Appendix 1

COMMERCIAL UNITS OPTIONS APPRAISAL

1 EXECUTIVE SUMMARY

This options appraisal report examines the case for the Council to purchase the commercial elements being constructed as part of the Civic Campus project. It sets out and considers reasons why that is a good objective for the Council, together with two options to achieve that aim. It recommends which is the best option to pursue, in support of the recommendations in the main cabinet report.

The case for the Council buying the commercial elements of the scheme is summarised as it will allow the Council 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.

2 BACKGROUND

2.1 The scheme

The Civic Campus Hall programme is a major regeneration programme for the London Borough of Hammersmith & Fulham (H&F).

It will transform West King Street into a civic, cultural and commercial destination; delivering a new four-screen cinema, commercial space (with affordable business space), 204 homes (of which 52% are affordable homes for local people), café, restaurant and retail establishments, a public events space and the extension and renewal of the Grade II-listed Town Hall. It will transform the way the Council operates and delivers its services to residents.

Background the project and the business case process and approval can be found the cabinet report 3rd December 2018.

3 STRATEGIC CASE FOR BUYING THE COMMERCIAL ELEMENT

3.1 Contribution to wider regeneration

As part of the Council's December 2018 Cabinet report, the strategic business case for the West King street programme was approved, concluding that;

The programme represents a significant opportunity for the Council to improve the use of its public assets, drive efficiency of operation and enhancement to public services whilst simultaneously creating social and economic value through development of a new cinema and much needed affordable housing.

The scheme will regenerate this part of King Street and create an a new destination. It will create a new civic and community campus, including new fit-for-purpose inclusively designed offices for the Council. It will act as a catalyst for change, with the inclusion of public realm and shared spaces within the Town Hall campus used by the neighbourhood as well as the greater community.

With its new population of residents and workers, civic and leisure destinations, the scheme will attract a more diverse set of retailers and improve the offer to workers, residents and visitors alike. The new square will provide much needed open space for local residents and can be used for programmed events to attract more visitors.

Associated economic benefits include increased footfall and commercial opportunities for local businesses with c.£140 million of commercial contracts generated by the scheme.

The project will help the borough meet ambitions set out in its industrial strategy *Economic Growth for Everyone* to make the borough one of the best places in Europe to do business. It will provide new attractive start-up and flexible workspace, while the refurbished town hall and new council workspace will reduce the Council's expenditure on maintenance and increase Council efficiency.

The development will help fulfil these key aims of the Council’s Industrial Strategy for H&F:

- A Great Place in London: improve 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
    - 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

3.2 Why invest in the commercial units and key conditions of the deal

The Council is considering buying the commercial units for four key reasons. These are:

- 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 Council is entering into a conditional land sale agreement with the joint venture partner, to deliver the scheme (The Council and A2 Dominion are 50:50 partners in the joint venture). The Council will provide the required land to the partnership and A2Dominion will act as the construction partner, leading on the development of the scheme.

To protect the council through this process, there are a number of conditions placed on the sale of land into the joint venture. These will ensure that crucial aspects of the deal are set in place, providing security to the deal and protecting the Council's interests. These conditions specifically address:

(a) affordable housing;
(b) building contract;
(c) decant;
(d) fit-out;
(e) funding;
(f) non-residential units;
(g) land value;
(h) offices;
(i) planning;
(j) relocation;
(k) Rights of Light strategy;
(l) any title conditions
(m) Stopping-up;

One of the key conditions is that either a letting, or purchaser, has been secured for all the commercial elements of commercial units. This means that end users/occupiers for all commercial elements must be in place before the sale contract to the JV can be completed.

The commercial units form a critical part of the overarching regeneration and one of the cornerstones of the land agreement. The baseline agreement assumes that they will be sold following redevelopment. There is an opportunity for the Council to purchase these units as an investment asset, above and beyond the current regeneration development.

4. PLACEMAKING AND SCHEME COMPONENTS

4.1 Design and role in placemaking

The scheme's design and its component uses have been carefully considered and designed to achieve the Council's regeneration ambitions and to fulfil the needs of residents, local businesses and the Council itself, and to restore and encourage the long term social, economic and environmental sustainability of this crucial part of the borough.

Block B forms a new eight-storey element at the north west corner of the scheme, addressing King Street on its northern elevation and the new civic square on its eastern elevation. The height of the block relates to the new datum set by the town hall's rooftop extension and other nearby buildings.

