Executive **15 December 2020**

Joint Report of the Chief Operating Officer / Chief Finance Officer

Portfolio of the Executive Member for Finance and Performance

New Stadium Leisure Complex Commercial proposal on restaurant units

Summary

1. The purpose of this report is to update Executive on the Commercial Deal that was agreed by Executive (19th October 2017) regarding the financial receipt due to the Council in respect of disposal and development of land adjoining the Community Stadium. That report informed Executive that the final receipt would be dependent on the number of restaurant units let at the time of Practical Completion. As Practical Completion approaches that risk has crystallised in that no units have been let and this report provides options as to the way forward.

2. The report highlights the financial impact of the current position alongside a commercial offer from the developer as to whether the council would wish to accept a lease for taking the units alongside a capital receipt or to take ownership of the units and forego a capital receipt. In doing so this report highlights the risks and advantages of the three options available.

Recommendations

3. Executive is asked to approve Option 1 and

(i) To accept that the 3 restaurant units are not let at Practical Completion and to accept the associated reduction in capital receipt of £1.375m towards the Stadium project.

(ii) To recommend to Full Council that a further £1.375m prudential borrowing be applied to the Community Stadium project to offset the loss of commercial investment in the project

ii) To recognise the additional ongoing Treasury Management costs of £96k that will need to be incorporated into future year’s budget strategies

Reason –

To ensure the stadium project is fully funded at the lowest risk to council finances going forward

Background

4. The Community Stadium scheme has been developed over a number of years. Some of the key decisions relating to the scheme are highlighted below.

5. In September 2014, the Cabinet confirmed Greenwich Leisure Ltd ("GLL") as the preferred bidder from the procurement exercise and GLL have been working with the Council and a wider team of partners since their appointment to finalise the NSLC scheme. This included noting the increase in budget and that the project would be partly funded from a £12m commercial land deal.

6. In 2016 the Executive agreed to a procurement bid from GLL to build a new stadium and leisure facilities at Monks Cross. The funding was approved by Full Council including the £12m assumed capital receipt from the commercial land deal.

7. In July 2017 – Executive noted lower the lower commercial land deal and the updated financial position and agreed to proceed to financial close.

8. In Oct 2017 Executive noted the new risk regarding the value of the Commercial Units would be subject to a reduced value if not let at practical completion.

9. The units included in the deal are located within the south east stand of the new stadium complex. They each are approximately 3,000 sq ft.

10. In order to secure finance for these new facilities agreements for separate land transactions were entered into with Legal & General (L&G). These were: i) the freehold sale to L&G of the cinema site and associated car park land for £4.85m and ii) the granting of a long (250 year) lease to L&G of 3 restaurant units within the East stand of the stadium on practical completion for a Premium of £3.825m. This value would be due if 2 of the 3 units were let by the time of completion of the build. This amount would be reduced by £0.6875m if only one of the units were let and reduced by £1.375m if no units were let at that time. This risk was accepted by Executive (19th October 2017) as a way of progressing the scheme and avoiding significant abortive costs. It should be noted that the developer also offered a contribution of £70k towards the council's costs should the risk materialise. The agreement obliged L&G to use reasonable endeavours to secure tenants for the 3 units on reasonable commercial terms.

11. At present none of the units have been let by L&G and therefore the council is not due the £1.375m.

12. A proposal has now been presented whereby the Council can take a 25 year lease of the units from L&G under the terms in Confidential Annex 2, meaning the units are technically let at completion. This would ensure the Council receives in full the additional £1.375m in capital payments.

13. Accepting a lease of these 3 units would also enable the Council to facilitate sublettings for the units to a wider market as the Council could review offers from local and smaller businesses that would not be considered under L&G's corporate benchmark although sublettings are subject to L&G's approval.

14. The Full Council approvals in March 2016 were based upon receiving the full £1.375m toward the new stadium and leisure complex budget, whilst noting this as a significant risk, and as such if these monies are not received the project budget will be in deficit and require further approvals.

