

## Slough Borough Council

<b>Report To:</b>	Cabinet Committee for Asset Disposals
<b>Date:</b>	16 <sup>th</sup> March 2023
<b>Subject:</b>	Nova House/GRE5 update report
<b>Lead Member:</b>	Councillor Rob Anderson Lead Member for Financial Oversight and Council Assets
<b>Chief Officer:</b>	Pat Hayes, Executive Director Property and Housing
<b>Contact Officer:</b>	Fin Garvey, Group Manager – Place Delivery
<b>Ward(s):</b>	Central Ward
<b>Key Decision:</b>	YES
<b>Exempt:</b>	Public with exempt appendices under paragraph 3 of Schedule 12A Local Government Act 1972 – Information relating to the financial or business affairs of the Council
<b>Decision Subject To Call In:</b>	YES
<b>Appendices:</b>	Appendix 1 – GRE5 Business Plan  Confidential Appendix 1 – Update on Insurance Claim Confidential Appendix 2 – Potential Insurance scenarios Confidential Appendix 3 – Financial Scenarios - Examples Table Confidential Appendix 4 – Outcome scenarios

### **1. Summary and Recommendations**

- 1.1 This report provides an update on the current position of Ground Rent Estates 5 Limited (“GRE5”) and sets out the Business Plan for the company for the five year period to March 2028.

#### **Recommendations:**

Cabinet Committee is recommended to:

Recommend to Cabinet:

1. Approval of the Business Plan for GRE5, which is included as Appendix 1 to this report.

2. Approval of an increase in the loan facility by £5m to allow the work programme to continue in advance of any recovery via the legal proceedings, future grant from Homes England or leaseholder recovery.

Agree to regular, at least quarterly, reports being presented to the Committee updating on progress and risks and for a future report recommending approval of an updated shareholder agreement.

**Reason: The refurbishment programme is currently paused, pending the availability of additional funding. As there are limited options for additional funding, a decision to increase the loan facility will enable the works programme at GRE5 to continue without any additional delay and cost.**

## **Commissioner Review**

Commissioners have reviewed the report and are content with the report.

## **2. Report**

### **2.1 Introduction**

Ground Rent Estates 5 Limited (“GRE5”) is a company which is wholly owned by Slough Borough Council (the Council). GRE5 owns the freehold of Nova House, a block of 68 apartments in Slough town centre. The building was previously office accommodation and was converted to an apartment block in 2015 with additional floors added to the building. All flats have been sold under leasehold titles. GRE5 does not own the leasehold titles for any of the individual flats.

GRE5’s core day-to-day activities include the collection of ground rent, freehold extensions and management of some services provided to residents/owners at Nova House. Its activities are very minor and small scale and includes income and costs of approximately £15k per annum. It has very limited options in terms of raising finance as it has minimal assets and value to provide security for an institutional funder such as a bank.

Following the Grenfell Tower fire, high rise residential buildings were subject to testing to identify whether they had a similar combustible cladding. Nova House failed flammability tests in 2017. Further survey work then revealed additional issues with the compartmentation within the building and further structural defects were identified in 2022 as set out in this report.

In 2018, following discussion with the then Ministry of Housing, Communities and Local Government (MHCLG) and Royal Berkshire Fire and Rescue Service, the Council approved the acquisition of 100% of the share capital of GRE5 for £1 due to concerns about the capacity and ability of the company, and its existing shareholders at that time, to undertake the substantial remediation works required and concerns about the safety of residents. Whilst the exact scope of works was unknown at that stage, costs were anticipated to be c. £10m and it was assumed at that time that the Council would be able to recover some or all of the costs associated with the remediation works to address the defects from a third party (not named at the time of acquisition) following a legal claim.

Following the acquisition of GRE5, 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. All measures continue to be assessed on an ongoing basis in conjunction with the Royal Berkshire Fire and Rescue Service (RBFRS).

A scope of works and a Development Agreement were agreed with Slough Urban Renewal (SUR) in 2020 to remove all Aluminium Composite Material (ACM) Cladding and associated replacement works. Under the terms of the SUR Partnership Agreement, SUR can undertake Community Projects to deliver building or infrastructure works. SUR and its supply chain are required to demonstrate value for money through transparent and open-book pricing with 80% of sub-contract packages market tested, and a fixed and agreed overhead and profit margin and independent VFM cost report.

The original works project experienced delays due to covid restrictions and the requirement to undertake additional tests and surveys due to concerns identified as cladding materials were removed from the building. All ACM was fully removed by the end of January 2022 which improved the safety of the building, although due to other defects, there was still a necessity to retain interim safety measures. A series of investigations took place in FY 2020/21 and again in FY2022/23 which identified a range of further defects and associated technical issues which are set out in this report.

