London Borough of Hammersmith & Fulham

Report to: Cabinet

Date: 02/12/2019

Subject: **TOWN HALL CAMPUS CIVIC PROGRAMME: APPROVAL TO PURCHASE COMMERCIAL UNITS AND JOINT VENTURE UPDATE**

Report of: **Cabinet Member for the Economy - Councillor Andrew Jones**

Summary

1.1. This report seeks approval for the acquisition of commercial units that will be constructed by the King Street Joint Venture as part of the Civic Campus Programme. For each of the buildings, the Council will then secure lesees paying rent to the Council, covering the cost of the acquisition over 45 years. Negotiations have already begun and discussion are well advanced with potential occupiers.

1.2. The report explains the rationale for investing in the units, the budgets required and the approvals needed at this stage from Cabinet and Council in order to progress with the investment. In order for the Council to proceed it will need to be satisfied that it offers value for money and is affordable within the Council's overall budget.

1.3. The report recommends that the Council proceeds to acquire the commercial units from the joint venture. This is on the basis that doing so will allow the Council to:

- To retain control of the campus as a whole, maintaining the appropriate long term stewardship role for the Council in the regenerated campus
- Benefit from the regeneration uplift the scheme will deliver
- Ensure the buildings' occupiers help to achieve the Council's Industrial Strategy
- Benefit from the long term income streams and potential future capital receipts available from the investment.

1.4. The viability modelling and sensitivity testing that the Council has completed shows that the acquisition is financially viable, generates a surplus in the long term, and has a positive NPV. The Council will continue to monitor, and review the market and finance environment before the completion of any

acquisition, and will be supported by external advice and valuation, to ensure that the proposition continues to be financially viable.

1.5. The report also provides an update on the joint venture and the equalisation of equity by the Council in the Joint Venture company.

Recommendations

Appendix A is not for publication on the basis that it contains information relating to the financial or business affairs of any particular person (including the authority holding that information) as set out in paragraph 3 of Schedule 12A of the Local Government Act 1972 (as amended).

That Cabinet approves

1.6. Subject to receiving a satisfactory external valuation advice, that the Council enter into a conditional sale agreement, and any other legal agreements which are required, with the King Street Joint Venture for the purchase of:

- 6,011sqm NIA of B1 office space.
- 523sqm NIA for office start-up units.
- 649sqm NIA commercial uses in A1–A3 use class.
- A new four-screen cinema totalling 1,283sqm NIA and 335sqm NIA restaurant.

1.7. Delegated authority to the Strategic Director for the Economy, in consultation with the Cabinet Member for the Economy, to finalise and complete negotiations with the Joint Venture company and enter into all necessary legal agreement/s in order to give effect to the decision in 1.6 above.

1.8. Delegated authority to the Strategic Director for the Economy, in consultation with the Borough Solicitor and the Cabinet Member for the Economy, to agree onward pre-sales and lettings to appropriate occupiers for each of the buildings following external property advice on commercial terms and values.

That Cabinet recommends to Full Council

1.9. To approve a capital budget of £64m for the purchase of the office space, start up units, commercial units, restaurant and cinema as set out in this report and the associated professional fees and Stamp Duty Land Tax (SDLT). The total budget will be funded by general fund borrowing, represented by an increase in the Council’s capital financing requirement, supplemented by capital receipts, or developer contributions when available, with final confirmation of funding delegated to the Strategic Director, Finance and Governance, in consultation with the Cabinet Member for Finance and Commercial Services.

1.10. To approve an additional capital budget of £25m to purchase a 50% stake in the joint venture limited liability partnership with A2 Dominion at the point at which the new town hall extension is handed over to the Council, funded by general fund borrowing, represented by an increase in the Council's capital financing requirement.

Wards Affected: Hammersmith Broadway

H&F Priorities

Our Priorities	Summary of how this report aligns to the H&F Priorities
• Building shared prosperity	Investment in the commercial units will allow the Council to manage and control the affordable workspace elements, meaning it can direct their use for shared prosperity
• Being ruthlessly financially efficient	The investment in the commercial units will allow the Council to generate a long term income and the potential for capital receipts in the future
• Taking pride in H&F	Investment in the commercial units allows the Council to take a long term stewardship approach to the Civic Campus, maintaining quality for the long term benefit of residents

Financial Impact

1.11. The full financial implications for the Civic Campus Programme were set out in the Full Council report in January 2019. This report seeks approval for two items not included at that time, being:

i. an additional capital budget of **£64m** to purchase the commercial elements of the scheme (commercial property investment). The final acquisition price will be subject to satisfactory valuation advice that meets best value requirements.

ii. a capital investment of **£25m** as a temporary re-investment of equity following the Council's occupation of the new town hall extension and prior to the distribution of JV profits (the equalisation mechanism).