15. There has also been a further offer from L&G whereby the council take ownership of the units but receive no financial contribution from L&G. The council would lose the full £3.8m premium referred to in paragraph 9 as well as a £0.63m capital contribution from L&G to the building costs of the units within the stadium. This would result in a financial contribution to the project £4.43m lower than the budget.

16. Strategically, this is therefore an opportunity for the council to support the economic prosperity of the city now and in the future albeit with a financial risk.

17. Executive therefore has three options as detailed below:

Option 1:

18. To accept the units are not let and that the £1.375m will not be received from L&G.

19. In accepting option 1 Executive needs to be aware it therefore needs to approve a further £1.375m of capital to cover the shortfall in the project budget.

20. The full costs of the borrowing required to finance this amount over the 25 years of the lease offered by L&G are covered in the business case in appendix 1.

Option 2:

21. To take a 25 year lease from L&G for the 3 units on the terms included in confidential Annex 2.

22. This secures in full an immediate payment of £1.375m of capital to the project budget and therefore requires no further approvals at this point.

23. The proposed lease would be for a term of 25 years, and the council would be responsible for all void periods and statutory service charges as well as a service charge to the landlord.

24. A base case has been modelled along with two other scenarios a “better case” which assumes higher rents in future years and shorter void periods and a “worse case” which assumes lower rents and longer void periods.

25. The outline business case is set out in the confidential appendix which sets out the return on the potential investment. The business case is based upon borrowing over 25 years and minimum revenue provision based on a commercial assessment. The lease terms being offered to the Council would make the Council (as tenant) responsible for ongoing repairs and maintenance of the property. As and when the Council sublets the units these obligations would be passed on to the occupiers (subject to terms of the subleases).

Option 3:

26. To accept full ownership of the units, thereby allowing Legal & General to walk away without further financial contribution.

27. To accept the loss in full of the £4.4m capital agreement with Legal & General.

28. In accepting option 3 Executive needs to be aware it therefore needs to approve a further £4.4m of capital to cover the shortfall in the project budget.

29. The financial implications of Option 3 are significant in terms of capital loss. The benefit is the value and retention of the units under Council ownership. There would be no rent to pay on this option and all revenue and lettings would be to the benefit of the Council. This must be balanced against the prudential borrowing costs of securing the units as Council assets.

Analysis

30. Each of the above options are considered below. Whilst financial costs can be modelled there are a number of other economic impacts that could be

considered as part of the development. There also are considerations as to the level of risk that the council will want to accept prior to making a decision.

Option 1 – To accept the units are not let

31. Option 1 has a clear financial impact of an immediate direct loss of the £1.375m capital payment to the project budget and therefore further approved funding would be required. The total cost of borrowing £1.375m over 25 years equates to £2.34m and therefore has an ongoing revenue cost of c £96k per annum. In year 1 this would reduce by £70k contribution from the developer.

32. The units will remain in the ownership of the L&G and they will be responsible for the letting of the units.

33. It is possible that the units will remain unlet given the current economic climate particularly around restaurant use.

Option 2 – To take a 25 year lease from L&G

34. Option 2 represents a full capital return on the land agreement approved with L&G in 2017. This enables the project budget to move to close down and reconciliation without the need at present for further capital finance into the project.

35. The council will pay a commercial rental to L&G for retaining the units and be responsible for subletting the units. The council will need to accept the risk that when the units are void the council is responsible for service charges, business rates and marketing costs. Also when the units are let the council needs to accept that there may be occasions when the values of rents receivable are lower than the rent paid to L&G.

36. Whilst the council is responsible for letting the units it is possible that it may be possible to fill the units.

37. A significant risk to accepting the units is that the owner/ developer has stated that the council would need their prior approval, acting reasonably, to any proposed future letting of any of the three units. Whilst further work would be required in evolving the proposed terms within an agreed formal lease documentation, there is a risk that the owner/ developer could reject the council's wish to under let a unit, if say they disagreed with the type of use or nature of the deal put forward and were able to demonstrate that this would cause a reasonable degree of loss to their interests. This could include the Council's ability to let a unit at a particular level of rental (if

below the considered market rate at the time). The effect of such would be to provide a risk in the ability of the council to secure an occupier. The result would be a negative impact on revenue, with the Council legally bound to pay the developer a rent irrespective of whether the units were occupied, as well as bearing the incidence of all property holding costs. In such a scenario, this would potentially result in a significant risk in physically achieving occupation of the units whilst continuing to pay rent. There are also restrictions on the ability to let the units for certain uses given that other deals already undertaken on the complex would prohibit the council leasing out one of the units which would unduly compete with those already let.