The block includes the uses set out below. Its upper element, slightly higher than surrounding buildings, forms a new wayfinding "marker" for this part of King Street, signalling the civic campus' presence as a destination offering its range of mixed uses to pedestrians further east on King Street.

Block B, together with the new smaller Block C to the eastern side of this part of the new public plaza, help frame the new civic space and the historic main front elevation of the refurbished listed town hall, and both blocks include active uses at ground floor to enliven the square - which can also be programmed for cultural events.

Within Block B these uses include the prominent entrance to the Grade A office space on its upper floors, a restaurant with frontages to King Street and the new plaza, and a cinema with its main entrance on King Street.

4.2 Offices

The 6,011 sqm of office space on the upper floors is reached via an externally expressed lift core that helps generate a distinct identity for Block B, acts as a marker when viewed from King Street and contributes to the lively character of the new square.

Block B has six typical office floors, designed to be flexibly let and occupied by multiple users. The seventh floor provides more office space and a generous roof terrace. A bicycle store and facilities are on the ground floor.

4.3 Cinema

The 1283 sqm (NIA) cinema occupies part of the ground floor, with its main foyer and café accessed from King Street. Its four screens (2x150 seats and 2x50 seats) are at basement level. Spaces for associated plant and servicing are in the basement and on the ground floor.

4.4 Restaurant
A 335 sqm (NIA) restaurant occupies the remainder of the ground floor space together with associated plant, and shares servicing access with the cinema and offices above. It has frontage to King Street and the new public plaza.

4.5 Affordable workspace
The 526 sqm (NIA) affordable workspace occupies part of the ground floor in Block A, fronting onto the Town hall.

4.6 Retail/café units
There are three units that occupy the majority of the Block C ground floor. The café unit is 120 sqm (NIA) and fronts onto the public plaza and town hall. The smaller retail unit is 190 sqm (NIA) with frontage on King street and the public plaza. The larger retail unit is 480 sqm (NIA) with frontage onto King Street.

5 DEMAND FOR THE COMMERCIAL UNITS

5.1 Market research

As part of the due diligence for the Civic Campus JV financial viability studies, the Council's consultants Colliers and Frost Meadowcroft have been appointed to provide advice on all uses apart from residential. They provided indicative values and yields that have been used in the appraisals and inform this options appraisal.

We have also been reviewing long term market demand for the office, cinema, restaurant and retail to understand the terms of indicative leases which have fed into our modelling. We have also received further advice from BNP Paribas who advised the Council on its best consideration valuation.

We are confident assumptions used are robust and backed up with evidence. Given current economic/Brexit uncertainty we have taken a cautious approach, carried out sensitivity analyses and considered potential exit routes.

5.2 Offices
Hammersmith has an established, decades-long presence as a key London office sub-market. Chiefly centred around Hammersmith roundabout, Hammersmith's office market has grown with the expansion of Heathrow because of its convenient road and underground connections to the UK's principle airport, and rapid journey times to City and West End.

Hammersmith town centre caters adequately for the daily needs of workers in terms of shops, restaurants, services, transport and nearby homes, although this offer has perhaps not kept pace with rival emerging centres - like Shepherds Bush, or Shoreditch or Islington for example.

Overall vacancy rates in central London offices are low at 4.3%, while supply has contracted to 9.5m sq ft, the lowest since 2016, according to JLL's latest Q4 2018 survey. And despite Brexit, London's overall leasing market remains strong. The annual total of pre-lets for 2018 of just under 4.1m sq ft (35% of all take-up) was the highest on record.