Commercial property investment

1.12. The expected purchase price of the commercial units and the capital budget required is £64m. It is expected this will be funded from external borrowing, with a potential contribution from S106. Alternative funding such as capital receipts, could be applied should they become available, and approval is sought for the final decision on funding to be delegated to the Strategic Director of Finance and Governance, in consultation with the Cabinet Member for Finance and Commercial Services.

1.13. If funded fully by borrowing, the Council will incur additional annual revenue costs of interest and Minimum Revenue Provision (MRP) (2.81% and 2.22% respectively) of the purchase price over the life of the borrowing/ asset amounting to £3.2m. There may be opportunities to amend the profile MRP through a revised policy for property investments resulting in lower costs in earlier years, increasing when the investment properties are established and inflation increases expected rental income.

1.14. The Council expects to generate an income stream from leasing units on a commercial basis to cover these costs. The leases will need to be managed with commercial terms to enable the investment to be self-financing. Income is reduced by costs of: management, marketing, rent free periods and voids, fees (eg legal, lettings, rent reviews), rates and service charges and other capital expenditure.

1.15. The expected rents and costs, and the profile of these, have been provided by Colliers and have been reviewed by the Council's advisers, BNP Paribas, to ensure that the assumptions on which the model is based are reasonable.

1.16. In relation to tax, legal advice will need to be obtained in relation to potential tax leakage and inefficiency in relation to SDLT.

Equalisation mechanism

1.17. To ensure that the Council and A2Dominion share equally both risks and rewards, it is proposed that the Council provide a cash injection of £25.3m as equity into the joint venture (JV) when the new Town Hall extension is occupied. This will be funded by general fund borrowing, represented by an increase in the Council's capital financing requirement. This has a cost to the Council, above that reported in January 2019, as the Council will either lose the opportunity cost of forgone investment income, or need to borrow and incur interest costs. Provided the development is financially viable this equity will be returned to the Council before any distribution of profits.

1.18. The additional costs of interest (or opportunity cost) will be reduced by increased profit distribution from the joint venture, due to reduced financing costs of the JV. This is because the Council's opportunity costis significantly lower than the JV's borrowing costs.

1.19. There remain risks, as set out in the January 2019 report, that should the JV not generate sufficient sales revenues or incur additional costs to those set out in the development appraisal model, that the Council will not have its equity of up to £25m returned to it.

Other financial risks and opportunities

1.20. The expected income and costs of the scheme, and therefore whether the scheme is self-financing, depends on a number of assumptions. If these assumptions differ from the base case, these could result in additional income or additional costs of the investment. These assumptions, in addition to those set out in 1.14, include the external borrowing interest rate, inflation on costs and rental, the market and occupancy of the properties, capital value on exit.

Legal Implications

- The Council has the power to acquire a lease of the land by virtue of Section 120 of the Local Government Act 1972. Were the Council to proceed without such an acquisition (where it is more efficient for SDLT reasons to retain ownership) and then grant a lease of the relevant space to a tenant, its power to do so arises under section 123 Local Governent Act 1972 provided it secures 'best consideration'. The Coucil will secure best consideration advice prior to granting a lease.

- Further support for the transaction is available under Section 111 of the Local Government Act 1972 which enables the Council to do anything which is calculated to facilitate, or is conducive to or incidental to, the discharge of any of its functions, whether or not involving expenditure, borrowing or lending money, or the acquisition or disposal of any rights or property.

- The Council's power to invest arising under Section 12, Local Government Act 2003 is relevant and can be exercised for any purpose relevant to its functions or for the purposes of the prudent management of its financial affairs. In exercising this power, the Council would rely on the second limb, namely that the proposals aid prudent financial management and should have regard to relevant statutory guidance. The financial implications should consider how the proposals assist the prudent management of the Council finances.

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Background Papers Used in Preparing This Report

Not applicable

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2. REASONS FOR DECISIONS

2.1. The decisions establish the strategic rationale for investing in the commercial units as part of the Civic Campus programme. The decisions allow the Council to enter into sale contracts with the joint venture, which will enable the development as a whole to proceed. They will also enable the identification and approval of budget for the investments and the onward leasing of any acquired units to third party occupiers.

2.2. Full Council has already granted approval to enter into a joint venture with A2 Dominion. Approval is now needed for the mechanism by which the Council will invest its equity ensuring that it is an equal partner in the joint venture.

3. PROPOSALS AND ISSUES

Strategic Overview

3.1. The Council's Cabinet on 3rd December 2018 approved the strategic business case and delivery strategy for the Civic Campus Programme and Full Council on 23rd January 2019 approved entering into a joint venture with A2 Dominion for the delivery of the scheme, a conditional land sale agreement from the Council to the JV, and the associated funding for the Civic Campus.