In 2022, structural issues were identified relating to the spine beam, bracing to the building, shims and column connections. This resulted in the halt of the cladding replacement works whilst contractors made assessments and provided remediation options for the structural issues. The design of technical solutions to address these issues has been complex but solutions have now been agreed and costed. Following technical advice, the structural issues are required to be addressed before the cladding and balconies can be replaced on the building. The main phase of works is now expected to be undertaken during 2023 and 2024 with completion of the build project forecast for Q3 FY24/25.

## **2.2 Current position**

### *Robust governance, management and oversight*

In October 2021, two new GRE5 Directors were appointed to oversee this complex project bringing a range of skills and experiences relating to communications, stakeholder management, governance and leading construction projects.

New governance and management arrangements have also been introduced to further strengthen management and reporting arrangements internally and into the Council. This includes weekly GRE5 team meetings, monthly GRE5 board meetings and monthly meetings between Council officers and GRE5 Directors with project, financial and risk reporting. The Council has established a corporate oversight function which includes representatives from across the Council and a SRO has been designated. The Council needs to improve its reporting to elected members, including ensuring that an annual business plan is approved, significant increases in funding, including loan arrangements, are approved at a member level and there is appropriate oversight by members. Reports will be presented to the Cabinet Committee, with matters that are reserved to Cabinet being determined by full Cabinet. In addition where appropriate the risks associated with this company will be reported to Audit and Corporate Governance as part of the corporate risk register. Overview and Scrutiny Committee will be able to consider whether it wishes to scrutinise this company as part of its annual work programming.

The GRE5 Team includes the Directors plus a project manager and finance support. Additional services and expertise is brought in as required. e.g. Communications support,

legal advice and technical advisors. A wider team of contractors are engaged in the project in relation to building works, security and a waking watch service.

The GRE5 Directors are responsible for leading communications with owners and occupiers and in early 2022 developed a new communications plan and, introduced regular leaseholder meetings and a wide range of leaseholder and resident communications. The Directors meet the leaseholders every two months and provided reports and updates at these meetings. The meetings also provide a forum for discussion about the project plus any other issues in relation to the management of the building and the insurance case. The meetings are also attended by Red Rock Management (the managing agent) and Fenchurch Law (GRE5's legal advisors on the insurance case).

### *Project changes, scope and costs*

As a result of the issues set out in the introduction, the scope of works required and the costs of the project have changed significantly since the Council's original estimate of £10m. The original Development Contract to remove and replace the cladding within a 22 month timeframe was originally expected to cost £11m. This is now expected to cost £17m due to the additional defects and in addition, further separate structural works are also required to enable the cladding works to take place, which have now been costed at a further £4m.

Total overall costs are now expected to be in the £28.4m compared to the estimate of £19.6m at the end of March 2022 before the additional defects were identified. Costs to date (up to the end of March 2023) are estimated to be £15.8m which includes the removal of all cladding, new protective temporary membrane, a range of essential fire and safety measures (including waking watch services and fire doors) and legal, financial and project management costs. The cost changes are set out in the following table.

<b>£m</b>	<b>Previous total cost estimate (as at March 22)</b>	<b>Current total cost estimate</b>	<b>Costs to date March 23</b>
1a. Waking watch costs	1.9	2.1	2.0
1b. Legal costs	2.6	2.1	1.9
1c. Project management costs etc.	1.0	1.1	0.7
1d. Other – SBC internal costs	-	0.7	0.1
2. Development Contract – fire and safety works	10.6	17.0	10.0
3. Development Contract – additional structural works	-	4.0	0.4
4. External works - other	0.3	0.8	0.7
5. Internal works	3.3	0.6	-
	<b>19.6</b>	<b>28.4</b>	<b>15.8</b>

### Development Contract – fire and safety

The fire and safety works contract (cost item 2) has increased due to the discovery of additional structural issues with the building, which need to be addressed before the cladding can be replaced. Specific changes include:

- additional costs re the balcony structures. When the balconies were removed, it was discovered that additional work would be required to reinstate them including secondary steel structures;
- the delay to the programme, which has resulted in extra costs due to additional preliminary costs, additional scaffolding costs, the cost of keeping the site safe and secure and inflationary impacts; and
- changes in working practices required due to the structural deficiencies in the building. Based on structural engineer's advice, the building is unable to support the scaffolding and hoists on which the original workplan was based. The new workplan requires additional specialist lifting equipment and has had an impact on work sequencing.

