 million, with additional contributions of £1 million per year planned for the remainder of the current Medium Term Financial Strategy period (to 2027/28). Should this be agreed, the reserve will stand at £6.7 million by 31 March 2028.

46. Following the initial interest-free period, there are positive cashflows for the Council from interest income alone (net of borrowing costs and MRP), in each year up to and including 2058/59.

47. The use of the annuity basis to calculate the Council's MRP charge means that the amount of MRP charged increases each year. This is an appropriate basis to use for investment income as it matches future charges against future expected increases in income streams. Whilst the interest income the Council will receive from the loan is fixed, anticipated rent increases will greatly increase the profit earned by Aspire, which can either be reinvested or distributed to the Council by way of dividends.

48. In each of the years from 2059/60 to 2075/76 inclusive, the interest income from the loan alone will not be sufficient to cover the Council's external borrowing costs and MRP charges. However, in each year, the forecast profits from Aspire will far exceed the costs incurred, resulting in a positive net cashflow position for the group as a whole.

49. Overall, the investment is forecast to deliver net profits to the group of c. £39.4 million over a 50 year occupation period. The full cashflow model is set out at Appendix A.

Other Implications

50. In June 2023, HM Treasury updated the lending terms of the Public Works Loan Board (PWLB). Under these terms, any local authority which incurs capital expenditure on investments primarily for commercial yield are unable to access the PWLB for new borrowing until the end of the following financial year.

51. In this particular case, strong representations would be made to HM Treasury concerning the need to protect and enhance the value of the Council's existing commercial investments, as set out at paragraph 34 above. However, it is ultimately for HM Treasury to determine their own lending terms, therefore it is considered likely that, should the Council proceed with making new loans to Aspire, it will be unable to access new PWLB borrowing until at least 1 April 2026. Furthermore, the specific borrowing undertaken to support the loan will be unable to be refinanced using PWLB at any point in the future.

52. The Council's current Capital Programme, as approved in February 2023, anticipates new borrowing totalling £2.1 million to support General Fund capital expenditure between 2023/24 and 2025/26. This is a relatively low level of borrowing in the context of the Council's Balance Sheet, and can be supported in the short-term by alternative borrowing sources such as other local authorities.

53. The Housing Revenue Account (HRA) Capital Programme does not currently envisage any external borrowing in 2023/24 or 2024/25. This was a conscious decision made in light of the ongoing review of the 30 Year Business Plan, which is due to conclude in the next few months on the affordability of further external borrowing in the HRA to support the delivery of new housing stock.

54. Should the review conclude that further borrowing is affordable to the HRA, it may be possible to bring forward some of the schemes currently planned for later years (from 2025/26 onwards). However, by proceeding with the loan to

Aspire, the Council will be prevented from borrowing from the PWLB to finance these until 1 April 2026.

55. Furthermore, the HRA Capital Programme currently forecasts new borrowing of £3.1 million in 2025/26 – again this would be unable to be financed from the PWLB, which could risk further delaying these schemes.

56. One possible solution to this issue would be to borrow from alternative sources (such as other local authorities or internally from the General Fund) in the short-term, then refinance this borrowing to the PWLB from 1 April 2026. Such an approach would be permitted by the current lending terms.

57. It is important to note that, should the loan to Aspire proceed, the Council would retain access to PWLB at all times for the refinancing of existing borrowing which falls due for repayment (with the exception of borrowing relating to commercial investments committed after November 2020, which is already excluded from PWLB financing). The refinancing risk to the Council's existing debt portfolio as a whole is therefore unaffected by the new loan.

Risk Analysis

58.

Risk	Likelihood	Impact	Mitigating actions
Cost overruns – funding is insufficient for development	2	1	Main contractor for Building 800 to be appointed on fixed price basis – total provisional contract sums relatively low (c. £300k).
Project delays – late occupation resulting in reduced rental income	2	3	Financing of construction phase on short-term borrowing market gives flexibility to reduce unnecessary borrowing costs should delays be encountered.

Risk	Likelihood	Impact	Mitigating actions
Underachievement of future rental income, including unplanned voids or longer than expected rent-free periods	1	3	Rental income assumptions are relatively prudent when compared to current market conditions and independent valuation advice.
Interest rate risk to Council at point of refinancing loan (on completion of building)	2	1	Cashflow model incorporates latest interest rate forecasts from external advisers, Arlingclose. Loan can be recalled by Council at any time should market conditions shift significantly (although in practice it would likely be difficult for Aspire to find alternative funding sources).
Decision not to proceed – impact on valuation of existing investment	3	3	External advisers have confirmed that a decision not to proceed would be likely to adversely affect the value of Aspire's existing investment in the Park, although this is difficult to quantify.