3.2. The strategic rationale for the Civic Campus Programme was set out in the reports, in summary, as:

i. The urgent need to intervene in the failing existing Town Hall office buildings, whilst creating an opportunity for improved ways of working in order to be ruthlessly financially efficient and address the financial challenges faced by the Council;

ii. Contributing to the borough's housing ambitions by increasing the supply of good quality, genuinely affordable housing for local residents to meet local housing need;

iii. Creating pride in H&F by transforming King Street into a new civic and cultural destination; improving the public realm and Grade II listed Town Hall, providing new local amenities for residents, including a new four screen cinema, café/restaurant, retail and public event spaces; and

iv. Promoting economic growth in line with the H&F Industrial Strategy, Economic Growth for Everyone, through the creation of new retail and commercial space, including affordable space for start-up businesses to combat High Street decline.

3.3. This report is concerned with the Council's role in delivering items iii and iv, and how investment in these units can allow the Council to benefit from the regeneration opportunity that they present.

3.4. For the development to proceed the Council and A2 Dominion will enter into a 50:50 joint venture. The Council will dispose of the land surrounding the Town Hall to the JV, under a conditional land sale agreement (CLSA). The consideration for the sale of this land is the delivery by the joint venture of the new town hall extension.

3.5. To protect the Council through this process, there have been a number of conditions placed on the sale of land to the joint venture. This will ensure that a number of crucial aspects of the deal are set in place before development can proceed, giving the Council security that the scheme will proceed as planned and the extension to the Town Hall will be built, protecting the Council's interests.

3.6. A key condition is that either a letting or purchaser has been secured for all the commercial elements. This means end-users or owners for all commercial elements of the scheme must be in place before the land can be formally disposed to the joint venture.

3.7. Under the terms of the CLSA the Council has the right to purchase the units.

The Council's Investment and Regeneration Opportunity

3.8. The Civic Campus masterplan has the following commercial units that the JV will be required to sell or enter into conditional sale agreements in order for the scheme to proceed:

- 6,011sqm NIA of B1 office space.
- 523sqm NIA for office start-up units.
- 649sqm NIA commercial uses in A1–A3 use class.
- A new four-screen cinema totalling 1,283sqm NIA.
- A restaurant at 335sqm NIA.

3.9. The development will create a new civic and community campus, including new fit-for-purpose, inclusively designed office accommodation for the

Council and act as a catalyst for change, with the inclusion of open public realm and shared spaces within the Town Hall used by the neighbourhood as well as the greater community.

3.10. With its new population of residents and workers, civic and leisure destinations, the scheme will be able to attract a more diverse set of retailers to this location and improve its offer to workers, residents and visitors alike. Not only will the new square provide much needed open space for local residents, it will be able to be used for programmed events to attract more visitors.

3.11. The development will deliver a regeneration uplift, increasing the value of homes, commercial spaces and businesses in the area thanks to the improved quality of the environment and the increased demand in the area (from additional staff and residents).

3.12. There are four key reasons for the Council to invest in the commercial units:

- To retain control of the campus as a whole, maintaining the appropriate long term stewardship role for the Council in the regenerated campus
- Benefit from the regeneration uplift the scheme will deliver
- Ensure the buildings' occupiers help to achieve the Council's Industrial Strategy
- Benefit from the long term income streams and potential future capital receipts available from the investment.

The development will contribute to the delivery of the Industrial Strategy for H&F in the following ways:

- A Great Place in London: improving H&F town centres and commercial hubs to transform what they offer and enhance their reputation in Europe and around the world.
    - Deliver a new Civic Heart in Hammersmith
    - Deliver 10,000 new homes – 50 per cent of these genuinely affordable – over 20 years
- Encouraging Enterprise: making H&F the best borough in Europe for business to start-up, survive and grow:
    - Address under-utilised Council land or assets
    - Use planning mechanisms to create new workspaces
    - Support investment in new office space.

Options considered

3.13. The Council has assessed two options for investment in the commercial units being delivered at the Civic Campus

- **Option 1** - the base case or *do nothing* scenario, which is to retain the status quo and do not purchase the units but allow the JV to sell the units to the open market.

- **Option 2** – the Council to purchase the units on the open market either through:

  - a traditional borrowing structure sourced from either the Public Works Loan Board or on the open market, or alternatively

  - a commercial loan structured as a sale and leaseback with a large commercial dealer.

Analysis of options – this analysis is based upon the Council's property investment strategy outlined below.

Investment property strategy

3.14. From a civic and operational point of view, the acquisition of the commercial units would allow the Council to select proposed commercial tenants and occupiers that complement the new civic campus.

