

The Board
Hexagon Housing Association Limited
130-136 Sydenham Road
London SE26 5JY

15th January 2015

Dear Sirs

Investment by way of loan to Horniman Housing Association Limited

Capita Asset Services (Capita) has been asked to advise the Board of Hexagon Housing Association (Hexagon) on the commercial terms of a proposed investment by way of loan to Horniman Housing Association (“Horniman”) and in particular whether the interest rate on the loan represents a commercial rate of return to Hexagon.

Hexagon is a charitable registered provider. Horniman is a non-charitable registered provider and a subsidiary of Hexagon by virtue of the control exercised by Hexagon over the board and business plan of Horniman.

Capita has received and reviewed the following documents;

- The investment policy of Hexagon
- A report prepared by Devonshires dated 12th January 2015 on the proposed investment by way of loan
- The Heads of Terms of the proposed loan to Horniman.
- The draft loan agreement in substantially its final form

Devonshires has advised that it would not be inappropriate for Hexagon to invest in Horniman in the way proposed subject to obtaining advice from its financial, tax and accounting advisors as in their words “this will be key to understanding whether the transaction is fully compliant”.

The investment policy of Hexagon sets out the rationale for investing surplus funds, the controls to be put in place to manage the risks of building for sale and the anticipated target returns from such investments. The investment policy sets a maximum exposure limit of £11.4 million or approximately 26% of the total reserves. The policy also sets a minimum required net rate of return of 15% after tax and

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interest for build for sale projects. We also understand that it is the intention of Horniman to gift aid any surpluses to Hexagon so as to minimise the tax charge in Horniman.

A draft loan agreement has been prepared by Devonshires. The purpose of the loan is to fund all the costs of developing housing for sale. The loan is secured by way of a fixed charge over the land and in due course the development agreements and building contracts. The loan, which is repayable on demand, is for an amount of up to £10.5 million and for a term of up to four years. The full terms and conditions of the loan agreement are summarised in the Devonshires' report

The interest rate on the proposed loan is fixed at 9% per annum payable quarterly in arrears with a default interest rate set at 4% above the fixed rate. This rate is higher than both the current average cost of existing debt and the marginal cost of new borrowing by Hexagon.

In view of the non charitable registered provider status of Horniman, and the facts that it is a subsidiary of Hexagon and therefore operates under the close control of its parent, that the loan is secured by way of first fixed charge over housing developments we are of the opinion that the fixed rate of 9% chargeable on the loan represents a commercial rate of return for Hexagon on the proposed investment loan. The ability to achieve the required return of 15% net of tax and interest, will depend upon the return that can be generated on the projects financed

For the avoidance of doubt, Capita has not reviewed specific development projects, the development appraisal models or the assumptions used in these models. In confirming that the anticipated return on the proposed loan represents a commercial rate of return we are not expressing any opinion on whether the returns envisaged from the underlying projects are achievable or not.

Yours faithfully



Howard Webb
Director

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