1 = Little or no risk or impact
2 = Some risk or impact – action may be necessary.
3 = Significant risk or impact – action required
4 = Near certainty of risk occurring, catastrophic effect or failure of project.

Cashflow Model

Appendix A

	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32	2032/33	2033/34	2034/35	2035/36	2036/37	2037/38	2038/39	2039/40	2040/41
Aspire																		
Rent Income	-	-	-	1,329	1,595	1,595	1,595	1,622	1,761	1,761	1,761	1,761	1,791	1,944	1,944	1,944	1,944	1,978
Interest Cost	-	-	-	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580
Tax Expense	-	-	-	-	-4	-4	-4	-11	-45	-45	-45	-45	-53	-91	-91	-91	-91	-100
Total Aspire	**-**	**-**	**-**	**-251**	**11**	**11**	**11**	**31**	**136**	**136**	**136**	**136**	**158**	**273**	**273**	**273**	**273**	**298**
Council																		
External Borrowing Cost	-189	-1,035	-1,095	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085
MRP Charge	-	-	-	-96	-101	-106	-111	-117	-123	-130	-136	-143	-151	-158	-167	-175	-184	-194
Interest Income	-	-	-	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580
Total Council	**-189**	**-1,035**	**-1,095**	**399**	**394**	**389**	**384**	**378**	**372**	**365**	**359**	**352**	**344**	**337**	**328**	**320**	**311**	**301**
Total Group	**-189**	**-1,035**	**-1,095**	**148**	**405**	**400**	**395**	**409**	**508**	**501**	**495**	**488**	**502**	**610**	**601**	**593**	**584**	**599**

	2041/42	2042/43	2043/44	2044/45	2045/46	2046/47	2047/48	2048/49	2049/50	2050/51	2051/52	2052/53	2053/54	2054/55	2055/56	2056/57	2057/58	2058/59
Aspire																		
Rent Income	2,146	2,146	2,146	2,146	2,183	2,370	2,370	2,370	2,370	2,411	2,616	2,616	2,616	2,616	2,662	2,889	2,889	2,889
Interest Cost	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580
Tax Expense	-142	-142	-142	-142	-151	-198	-198	-198	-198	-208	-259	-259	-259	-259	-271	-327	-327	-327
Total Aspire	**424**	**424**	**424**	**424**	**452**	**592**	**592**	**592**	**592**	**623**	**777**	**777**	**777**	**777**	**811**	**982**	**982**	**982**
Council																		
External Borrowing Cost	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085
MRP Charge	-204	-214	-225	-237	-249	-262	-275	-289	-304	-320	-336	-354	-372	-391	-411	-432	-455	-478
Interest Income	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580
Total Council	**291**	**281**	**270**	**258**	**246**	**233**	**220**	**206**	**191**	**175**	**159**	**141**	**123**	**104**	**84**	**63**	**40**	**17**
Total Group	**715**	**705**	**694**	**682**	**698**	**825**	**812**	**798**	**783**	**798**	**936**	**918**	**900**	**881**	**895**	**1,045**	**1,022**	**999**

	2059/60	2060/61	2061/62	2062/63	2063/64	2064/65	2065/66	2066/67	2067/68	2068/69	2069/70	2070/71	2071/72	2072/73	2073/74	2074/75	2075/76
Aspire																	
Rent Income	2,889	2,939	3,189	3,189	3,189	3,189	3,245	3,521	3,521	3,521	3,521	3,582	3,888	3,888	3,888	3,888	3,955
Interest Cost	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580	-1,580
Tax Expense	-327	-340	-402	-402	-402	-402	-416	-485	-485	-485	-485	-501	-577	-577	-577	-577	-594
Total Aspire	**982**	**1,019**	**1,207**	**1,207**	**1,207**	**1,207**	**1,249**	**1,456**	**1,456**	**1,456**	**1,456**	**1,501**	**1,731**	**1,731**	**1,731**	**1,731**	**1,781**
Council																	
External Borrowing Cost	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085	-1,085
MRP Charge	-503	-529	-556	-584	-615	-646	-679	-714	-751	-790	-831	-873	-918	-966	-1,015	-1,068	-1,123
Interest Income	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580	1,580
Total Council	**-8**	**-34**	**-61**	**-89**	**-120**	**-151**	**-184**	**-219**	**-256**	**-295**	**-336**	**-378**	**-423**	**-471**	**-520**	**-573**	**-628**
Total Group	**974**	**985**	**1,146**	**1,118**	**1,087**	**1,056**	**1,065**	**1,237**	**1,200**	**1,161**	**1,120**	**1,123**	**1,308**	**1,260**	**1,211**	**1,158**	**1,153**