The scope of works and costs of the Development Contract have been independently reviewed by Artelia in their role as Employer's Agent and the Independent Certifier to GRE5 and Cushman & Wakefield on behalf of Homes England as part of the grant funding claim process. Both advisors have confirmed that the scope and costs are in line with expectations and represent a cost effective solution.

### Development Contract – structural works

The scope of works for the structural works been assessed as being the minimum specification to enable the completion of the works programme. The cladding cannot be replaced until the structural issues have been resolved as the structure is not capable of supporting the new cladding. Advice on the specification has been provided by Arup and Morgan Sindall and verified by the independent Consultant Engineer working on the insurance claim.

Based upon the range of independent assessments as set out above, the GRE5 Directors are assured that the revised specification and associated costs represent the optimal cost effective solution.

During the first phase of works, the balconies were required to be removed before the original cladding could be removed. The reinstatement of the balconies will require additional work following structural engineer advice to ensure fire and building safety when attached to the primary steel frame. These costs are now highly likely to be classified as "eligible works"/costs for additional Homes England funding. This is discussed further in the financial section.

The impact of these changes is summarised in the following table.

	£m
<b>Original contract sum (dated 2021)</b>	<b>10.6</b>
Increase due to additional balcony works	2.7
Extension of time costs	1.8
Change in work approach due to structural safety issues	1.3

	<b>£m</b>
Weatherproofing costs due to building being without cladding	0.2
Other cost items (eg additional surveys)	0.4
<b>Revised contract sum (excluding structural works) as at March 2023</b>	<b>17.0</b>

### Internal works

The internal works (cost item 5) are no longer required due to revisions to the scope of works in the Development Contract (cost item 2).

### Cost variation summary

	<b>£m</b>
<b>Cost estimate as at March 2022</b>	<b>19.6</b>
Increase in main Development Contract	6.4
Decrease in internal works	(2.7)
New structural works	4.0
Other changes	1.1
<b>Revised cost estimate as at March 2023</b>	<b>28.4</b>

### *Funding arrangements in place*

The Cabinet approved a loan of £10m in 2019, although it was not in accordance with the Council's Treasury Management Strategy and therefore not in accordance with the budgetary framework. It was re-approved by full Council in July 2021 and the loan facility was formally executed in 2022. A variation to the loan to allow an additional £5m of funding is proposed and has been included in the Business Plan attached as Appendix 1 to this report.

It is anticipated that some, or all, of the loan from the Council maybe repayable by GRE5 out of the proceeds of the legal claim although there are risks associated with the repayment of the loan, which are set out in the confidential appendix. The ability of GRE5 to repay this loan is dependent upon a number of factors including the total overall final costs, any grant clawback, outcome of the legal claim and potential recovery of costs from leaseholders.

In 2021, the GRE5 were successful in being awarded a grant from Homes England for £9.2m towards the cladding removal works. Additional grant funding is also being discussed with Homes England but is not yet approved. Homes England has confirmed in writing that it will not approve any further grant funding until the Council has approved the extension of the loan facility. This will provide Homes England with evidence that the programme can be completed. The Business Plan assumes that additional funding will be available from Homes England for the additional structural works (£4.0m) only although additional grant funding may be more or less than this amount. This funding is required over and above the £5m loan extension and will reduce the risk of the Council having to further increase its loan to fully cover the costs of the works.

Homes England have confirmed in writing that they will work with GRE5 on a new grant claim for the balance of the development works, both in relation to increases to the cladding contract and the new structural works. They have stated that they will not provide a funding offer in advance confirmation of the proposed variation to the Council loan and

that they are concerned about the current delay/pause in the programmed works. Whilst they recognise that this is a highly complex project, they have stressed the need to secure the relevant funding approvals and accelerate the remedial site work. Approval of the variation to the Council's loan is the first step in this.

A contribution to legal costs of £0.2m has been received under the insurance claim. This has been used to fund an element of GRE5's legal costs incurred by GRE5.

Total secured funding of £19.4m is therefore in place via the Council loan (£10.0m), the HE grant (£9.2m) and the contribution received under the insurance claim (£0.2m), compared to projected costs of £28.4m (a funding gap of £9m). The extension of the Council's loan facility (£5.0m) and £4.0m potential additional funding from Homes England will provide sufficient funding to allow the works programme to progress prior to any receipt of funds from the insurance claim or leaseholders, subject to the costs of works not further increasing.