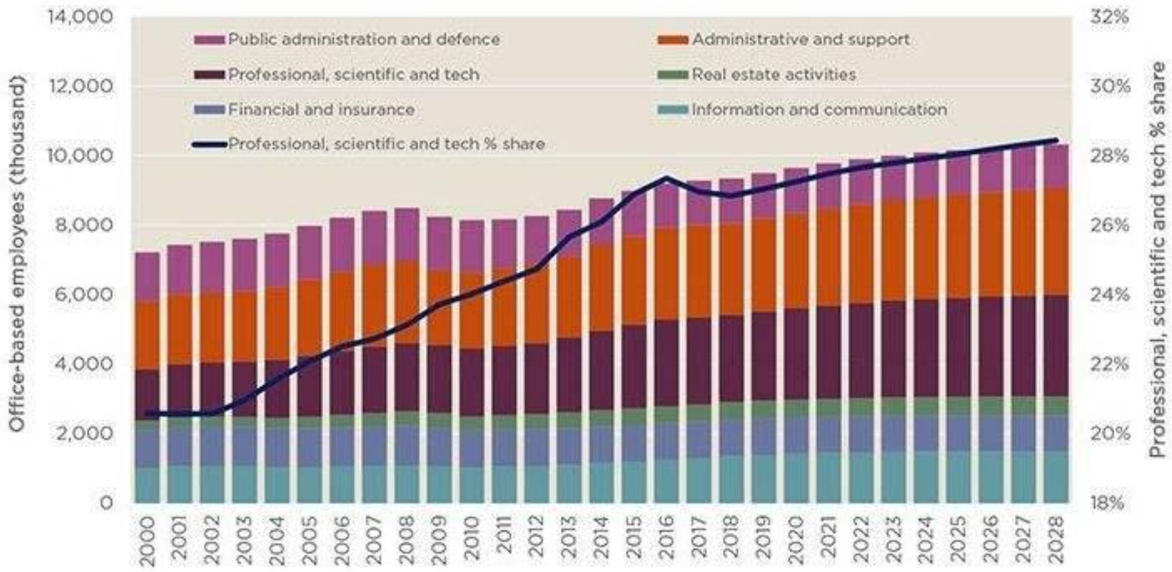
Background economic activity and demand for business space in the central London market remains strong, despite Brexit, domestic political, and international economic uncertainty, including predictions of gently rising interest rates.

There is also a beneficial effect for office values in the borough from reducing reliance on cars, improved overground links, and continuing growth in cycling, with office providers increasingly encouraging cycling by providing shower, changing and cycle storage in schemes, enshrined in planning policy. This is encouraging workspace in a wider range of locations.

The Savills research article below demonstrates a positive outlook for offices:

POSITIVE OFFICE-BASED EMPLOYMENT FORECASTS FOR NEXT 10 YEARS

The 10-year forecasts for UK office-based employment, as shown in the chart above, shows a rising trend. Despite the notion of automation/AI replacing human activity for specific tasks, there still remains a need for additional office space in the future. In a post-Brexit world, the UK will increasingly play to its strengths and the rising percentage share of employees within the 'professional, scientific and tech' sector is key. Office space for these sub-sectors should be an investor's focus.



https://www.savills.co.uk/research_articles/229130/279227-0

This is the promising background to the office offering and the development itself should help improve Hammersmith's offer to businesses seeking increasingly scarce new workspace, for which there is likely to be ready demand.

5.3 RESTAURANT

Hammersmith town centre has a wide range of places to eat and drink of varied quality. It would seem likely a successful operator would be interested in the restaurant space, not least because of the Council presence and that of other occupants on site or in offices nearby and the presence of the cinema.

5.3 CINEMA

Demand for cinemas is reliant on the disposable income of individuals, and therefore general economic conditions. Hammersmith & Fulham, however, is one of the capital’s most prosperous boroughs, with rising levels of employment and business formation.

The cinema is likely to attract local residents and tourists, and presumably workers, enhancing the vibrancy and frequency of visits to Hammersmith town centre - a key requirement of planning policy.

5.4 RETAIL

The age profile of the Hammersmith Primary Retail Market Area includes a particularly high proportion of adults aged 25-44; young adults aged 15-24 are also over-represented. In the 2011 Census, the Hammersmith area contained an above average proportion of working age adults within the most affluent social group. In contrast, the least affluent social groups are particularly under-represented in the area. These demographics mean Hammersmith remains affluent and residents' disposable income is favourable for retailers and leisure establishments.

Although there is little evidence for rental growth, supply remains low which will keep pressure on rents to remain stable, if not rise, when newly renovated stock becomes available.

5.5 AFFORDABLE WORKSPACE

523sqm of affordable workspace is to be provided in the scheme in the form of units targeted at start-up businesses. There is a requirement for this space to be included in the scheme, set out in the S106 condition accompanying the planning permission, in line with the Council's planning policies, and helping to achieve the aims set out in its industrial Strategy, *Economic Growth for Everyone*.