3.15. From an investment point of view, there are a number of key criteria for a property investment acquisition that needs to be considered.

3.16. The investment value is determined by the rent income flow and its sustainability, attractiveness of the space for commercial/business occupiers. The investment value of a commercial asset depends on the total anticipated rental flow but also the anticipated growth in income from a particular property sector. The yield from commercial property is different for retail, offices, restaurant and cinema use. There have been a number of acquisitions of freehold offices within the Borough and specifically within W6 which help guide the value of the brand new offices being constructed as part of the campus.

3.17. The majority of the capital value of the investment is the office block (Block B) within the development. The Council appointed external property agents at the time of its decant office search who have very recent property intelligence of office lettings and office disposals. The external property consultant also undertook best consideration advice as part of the Town and Country Act 1990. There have been few office transactions in the last three months as the market has slowed down, waiting for a resolution of Brexit and its effect on the economy and property investment market. It is important to note, the office block will not be finished and let out until mid-2022. Property sector experts are forecasting that increases in commercial office rents will re-stabalise by that point. The BNP Paribas have been appointed to validate and review assumptions in the financial model.

3.18. The property market for retail premises is changing as customers change their purchase avenues with less footfall in many High Streets and town centres. King Street, Hammersmith, has adapted to the changing needs of the retail world and the Civic Campus masterplan reflects these changes. It will have smaller retail units clustered around the new Civic Campus and an increased footfall with more residents, workers and visitors. Property advice received is that the rental and yield performance of the proposed units in the Civic Campus should be robust in this part of King Street/Hammersmith.

3.19. The Council is in the final stages of completing heads of terms for the cinema. These income flows profiled in the investment are relatively small but will also help to increase the attractiveness to businesses (existing and new).

3.20. The investment appraisal calculations have profiled rent-free periods that reflect market norms for offices, retail and other uses. There are also assumptions on voids for time-limited periods during the cashflow. These reflect time required to re-let properties.

3.21. The Council has laid out heads of terms for the property transaction in the form of a conditional sub-lease. The sub-lease will be structured so it allows the Council to sub-let, assign and retain stewardship of the estate to maximise its investment value.

Option 1

3.22. The current JV option is to build the commercial units and sell separate elements to occupiers/investors on completion, ie development of the units is conditional on the JV securing end occupiers for the relevant space. Option 1 includes a do-nothing appraisal, estimating the impacts if the Council was not to alter the current JV agreement in place.

3.23. The land sale agreement is conditional on having end-users identified for all elements, therefore limiting the JV's (in which the Council has a 50% interest) exposure to leasing risk. It will limit the Council's exposure to any fluctuations in the market in comparison with purchasing the units. On the downside, it may prove a difficult aspiration to deliver should market conditions deteriorate.

3.24. The financial impact of this option on the Council is limited to its role as a 50% partner within the JV. The Council, however, must act in the interests of the JV and therefore will be tied to the aspirations of the JV partner.

3.25. This denies the Council full control over non-residential elements of the Civic Campus.

3.26. As a consequence, the Council will lose the opportunity to benefit from any regeneration uplift (beyond its share in the returns from the JV) because the asset will be sold. It will also lose control of who occupies the commercial units, although some control can be exercised by mutally agreed lease conditions. Private long-term ownership of the commercial units may not be aligned to the Council's regeneration aspirations or its industrial strategy.

Viability of Option 1

3.27. Viability of Option 1 – there is no additional financial impact to the Council in this option.

Option 2

3.28. Option 2 is that the Council purchase the commercial units from the JV as an investment with consideration of how the Council funds that purchase.

3.29. Subject to final legal advice on efficient structuring of the transaction the Council would enter into a conditional sale agreement with the Joint Venture, the Council agreeing to purchase the units on completion for a fixed price under long lease from the JV. The lease agreement would have provisions incentivising the JV to complete the units on time and on budget. Failure to do so would result in compensation to the Council (as investor/ purchaser) or allow the Council to void the sale contract if the delay was significant.

3.30. The Council would be responsible for leasing the cinema, restaurant, café, retail and office. The Council would have external agents to undertake these lettings and manage the commercial space. The Council would be able to do this ahead of completion through conditional leasing or pre-letting arrangements, similar to the ones that the Council would enter into with the JV. This would allow the Council to have certainty of who the occupiers would be on completion and taking an investment approach to occupiers, except in the case of the affordable office space which has a clear objective to support the Council's Industrial Strategy.

3.31. This would create a significant amount of leasing risk to the Council as the markets for office, cinema and restaurants are prone to market fluctuations. Such risk is mitigated by robust market research and financial assumptions in the appraisal modelling; as well as signing up occupiers to the pre-lettings agreements as early as possible.