<u>Option 3 - To accept full ownership of the units, thereby allowing Legal & General to walk away without further financial contribution.</u>

38. Option 3 has a clear financial impact of an immediate direct loss of the £4.4m capital receipt to the project budget (£3.0m higher than Option 1) and therefore further approved funding would be required. The total cost of borrowing £4.4m over 25 years equates to £7.7m and therefore has an ongoing revenue cost of c £308k per annum.

39. Within this option the council takes ownership of the units and is therefore not subject to restrictions of the needing approval to subletting the units.

40. This option provides the greatest opportunity for the units to be let however does come with a significant long term financial cost. The Council has taken external valuation advice that suggests in the current market the value of the units are lower than the additional receipt foregone by the council (£3.0m).

41. The council is however still liable to business rates and service charges whilst the units are not let.

Financial Analysis

42. The options around the decision have ongoing cost implications to the council. The modelled cost of the various scenarios is shown by year in appendix 1 using assumptions shown in confidential annex 2. The overall costs shown in the table below. These are deemed to be the most likely outcomes based on recent market conditions. However there are scenarios where the costs could be significantly lower should the development be particularly successful or potentially worse should units take longer to let.

Option	Modelled Cost over 25 years	Average per annum

1 – Not receive £1.375m receipt	£2,337k	£96k
2 – Take a 25 year lease	£2,066k - £6,018k (Base £4,328k)	£83k - £241k (Base £173k)
3 – Not receive £4.4m receipt and take 3 units	£3,727k - £7,710k (Base £5,990k)	£149k - £308k (Base £239k)

43. Option 1 will require council approval to borrow a further £1.375m in lieu of the commercial receipt that will no longer be forthcoming. This will require an additional £96k to be included into the Treasury Management budget to reflect the additional borrowing costs. This would need to be incorporated in the 2021/22 budget strategy

44. All of the scenarios across Option 2 demonstrate that the council will have a significant annual net cost. There are significant risks associated with letting the units and potential long term costs dependent upon the lettings market. This brings with it inherent risks of void periods and therefore costs for statutory services, and service charges as well as Business Rates. The most significant sensitivity with regard the financial outcome relates to the number of units that are let at any one time. If all units are let at aggregate/combined annual rent at least equal to rent payable by the Council to L&G then there is no cost to the council but each void unit costs up to c £151k per annum.

45. Option 2 will require the council as part of future budget process to add in a provision to fund the ongoing losses that will occur over the 25 year period. The net cost will be dependent on the number of units that are let at any time and will vary over years. The figures in Table 1 show that this value is likely to be higher than that required for borrowing in the base case being an average of c £170k per annum.

46. Option 3 is more expensive to the council as the annual cost of borrowing is held by the council. Even when the units are fully occupied there is a net cost to the council. The level of this will be dependent on the level of commercial rents achieved. When units are vacant the cost to the council becomes significantly greater.

47. Option 3 will require council approval to borrow a further £4.4m in order to take ownership of the units. The borrowing costs over 25 years equate to £308k per annum. This will be offset by rents when occupied but would still lead to an average loss of over £240k per annum on the base case. This financial liability would need to be identified within the 2021/22 budget strategy.

48. It should be noted that under this option the council retains the asset beyond year 25.

Conclusions

49. From a purely financial perspective based on current rental levels and market analysis it is concluded that option 1 provides the council greatest financial certainty and limiting future liabilities. Following the pandemic the level of rents that can be expected letting the units in the early years are lower than those that will need to be paid to the Landlord. Whilst the market can be expected to improve over future years that would be a risk that the council would need to accept and make appropriate financial provisions.