Inclusion of the space will help improve the offer to new local businesses and their employees and assist with reversing economic decline in this part of the borough.

6 THE CASE FOR BUYING THE COMMERCIAL UNITS

Two options were assessed in evaluating the proposed acquisition of the commercial units:

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

- **Option 2** – the Council to purchase the commercial units on the open market in the following ways:

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

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

    - The Council also has the option to fund the units throughout construction if that proves financially more advantageous

6.1 OPTION 1

Summary -
The current JV option is to build commercial units and sell separate use elements to occupiers/investors on completion, as part of the overall scheme, on completion.

Option 1 includes a do-nothing appraisal, estimating the impacts if the Council did not alter the current JV agreement, in which the Council is a 50% partner.

The land sale agreement is conditional on having end-users identified for all elements, therefore limiting the JV's exposure to construction and leasing risk. This will significantly benefit the Council in the long term as it will mitigate the construction and leasing risk surrounding the new build scheme, limiting the Council’s exposure to fluctuations in the market.

On the downside, it may prove a difficult aspiration to deliver should market conditions deteriorate.

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.

The Council will lose the opportunity to benefit from any regeneration uplift as a consequence of this option because the asset will be sold. It will also lose control of who occupies the commercial units, although this can be mitigated by lease conditions to a certain extent. Private long-term ownership of the commercial units also may not be aligned to the Council’s regeneration aspirations or its Industrial Strategy.

6.2 OPTION 2

Summary

Option 2 is for the Council to purchase the commercial units from the JV as an investment with consideration of how the Council funds that purchase. That could be either:

- a traditional mortgage 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

- The Council also has the option to fund the units throughout construction which might prove marginally more financially advantageous in the right interest rate environment

Key considerations
The Council is considering buying the commercial elements from the JV as an investment, for three key reasons:

- to benefit from regeneration uplift
- to ensure the building's occupiers help achieve borough ambitions
- the Council wants to retain control of the main elements of the campus as long-term civic steward and landlord

The Council would be responsible for leasing to cinema operator, restaurant, café, retail and office occupiers. This would create significant leasing risk to the Council as the market for officed, cinema and restaurants are prone to market fluctuations. Such risk is mitigated by robust market research and financial assumptions in the appraisal modelling. Market research and operational cost assumptions have been provided by Colliers and Frost Meadowcroft and reviewed by BNP Paribas.

Operational costs include:

- Rental levels for each asset class, office, retail, restaurant, cinema and affordable workspace
- Rental inflation at 2%
- Cyclical repairs/lifecycle costs
- Capital expenditure at lease ends
- Re-leasing costs
- Rent-free periods on new lettings

Exit routes
As long-term owners of the commercial units the Council must consider what its exit routes are if the mitigations on the market exposure are not achieved. A number of exit strategies have been considered by officers. The main exit routes are outlined below:

- **Retain and re-purpose** – 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 is always available, the main risk is whether the Council's loan could be re-paid. The financial modelling (see Appendix 1) demonstrates that the units could be sold on the open market at certain

years and either break even or return a modest surplus. These values are dependent upon assumptions of capital growth.

Risks and benefits

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 including 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

Risks and mitigation measures

Risk and impact	**Mitigation measures**
Selection of the right funding option to give the maximum flexibility for the Council in long term.	A full comparison of funding opportunities will be examined before the optimum route chosen.

Proposed arrangements are found to be in breach of Public Procurement Regulations, leading to legal challenge.	The contractual arrangements will be structured so as to avoid the creation of an enforceable obligation to undertake works. The Council has been advised of such an approach in the context of the delivery of the development as a whole by the A2Dominion joint venture
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 Guarantor 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 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	Sensitivity analysis has been undertaken as

to lower rental values, thereby affecting scheme viability.	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 recessions.	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 Council's capital and revenue costs

Conclusion
This option will require the Council to pay c£64M as the purchase price (including costs) for the commercial units.

In addition to the previously stated regeneration and stewardship benefits, the financial viability model (see Exempt Appendix 1) demonstrates that over a 45-year period the loan can be paid off in full and all annual interest payments met.

This is based on the rental values suggested by Colliers and Frost Meadowcroft and reviewed by BNP Paribas. The cost of borrowing has been modelled based upon current PWLB rates and MRP assumptions from the Council finance team.

There are also the potential exit routes described above to protect the Council if the rental values are not achieved.