3.32. The market research and operational cost assumptions have been provided by Colliers and Frost Meadowcroft for the Council and reviewed by BNP Paribas.

3.33. As potential long-term owners of the commercial properties the Council must consider what its exit routes are if the mitigations on the market exposure are not achieved.

3.34. A number of exit strategies have been considered by officers and the main ones are outlined below:

- Retain and repurpose – because of its long-term ownership, the Council would have the flexibility to use some of the commercial units for Council uses or convert to residential

- Sell – the option to sell the commercial units as an investment is always available, the main risk is whether the Council’s loan could be re-paid. The financial modelling demonstrates that the units could be sold on the open market and either break even or return a modest surplus – these amounts are dependent upon assumptions of capital growth.

Viability of Option 2

3.35. The financial modelling demonstrates that the Option 2 proposal is a viable investment for the Council based upon the current assumptions. Meaning that:

- the debt is fully paid off in a 45 year period
- debt interest payments are covered (no additional general fund subsidy required)
- the properties have a capital value at year 45 estimated at over £100m, on the basis of a 5% yield
- the potential for an estimated cumulative net revenue surplus of £4,212,673m over a 45 year period.

3.36. The total cost of the acquisition would be up to £64m including transaction costs. The net annual income after all expenditure (see assumptions on operational costs in 4.39 below) is sufficient to pay the annual interest on the loan and the minimum revenue provision (MRP) that will build up enough funds by year 45 to pay back any associated borrowing.

3.37. At the end of the 45-year period the Council will own the commercial units without any debt and they will have a value of approximately £116m dependant upon capital appreciation, based on assumed annual inflation of 2% and yield of 5%.

3.38. For modelling purposes a borrowing rate of 2.81% has been used to assess the viability (based on the PWLB rate available to the Council on 16 October 2019) and a minimum revenue provision (MRP) over the 45 year life of the asset.

How could option 2 be funded?

Public Works Loan Board Funding or open market funding

3.39. The funding could be sourced through either the Public Works Loan Board or the open market to achieve the most advantageous interest rate for the Council.

3.40. Upon completion of the construction the Council would purchase the building from the JV at an agreed value, set out in the conditional sale agreement.

3.41. The interest and debt (including minimum revenue provision) would be repaid using the Council's income through rental revenue from the occupiers.

3.42. The Council maintains control of the commercial units, but it can sell its interest at any time, if required for example if the commercial lettings are difficult to achieve or if the Council want to release capital for other uses. Optimal exit years have been identified in Years 7, 17 and Year 27 to maximise the returns for the Council. It is very common for commercial investors to sell out or re-finance and this proposal allows the Council to achieve similar flexibility.

Sale and leaseback

3.43. The funding could alternatively be sourced through a commercial loan structured as a sale and leaseback with a large institutional investor.

3.44. In this scenario, the Council would retain the freehold of the building but enter into 125-year lease with the investor, who would then lease it back to the Council. The lease back to the Council could be for a period of 30-50 years depending on the most advantageous financial position for the Council.

3.45. The investor would provide funds for land and construction (subject to a retention to cover against cost-overruns). The Council would enter into the leasing arrangement at the beginning of construction and would commit to pay the investor lease payments once the buildings have completed. The Council would separately contract with the Joint Venture to ensure the delivery of the commercial units on time and on budget. At the end of the lease period the Council could purchase the reversionary interest for a £1.

3.46. As in the PWLB or open market alternative above, the risk for leasing the units is exactly the same and is retained by the Council above. However, the exit route flexibility in the option is reduced as the investor would wish to control the sale to protect their loan. However, this option might provide for lower revenue costs in the early years of the investment whilst the revenue streams mature. The Council would benefit from regeneration uplift in terms of increasing profit rents, and from increases in capital value, once the 50-year leaseback term has expired. But the Council has to accept a leaseback that is linked to the consumer price index (CPI).

3.47. The Council will receive a number of benefits from this funding option, including full open market value for its land interest on day one and 100% of project development costs on a flexible drawdown basis that would help to ensure the building programme is maintained.

Preferred funding route

3.48. The preferred option route will be tested by officers to ensure that the optimum funding routeis chosen.

3.49. If the Council decides to fund this through borrowing, the Council also has the option to fund the units throughout construction if that proves financially more advantageous.