50. There are scenarios whereby taking ownership of the units does provide wider economic benefits however they come at a cost to the council.

51. For this reason the recommendation to the report is Option 1.

Council Plan

52. The Stadium project supports a number of themes across the council plan. In particular the proposed New Stadium and Leisure Centre scheme delivers significantly enhanced leisure facilities for residents, including securing the continued operation of Yearsley Swimming Pool (subject to the ongoing Review). The major investment in facilities also creates jobs, significant community use, creates wider economic benefits for the city, and sees a significant uplift in business rates income.

Consultation

53. Scrutiny Management Committee have been requested to provide their comments on the proposed commercial offer and they will be provided to the Executive.

Implications

54. The implications are

    Financial – These are included within the report and the key points repeated below

    Option 1 (recommended option) will require council approval to borrow a further £1.375m in lieu of the commercial receipt that will no longer be forthcoming. This will require an additional £96k to be included into the Treasury Management budget to reflect the additional borrowing costs. This would need to be incorporated in the 2021/22 budget strategy

Option 2 will require the council as part of future budget process to add in a provision to fund the ongoing losses that will occur over the 25 year period. The net cost will be dependent on the number of units that are let at any time and will vary over years. The figures in Table 1 show that this value is likely to be higher than that required for borrowing in the base case being an average of c £170k per annum.

Option 3 will require council approval to borrow a further £4.4m in order to take ownership of the units. The borrowing costs over 25 years equate to £308k per annum. This will be offset by rents when occupied but would still lead to an average loss of over £240k per annum on the base case. There are also high forecast costs in the early years prior to units being let. This financial liability would need to be identified within the 2021/22 budget strategy.

Human Resources (HR) – There are no HR implications to this report

One Planet Council / Equalities – There are no specific one planet council or equalities implications arising from the decision set out in the report.

Legal –

Regarding both Option 2 (i.e. that the Council take a 25 year sublease back of the 3 units from L&G) and Option 3 (that the Council take back/acquire full ownership of the 3 units from L&G):

Section 120 of the Local Government Act 1972 gives the Council power to acquire (including taking a lease of) by agreement any land/property:
(i) for the purposes of any of its functions under that Act or any other Act or
(ii) for the purposes of the benefit, improvement or development of the Council's area or
(iii) for any purpose for which the Council is authorised by that Act or any other Act to acquire land

It is considered that as both Option 2 and Option 3 would involve entering into a lease (but not any redevelopment works etc), this would be authorised by Section 120. (Therefore, the Council would not need to rely on the 'general power of competence' granted by Section 1 of the Localism Act 2011 and so section 4 of that Act would not require to take the lease in the name of a Council-owned company even if it was considered that the Council's primary purpose in taking a lease is 'commercial' (revenue/profit driven) rather than primarily for non-commercial reasons.)

If the Council accepts a sublease back from L&G then (depending upon the precise terms of any actual sublease) the Council should be entitled to assign(transfer) the lease to someone else or to sub-underlet the units to someone else, subject to obtaining the prior written consent of L&G.

Information Technology (IT) – There are no IT implications

Crime and Disorder – There are no crime and disorder implications

Property – All property implications are covered in the report.

Risk Management

55. Option 1 leaves the council with a minimal risk in that the cost of the additional borrowing is known and can be budgeted. This option however means that if the development is successful and fully let the council will have foregone additional income.

56. Options 2 and 3 involves the council taking additional financial risk. As with all property acquisitions there is a risk that the value of the property may decrease over time. There is also a risk that there may be a level of empty properties or voids. The business case makes provision for that risk and specialist advice has been obtained to provide an independent view of the anticipated revenues from the development.

Contact Details

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Wards Affected: All

For further information please contact the author of the report

Background Papers:

Annexes

Appendix 1 – Summary of Business case.
Confidential Appendix 2 – Financial Appraisal Assumptions

List of Abbreviations
GLL – Greenwich Leisure Limited
L&G – Legal and General