Option 2 is therefore the recommended option.

7 FINANCIAL CASE AND FUNDING ROUTES

The Council will need to decide if it borrows from PWLB or another lender, or whether a sale and leaseback deal may be better.

7.1 Traditional mortgage structure sourced from Public Works Loan Board or the open market

The recommended Option 2 will require the Council to purchase the units for c£64M, subject to valuation.

On completion of construction the Council would purchase commercial units from the JV. The funding would be sourced through either the Public Works Loan Board or the open market to achieve the most advantageous rate for the Council.

The Council would be responsible for leasing to cinema operator, restaurant and office occupiers. The debt would be repaid using the Council's net income through rental revenue from Commercial units' occupiers.

The loan would be either on an "interest-only" or "blended debt repayment" basis. An interest-only payment takes the total loan amount and charges only an interest payment on this over the amortised life of the loan. At the end of the amortisation period, a large one-time payment is required to pay off the outstanding balance.

The blended debt repayment option, blends both the interest and principal payments into one payment. This will reduce the outstanding balance on the loan over its lifespan and in turn reduce interest payments as the loan reduces. It has options, therefore, to maximise income through rents, or reduction of debt.

Optimal exit years have been identified in Year 5, 10 and 27 to maximise the returns for the Council, based on an analysis of likely tenancy turnover and anticipated building expenditure.

The Council is familiar with the PWLB route and, given current interest on long term borrowings are low at present, that may be the best option.

Officers are aware of other investors who are interested in lending to local authorities in current economic circumstances, however, because they have a very good covenant.

7.2 Commercial loan structured as a sale and leaseback

Officers have had initial discussions with Aviva on a sale and leaseback deal. This was only for Block B, however.

The proposal is that the Council would enter into 125-year lease from Aviva, and then Aviva would provide funds for land and construction (subject to a retention to cover against cost-overruns).

The council would enter into a 50-year leaseback on completion and would also be responsible for leasing to cinema operator, restaurant and office occupiers.

The Council would have a contract with the Civic Campus JV (Council and A2Dominion) to build commercial units on time, to budget.

In this structure, the freehold would remain with the Council. Aviva will fund 100% of the development costs of the new office and cinema and take a long leasehold of 250 years with the option to collapse the lease on maturity of the term.

The Council will take a headlease back from Aviva for a period of 50 years and will be in charge of operating the buildings. This will include all operational leases and management of the buildings.

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).

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.

In addition to this, the Council could receive an annual operating surplus from the building based on a projected positive variance in net operating income and the Aviva debt service.

The current figures (Block B only) suggest that over the 50-year lease term there is no significant difference in the borrowing costs between this option and the traditional PWLB or open market option.

Working with Aviva would provide an external "challenge" to Council assumptions during the development process, helping to support timely and effective delivery, and subsequent management of the completed project.

7.3 Long-term issues/risk analysis and management implications

The final decision on where the Council borrows the money will be made closer to finalising the forward purchase agreement with the JV as the Council will want to ensure it gets the best deal on offer at that time.

For modelling purposes officers have used a 2.81% interest rate plus set aside of MRP.

The recommended Option 2 is financially viable, however officers recognise that the Council must carry out scenario testing to ensure the investment is still viable where circumstances change.

Sensitivity analysis

The viability has been based upon the following assumptions:

- Colliers/Frost Meadowcroft assumptions on the operational costs and reviewed by BNP Paribas
  - Rental levels for each asset class, ie office, retail, restaurant, cinema and affordable workspace
  - Rental inflation at 2%
  - Cyclical repairs/lifecycle costs
  - Capital expenditure at lease ends
  - Re-leasing costs
  - Rent free periods on new lettings
  - Increase in capital value of the units

- S106 monies are available to enable the affordable workspaces and the use of them has been reflected in the sensitivities in 4.49 below

See the full options appraisal at Exempt Appendix A for more details

7.4 How could option 2 be funded?

Public Works Loan Board Funding or open market funding

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.

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.

The interest and debt (minimum revenue provision) would be repaid using the Council's income through rental revenue from the occupiers. The loan would be either on an "interest-only" or "blended debt repayment" basis.
An interest-only payment takes the total loan amount and charges only an interest payment on this over the amortised life of the loan. At the end of the amortisation period, a large one-time payment is required to pay off the outstanding balance.