Options compared

3.50. Benefits, risk and financial impact for the Council (not the JV) are compared in the table below:

NON-MONETARY BENEFIT	OPTION 1 Status Quo	OPTION 2 Purchase commercial units
Meets the Council's priorities	Possibly	Yes
Retain /attract talent to the Borough	Unknown	Yes
Improve commercialisation and future revenue opportunities for the Council	No	Yes
FINANCIAL IMPACT		
Purchase Price incl costs	£nil	£64m
Interest Rate	N/A	2.81% and MRP
Hold Period	N/A	45 years with flexibility to sell or re-purpose
Viable	Yes	Yes
RISK	Low	Medium, but mitigations
Recommended	No	Yes

Recommended – Option 2

3.51. The conclusion of the above analysis suggests that Option 2 enables the Council to achieve its strategic objectives to:

- Benefit from the regeneration uplift the scheme will deliver
- Ensure the building's occupiers help to achieve the Council's Industrial Strategy
- To retain control of the campus as a whole, maintaining the appropriate long term stewardship role for the Council in the regenerated campus
- Benefit from the long term income streams and potential future capital receipts available from the investment.

3.52. The proposal shows a positive discounted cashflow (net present value (NPV)) for all modelled sensitivities shown in Exempt Appendix A – i.e. the investment would be expected to favourable in cash terms for all scenarios as modelled.

3.53. However, it is important to also consider the impact on the Council's revenue position. There are scenarios in the sensitivity model where, while the overall investment may still be cash positive, the Council incurs a net revenue cost. Furthermore, at the extremes of the model this cost could be significant. This is because:

- The income in the model is a combination of capital and revenue; in local authorities, capital income (capital receipts) cannot be used to support revenue expenditure.
- Local authorities are obliged to make a charge to revenue over the life of the investment to set aside a provision to repay the underlying debt (known as the minimum revenue provision or MRP).

3.54. The base scenario currently shows a revenue positive position however this is currently at the margin and a ten to twenty basis point increase in interest rates would turn this negative.

3.55. There are some mitigations the Council could explore. For example, all ongoing expenditure is currently considered as revenue; much of this could feasibly be capital in nature. This would not alter the lifetime revenue cost but may help to manage peaks and troughs in the revenue forecast. However, this could also increase borrowing costs.

3.56. As can be seen from the matrix in Exempt Appendix A any changes to the interest rates and net operating income have an impact upon the long-term performance of the investment.

3.57. The interest rates will be fixed at the time the capital is borrowed so that is a short-term risk and for modelling purposes a figure of 2.81% has been used based on the PWLB rate at 16 October 2019.

3.58. The longer-term risk concerns the ability to let the units and to protect the assumed net operational income. The following mitigations have been considered:

- If the office rents were lower than profiled or there was some void space, then the Council could re-locate staff (and its partners) from other freehold assets to allow them to be sold or re-developed with an income or from leased accommodation to save on lease costs. The cost/benefits of moving Council staff into the office accommodation would need to be fully assessed so actual financial expenditure and savings were understood.

- Although, not included within the proposed purchase of the commercial units, there are other options for the other Civic Campus that could be considered.

- If there was void space within new office meanwhile uses could be considered.

3.59. Further mitigation to be considered as an exit route if the Council wished to realise a capital receipt:

- The Council could sell a long lease of the office block at any time or it could sell the freehold of the office block and also the cinema and ancillary uses at the time. A marketing strategy including advice on tax and structure of a deal to realise capital receipts would be required. If the office was occupied by one occupier then at a future date it might want to acquire a long lease of the block to have control over its future location in the Borough.

- The Council may wish to grant a long lease of the new additional (under a long lease) offices at the Town Hall to secure a capital receipt.

- An option could be to sell the commercial assets to secure capital receipts as a contribution for a different regeneration or place making project or any other capital project in the Borough.

- The Council could do a sale and leaseback at a future date but this could result in a revenue pressure.

4. JOINT VENTURE EQUALISATION

4.1. The January 2019 Full Council report noted that:

> *"On completion of the development, each party would share 50:50 in the benefits produced by the JV either in distribution of profits or the assets developed. It is proposed that the Council will receive the new extension to the Town Hall building, as well as a share of any JV profits from the scheme. The JV agreement will include an equalisation process so that each party contributes and benefits equally, depending on the profit or assets returned on completion and the price paid*"

4.2. In the previous arrangement the Council withdrew its equity from the JV in the form of the handover of the new Town Hall extension. However, this arrangement was unequal as the Council withdrew its equity whilst A2Dominion still had equity in the joint venture and therefore incurred financing costs, as the completion of the Town Hall extension happened in advance of the other sales. We have taken the opportunity to improve profitability for the JV, by introducing an equalisation mechanism.

4.3. Therefore the Council will purchase a 50% stake in the joint venture limited liability partnership with A2 Dominion at the point which the new town hall extension is handed over to the Council for £25m. This has implications for the Council as the Council will now bear a financing/interest cost or opportunity cost for this £25m investment. It is expected that all of this increased financing cost should be returned to the Council through an increased share of profits from the JV, if the project remains financially viable, as with the injection of cash the JV will have reduced financing/ interest costs. The equity is expected to be returned to the Council before any share of profits from the JV.