The loan is required to be repaid to the Council from any settlement on the legal claim. Homes England may also clawback a proportion of any settlement and this will be agreed following the outcome of the case. The wider financial implications of this project are set out in the Business Plan appended to this report. Due to the lack of security and therefore availability of institutional funding, the only deemed viable options for funding the completion of the works programme prior to any receipt from the legal proceedings is via a Council loan or a HE grant. GRE5 have explored options for an extension or further grant from HE, however it is unwilling to commit to any further grant, without GRE5 demonstrating it has in place additional financing to progress the development works. Some costs may be capable of recovery from leaseholders, however this has been complicated by the introduction of the Building Safety Act 2022.

### *Legal claim*

Legal proceedings are underway against the builder's warranty provider and mediation is expected to take place in Summer 2023. Counsel has advised that the court case is unlikely to be scheduled until Summer 2024 at the earliest.

Legal proceedings have been delayed due to the identification of the additional structural defects which have impacted upon the design of a final solution and costs estimates. Information has now been provided to the insurer and all documentation is currently being reviewed. Further details in relation to the legal claim are provided in the Confidential Appendix 1 to this report.

## **3. Implications of the Recommendation**

### **3.1 Financial implications**

The cost and cash flow planning for this project is complex due to a number of factors including uncertainties in relation to potential Homes England clawback, the outcome of the legal claim, total final costs and the potential recoverability of some monies from leaseholders.

The maximum cost exposure to the Council would be £15.0m (with the loan extension to £15m from £10m). This is based upon £nil receipt from the legal claim and Homes England funding the additional structural works required on Nova House. If the HE grant is not forthcoming, a further report will be presented to Cabinet with options in relation to further funding requirements.

The Council's financial exposure may be reduced by some or all of the following:

- **Recovery from leaseholders** - Although a tribunal determined that leaseholders, and not the freeholder, are liable for waking watch costs, this has been superseded by the Building Safety Act 2022 which limits compensation payable by qualifying Leaseholders to £10k each. GRE5 is currently seeking advice as to the interpretation of the new Building Safety Act 2022 and its implications for recovering monies from leaseholders. This new Act has not yet been tested through the courts. An assessment of the number of qualifying and non-qualifying leaseholders in Nova House will be required and the amounts that could be recharged to each group considered as part of a recovery strategy. Assuming all leaseholders are qualifying (although this is unlikely to be the case) and therefore their liability is capped at £10k each, would results in a maximum potential recovery of £0.7m. This would reduce the Council's cost exposure further.
- **Receipt of insurance claim proceeds** – the quantum and timing of any insurance claim receipt is unknown and will depend on the legal route taken (mediation v court). The uncertainty makes it difficult to quantify the impact on the Council's cost exposure. A process chart of possible outcomes is included as Appendix 2 in Part B to this report. The financial impact of different outcomes is considered in the Business Plan included in Appendix 1.
- **Homes England clawback** – as set out in the Grant Funding Agreement, Homes England requires GRE5 to take reasonable legal action against insurers/third parties and it *may* recover monies from the proceeds of any settlement which are specifically related to costs that it has funded. This is unknown at this stage and could range between £nil and £9.2m (the total current GFA amount). If any further grant is awarded, it is likely to be subject to similar clawback provisions.
- **Scope and/or cost variations** – whilst additional works have been fully costed, contracts have not yet been agreed and costs may increase. In addition, the scope of works continue to be subject to negotiation and third party advice on reasonableness as highlighted in this report.

Several recovery scenarios have been considered – they are included in the GRE5 Business plan and Appendix 3 and 4 of the Confidential report.

### 3.2 Legal implications

GRE5 is responsible for regulatory compliance of the Nova House site and has worked closely with key stakeholders: RBFRS, SBC Building Control and Housing Regulation. The introduction of the Building Safety Act 2022 has significantly changed the rights, powers and protections for residents of high-rise buildings. The purpose behind the legislation is to provide leaseholders with protection from the costs associated with non-cladding defects, including interim measures like waking watches. Residents also have rights to report concerns to the Building Safety Regulator. Not all elements of the Act are in force and the Government is consulting on secondary legislation at present. This includes the provision of statutory guidance on reasonable steps required to be taken by landlords to ensure that all reasonable avenues of cost recovery have been explored before passing remediation costs on to leaseholders. Pending clarification of these matters, GRE5 and the Council must make reasonable decisions, based on the best evidence available and on advice from relevant professionals.

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. As stated in the report to Cabinet in June 2021, some of the works required to cover building defects are not covered by a Homes England grant, although there has been an indication that grants will be extended to cover a wider range of works. Any works undertaken by GRE5 to the building are likely to increase the value of the leases, but unlikely to substantially increase the value of the freehold interest. Therefore the Council needs to consider the recoverability of any loans, rather than assume that the value of its shareholding will increase.