The blended debt repayment option, blends both the interest and principal payments into one payment. This will reduce the outstanding balance on the loan over its lifespan and in turn reduce interest payments as the loan reduces. It has options, therefore, to maximise income through rents, or reduction of debt.

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, 107 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

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

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.

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.

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 see 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).

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

The preferred option route 2 will be tested by officers to ensure that the optimum loan facility is chosen. The decision on how the development should be funded is included in the delegation.

The Council also has the option to fund the units throughout construction if that proves financially more advantageous

Options compared

4.47 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 including 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

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.

The proposal shows a positive discounted cashflow for all modelled sensitivities – i.e. the investment would be expected to favourable in cash terms for all scenarios as modelled.

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; capital income (capital receipts) cannot be used to support revenue expenditure.
- The Council is 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).

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.

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.

Changes to interest rates and net operating costs impact on the long-term performance of the investment as can be seen from the matrix in Appendix 1.

Interest rates will be fixed at the time the capital is borrowed and for modelling purposes a robust figure of 2.81% has been used.

Management implications and mitigation tactics

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

- If the office rents were lower than profiled or there were tenancy voids, then the Council could re-locate staff (and that of its partners) from other Council-owned properties to allow the assets to be sold or re-developed with an income. The cost/benefits of moving H&F staff into the office accommodation would need to be fully assessed so actual financial expenditures were understood

- The Council could consider letting space in the new Civic Campus (new top floor) on a commercial lease for an events company with some reserved times for community/civic uses

- The Council may wish to let out HTH space on a commercial basis to public sector partners too as further agile working is implemented

- Lease out space at 145 King Street to provide additional income.

- If there were voids within the new offices, meanwhile uses could be considered to generate short term income

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

- The Council could sell to 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 deal structure 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 location in the borough

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

- A further option would be to sell the commercial assets to secure capital receipts as a contribution for a different regeneration or place-making project in the borough

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

Soft market testing of the commercial units market
Officers have been working with Colliers and Frost Meadowcroft to soft test the current market for the commercial units. The latest position is:

Cinema
The previous redevelopment proposal by King Street Developments (KSD) included a cinema. This was included in KSD's planning application and is popular with local residents.

Our current planning permission requires a four-screen cinema. We have continued discussions with a cinema operator that has a diverse offering of Hollywood, Independent and Foreign Language film as well as streamed events such as Opera will appeal to residents.

We have, via Colliers, spoken to an operator who have made an offer to lease the cinema on a 25-year lease basis on terms reflected in the viability model.

Restaurant
Colliers have advised it may be beneficial to retain the restaurant until the long-term occupier of Block B offices is determined. This would mean the lessee of the offices could make use of the restaurant if they wished. Co-working operators routinely seek a café or restaurant as part of their offering to occupiers. The Council could still sell the restaurant on a long lease to an investor if it wishes.

Offices
Through our agents, Colliers and Frost Meadowcroft, we asked co-working companies if they would be interested in a suitable office scheme (without revealing the exact site) to be ready for occupation in four years' time. They said they would be interested and would require minimum space of 4000 sqm. A marketing pack is being put together so that we can start the soft market testing in more detail.

Retail & café units
As with the restaurant units the advice from Colliers is to wait until closer to completion before we market the retail units. However, there has been an interest in the larger unit from a convenience store operator. Officers are having initial discussions as they may be prepared to enter into an agreement for lease.

Affordable workspace
These units have not been soft market tested as yet, as we know there is a high demand for discounted workspace.

9 PLANNING AND TIMETABLE

Resolution to grant planning permission was achieved in February 2019, subject to a GLA review and finalisation of S106.

The conditional land sale and formation of the JV will therefore happen in December 2019 following expiry of the planning judicial review period.

There are nine conditions linked to the land sale agreement (see 3.2 above). The conditions that form part of the sale agreement will need to be satisfied by April 2020 to enable the main start on site in June 2020.

As the financial and risk impact of the Commercial units' condition is significant for the overall scheme the Council needs to make the decision whether to invest in the Commercial units in **December 2019**.

10 RECOMMENDATIONS

10.1 Recommend to Cabinet that the Council purchases the commercial units at the Civic Centre campus from the JV at a value of c£63M (subject to final valuation).

10.2 Recommend that Cabinet delegate authority to officers to agree final terms with the JV and to agree the most advantageous funding terms.