4.4. There remain risks, as set out in the January 2019 report, that should the JV not generate sufficient sales revenues that the Council will not have its equity of up to £25m returned to it.

4.5. As noted, Full Council has approved the Council entering into the JV. Prior to formally completing the JV agreement, the Assistant Director for Legal and Governance will review the documentation, and supported by advice from Gowlings WLG, will make a recommendation to the Civic Campus Programme Board (the internal governance board for the project).

5. CONSULTATION

5.1. Consultation for the wider Civic Campus programme has been outlined in previous Cabinet reports.

6. EQUALITY IMPLICATIONS

6.1. The Council has given due regard to its duties under Section 149 of the Equalities Act 2010 and a full Equality Impact Assessment is being conducted.

6.2. The Civic Campus design team has actively engaged the Disability Planning Forum and members of the Disabled Residents Team (a key stakeholder group) using the Council’s new co-production approach to planning for the Civic Campus Programme and Town Hall refurbishment.

6.3. *Implications completed by Fawad Bhatti, Policy & Strategy officer, tel. 07500 103617*

7. LEGAL IMPLICATIONS

7.1. Gowlings have been retained by the Council to provide advice on the Civic Campus commercial units purchase, and have previously advised on the JV set up and appropriation. The advice on the Civic Campus commercial units purchase is set out in the exempt appendix.

7.2. The rationale for the acquisition is both investment and regeneration led. The purpose for which land is acquired is relevant to the powers to be relied upon. Officers have identified the site as an investment opportunity, and it underpins the wider regeneration of the area. The Council has the power to acquire a lease of the land by virtue of Section 120 of the Local Government Act 1972. Were the Council to proceed without such an acquisition (where it is more efficient for SDLT reasons to retain ownership) and then grant a lease of the relevant space to a tenant, its power to do so arises under section 123 Local Goverment Act 1972 provided it secures 'best consideration'. The Coucil will secure best consideration advice prior to granting a lease.

7.3. Further support for the transaction is available under Section 111 of the Local Government Act 1972 which enables the Council to do anything which is calculated to facilitate, or is conducive to or incidental to, the discharge of any of its functions, whether or not involving expenditure, borrowing or lending money, or the acquisition or disposal of any rights or property.

7.4. The Council’s power to invest arising under Section 12, Local Government Act 2003 is relevant and can be exercised for any purpose relevant to its functions or for the purposes of the prudent management of its financial affairs. In exercising this power, the Council would rely on the second limb, namely that the proposals aid prudent financial management and should have regard to relevant statutory guidance. The financial implications should consider how the proposals assist the prudent management of the Council finances.

7.5. The Ministry of Housing Communities and Local Government (MHCLG) issued revised statutory guidance under section 15 of the Local Government Act 2003 on local authority investments on 1 April 2018 (the Guidance). In approving the proposals both officers and decision makes should have regard to relevant aspects of the MHCLG Guidance.

7.6. Local Authorities are required to have an updated investment strategy as is required in the Guidance. The investment metrics must be confirmed as being acceptable in line with the current Investment Strategy.

7.7. The Guidance references 'non-financial assets' which includes certain property portfolios: 'non-financial assets that the organisation holds primarily or partially to generate a profit; for example, investment property'. There are specific requirements for non-financial investments, and property portfolios, set out in paragraphs 37 to 40 of the Guidance. The Guidance requires local authorities to consider whether the asset retains enough value to provide security of investment using the fair value model in International Accounting Standard 40: Investment Property as adapted by proper practices.

7.8. In taking forward the proposals, finance officers should be aware of the impact of MHCLG's guidance and whether the arrangements qualify as 'non-financial assets' under it. Consideration of the financial implications should include the extent to which the proposals amount to fair value and any proposed mitigation of risks.

Implications completed by Richard Beckingsale, Gowlings Solicitors acting on behalf of the Council and verified by Rhian Davies, Assistant Director of Legal and Democratic Services.

8. COMMERCIAL AND PROCUREMENT IMPLICATIONS

8.1. There are no additional commercial and procurement impliations beyond those set out elsewhere in the report.

Implications completed by: Andra Ulianov, Procurement Consultant, tel. 0208 753 2284

9. IT IMPLICATIONS

9.1. No IT implications are considered to arise from this report. Should this change, for example, by requiring new systems to be procured or existing systems to be modified, IT Services should be consulted.

9.2. IM implications: Any suppliers/partners involved in this acquisition will be expected to have a GDPR policy in place and staff will be expected to have received GDPR training. If not already in place, a Privacy Impact Assessment should be carried out, and (Cloud) Supplier Security Questionnaire(s) should be completed by any suppliers/partners, to ensure that all the potential data protection and information security risks around this acquisition are properly assessed with mitigating actions agreed and implemented.