The Council has put in place governance arrangements to manage any conflict of interest between the GRE5 board of directors and the Council as shareholder. The Council's Executive Director of Housing, Planning and Property is the Council's shareholder representative and there are separate appointments of individuals to be board of directors, based on these individuals' skills.

The Council has powers of investment under s.12 of the Local Government Act 2003, which permit it to invest for any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs. In deciding whether to invest, the Council must take account of Government guidance. Investments are split into investments held for treasury management purposes and other investments. Investments for treasury management purposes must comply with the requirement to prioritise security, liquidity and yield. A proposed loan to GRE5 is unlikely to come within these requirements.

Other investments should be presented in a way that discloses the contribution it makes towards service delivery objectives and/or place making role of the local authority. The Council's Treasury Management Strategy makes reference to loans being provided to council owned companies, including GRE5.

The Local Government Act 1988, section 24 provides a power to provide financial assistance for privately let housing accommodation. Subject to s.25 a local housing authority shall have the power to provide any person with financial assistance for the purpose of, or in connection with, the acquisition, construction, conversion, rehabilitation, improvement, maintenance or management of any property which is or is intended to be privately let as housing accommodation. The financial assistance can include a grant, loan, guarantee, indemnity or the acquisition of shares or loan capital. Privately let includes accommodation occupied in pursuance of a lease or licence or statutory tenancy where the immediate landlord of the occupier is not a local authority. Section 25 requires consent to be obtained from the Secretary of State. A number of general consents have been issued which include General Consent C permitting financial assistance to be provide to private landlords for the purposes of, or in connection with, the acquisition, construction, conversion, rehabilitation, improvement, maintenance or management, whether by that person or another, of any property which is intended to be privately let as housing accommodation. This consent is intended to be a wide general consent. This is the most suitable power to rely on to extend the loan to GRE5. The Council acquired the shares of GRE5 with a view to improving the safety of the building for its residents, as opposed to for an investment purpose. This is the only known high rise residential building in Slough that has failed flammability tests in relation to ACM cladding and providing funding for the specific purpose of addressing the building defects is not likely to create an expectation that other building owners will be able to secure loan or grant funding from the Council.

### 3.3 *Risk management implications*

GRE5 maintains a risk management plan which is considered as part of the overall review of GRE5 and the project Action Plan. The key risks included on the plan, and additional Council specific risks, are set out below:

- *Increased costs* – As the project has progressed, several additional defects have been identified which have resulted in delays and the additional costs outlined under the Financial Implications section of this report. Costs continue to be monitored and managed and may increase further. All structural works have now been fully costed by independent third parties.
- *Further unknown defects* – There is an ongoing risk that further defects may be identified during remediation works, although this risk is reduced due to the nature of existing survey work completed.
- *Programme delays* – delays to the programme have been experienced due to the COVID 19 pandemic and additional structural defects found. The delays have contributed to the cost increase due to inflationary impacts and the ongoing costs associated with keeping the site safe and secure, including monthly waking watch costs.
- *Legal claim* – The actual amount recoverable remains unknown until either mediation or, if that is unsuccessful in terms of agreeing quantum, the court case. Until this, and the claw back position with Homes England, is known, the final position in cost exposure for the Council remains uncertain.
- *Leaseholder recovery* – The amount that will be sought from Leaseholders to meet any shortfall in with the insurance claim remains uncertain and is subject to the provisions of the Building Safety Act 2022. The Building Safety Act limits cost recovery from qualifying leaseholders to £10k. Current work is ongoing to identify how many leaseholders in Nova House are qualifying and non-qualifying.
- *Delay to Home England grant funding* – The main GFA has been signed and six payments have been made under the Agreement to date. Claims are put in monthly, but any delay to claims being paid will impact the peak loan requirement from the Council.
- *Reputational impact* – the Council reputation may be impacted negatively if the project continues to be delayed or if there is a breach of any of its statutory requirements.

### 3.4 *Environmental implications*

There are no identified environmental implications associated with the project at this time. The project is not setting out to enhance the environmental performance of the building although it will have regard to matters of sustainability in product selection.

### 3.5 *Equality implications*

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

### 3.6 *Procurement implications*

There are no procurement implications at this point of the project.

### *3.7 Workforce implications*

There are no workforce implications, although it is recognised that additional Council resource may be required to provide oversight of this project. The resources are provided to GRE5 at cost under its SLA with the Council. There is GRE5 specific resource in place to manage the project, the legal claim and provide corporate oversight and governance.

### *3.8 Property implications*

The property implications are covered in the main body of this report.

## **4. Background Papers**

None attached.