9.3. Any contracts arising from this report will need to include H&F's data protection and processing schedule. This is compliant with Data Protection law (the General Data Protection Regulation (GDPR) 2016; and the Data Protection Act (DPA) 2018).

Implications completed by: Tina Akpogheneta, Interim Head of Strategy and Strategic Relationship Manager, IT Services, tel 020 8753 5748.

10. RISK MANAGEMENT IMPLICATIONS

10.1. Insurance – The Council will grant the JV a conditional land sale agreement of the wider Civic Campus and it will be the Council's responsibility to ensure there is building insurance cover for the whole scheme.

10.2. Where there are head-leases or sub-leases the Council will undertake inspections of the estate to ensure all insurance obligations are carried out.

10.3. As this is a multi-let Civic Campus, the Council will seek guidance on the cover and stipulations to ensure a robust insurance plan is in place.

10.4. As part of the delegated authority sought under 1.7 the Strategic Director of Economy and Project officers will need to liaise further with the shared insurance service to ensure that effective insurance arrangements are in place for the construction phases of the project. It is currently proposed the Council will undertake the refurbishment of the Town Hall on one contract and the JV will undertake the rest of the construction on another contract. This contract may need to be in phases or find a mechanism to manage the anticipated issue that the works to build a vertical extension to the Town Hall will require the Council as the insurer of the existing structure to effect Joint named Construction insurance for those works.

10.5. Officers have considered the risks associated with the various stages of this programme, as set out above, and sought to put in place appropriate mitigations. It is recommended that they continue to review, monitor, and escalate as appropriate until the programme objectives have been delivered and ensure that new risks identified are assigned to risk owners. The financial implications section in this report identifies a number of key financial risks which will need to be closely monitored and managed and subject to regular reporting to Members.

10.6. A summary of the key risks and mitigation measures set out by officers is provided below:

Risk and impact	**Mitigation measures**
Financial assumptions (including those identified in the Financial Implications) are incorrect and affect the viability of the scheme.	To proceed, the Council will need to be satisfied that the scheme offers value for money and is self-funding and affordable within the Council's overall budget.
Selection of the right funding option to give the maximum flexibility for the Council in long term.	In addition to assessing the overall viability of the scheme, a full comparison of funding opportunities will be examined before the optimum route is chosen.
The JV does not deliver the commercial units on time or to budget	The Council is a 50:50 partner in the JV. The Council has commissioned a review of A2Dominion Group's financial strength, including A2Dominion Developments. A Parent Company Guarantee will also be sought for A2Dominion's and A2 Dominion Developments' share of obligations under the JV agreement. The JV Board will receive monthly construction updates on build progress. The Council will only purchase the units under a conditional contract and it will only take a lease on practical completion. Any pre-lets will also have this conditionality too. There are liquidated and ascertained damages

	(LADs) within the JV contract that will mitigate losses for delay to the scheme being delayed that prevents use of the new commercial units.
Brexit has a detrimental effect on the supply chain, construction workforce, interest rates, borrowing and inflation, thereby affecting scheme viability.	The Council and its partners will continue to monitor the implications of Brexit making any reasonable adjustments to the programme delivery strategy and reviewing scheme viability prior to go live. The proposed draft Brexit deal may help provide greater certainty and confidence in the UK market The Council's sale contract with the JV will require a fixed price. The JV price with the construction contractor will be fixed.
The market deteriorates leading to lower rental values, thereby affecting scheme viability.	Sensitivity analysis has been undertaken as part of the business case development we will continue to monitor viability. There are mechanisms in the conditional sub-lease agreement that will determine the acquisition price by a third party.
Rental values do not recover in event of a recession.	The Council can consider exit routes of re-purposing the assets or selling. The Council would need external advice to outline options that cover tax and effect on Counci's capital and revenue costs.

Implications validated by: David Hughes, Director of Audit, Fraud, Risk and Insurance, tel: 0207 361 2389

11. IMPLICATIONS FOR BUSINESS

11.1. This is a significant commercial opportunity for businesses in the borough, with c.£140 million of commercial contracts expected to be available. The Local Planning Authority through the s106 agreement would secure a commitment to partner with the economic development team and the local supply chain programme to ensure that local companies are able to bid for opportunities.

11.2. The current proposals also include affordable studios and workspace which will be targeted at small to medium enterprises, as well as an additional 65,000 sqft of B1 office space, which will support business generally in the Hammersmith Town Centre area.

Implications verified by David Burns, Assistant Director – Growth, tel. 020 8753 6090.

Appendixes

Appendix A – Exempt Appendix
Appendix 1 – Options Appraisal