

CABINET



Report subject	Bournemouth Town Centre Vision (TCV): Winter Gardens Site
Meeting date	12 February 2020
Status	Public
Executive summary	The purpose of this report is to update Members on the progress of this £150 million project and to seek approval for a number of decisions which have an impact on the ability to secure third party funding for the scheme.
Recommendations	<p>It is RECOMMENDED that Cabinet approves:</p> <ul style="list-style-type: none"> (a) The amendment of the existing £3.4m loan for the purchase of the Exeter Road site to an “<i>Additional Council Finance loan note</i>”. (b) The increase in the long lease term from 150 years to 250 years (or whatever is market appropriate) (c) The increase to the “<i>Advance Sum</i>” budget to the sums set out in the <i>Advanced Sum’s</i> table in the report. (d) A change to the “<i>Option Execute Date</i>” to 3 years after the date of planning consent.
Reason for recommendations	<p>To enable this exciting and reputationally important scheme to go ahead, helping to deliver high quality homes and increased footfall in Bournemouth Town Centre.</p> <p>To contribute to the Council’s vision, specifically helping to create dynamic places, investing in the homes our communities need and revitalising and re-inventing our high streets and local centres.</p>
Portfolio Holder(s):	Councillor Mark Howell, Regeneration and Culture

Corporate Director	Bill Cotton, Executive Director, Regeneration and Economy
Contributors	Report Author: Martin Tiffin, Town Centre Vision Programme Leader Chris Sheppard, Director – Development Officers from Property, Finance and Legal Departments
Wards	Town Centre / West Cliff
Classification	For Decision

Background

1. Since 2013, Bournemouth Town Centre has seen unprecedented levels of development activity following the launch of the Town Centre Vision in 2008 and the start of a ground-breaking initiative to work more closely with the private sector.
2. A key part of the initiative was to form a bespoke delivery vehicle to undertake development on a number of Council owned sites. Following an EU wide procurement exercise in 2009/10, Bournemouth Development Company LLP (BDC) was formed with three distinct development projects starting in 2013.
3. Since 2013, £350 million of development has been completed involving both BDC, the Universities and the Private Sector. There is currently over £150 million of development nearing the end of the construction phase and a further £400 million of development planned in the next 2 to 3 years.
4. In 2015/16 Bournemouth was recognised as the town with the 3rd most development activity outside of London. This was an incredible turnaround in fortunes which meant that some £350 million of construction spend has been with businesses with a BH postcode.
5. A key stage in the Town Centre Vision has now been reached and the next set of schemes in the pipeline have the ability to change the perception of our region. The Winter Gardens project and the Cotlands / York Road project, with a combined gross development value (GDV) in excess of £300 million are currently being promoted on the international stage as part of the Department of International Trade inward investment programme.
6. In October 2015, Bournemouth Borough Council approved the Winter Gardens Site Development Plan. Following four years of detailed design, in March 2019 BDC secured planning permission for a £150 million residential led mixed-use

development at the site of the former Winter Gardens Concert Hall and the surrounding area. This ground breaking scheme has won many supporters within the development community and demonstrated what is possible when the public sector and the private sector share a common vision.

7. The residential accommodation is located in four slender multi-storey buildings of varying heights, set amidst considerable landscaped grounds that provide leisure, recreation and residential amenity. Reflecting a demand for contemporary town centre living, it will comprise an excess of 352 homes, made up of a mix of one, two and three-bedroom flats, and a small number of penthouse apartments, arranged across four multi-storey buildings of varying heights. It will provide up to 600 car parking spaces, including the re-provision of 225 safe and secure public car parking spaces, almost all in a four-story basement car park, plus secure cycle parking areas. There will be up to five units for high-quality restaurants along Exeter Road, and a new food store, helping to raise and diversify the choice of dining experiences in the area, enliven the streetscape, and contribute to the local economy.
8. As well as a dedicated family area, there will be a new piazza at the junction of Exeter and Cranborne Road, a linear park alongside Cranborne Road and other publicly accessible open spaces with opportunities for outdoor cafés and children's play areas. A widened landscaped pedestrian area along Exeter Road will help to deliver an important part of the Grand Garden Walk, an initiative to provide a continuous promenade for pedestrians and cyclists around the town centre.
9. A procurement process to select a main contractor has been completed and the preferred contractor has been appointed and is working closely with BDC under a pre-construction services agreement to refine the design and procure the sub contract packages.
10. The next key stage with this project is securing the necessary finance to start the construction phase. Although this particular journey has started, there is still some way to go before the necessary funding is secured and works can start on site.

Contractual and Financial Information

11. The purpose of this report is to update Members on the progress of this £150 million project and to seek approval to a number of decisions which have an impact on the ability to secure third party funding. These relate to:
 - the loan note structure
 - amendments to the Project Documents
12. It is important to explain therefore that the contractual relationship between the Council and Morgan Sindall Investments (MSIL), as members of the BDC, in a

number of legal documents, one of which is the Limited Liability Partnership Members' Agreement ("LLP MA").

13. The Delegations policy contained in the LLP MA requires certain decisions to be taken at "LLP Member" level. Amendments to the Project Documents and to the nature of the members loans requires Council approval.

14. The legal documents that set out the contractual relationship between the members are as follows:

- LLP Members Agreement. This is the overarching constitutional document which regulates the affairs between BDC, the Council and MSIL.
- Option Agreement. The terms upon which the Council can "put" a site to BDC and the terms upon which BDC can "call" for a site.
- Development Management Agreement. The terms upon which MSIL provide development expertise and services to BDC.
- Loan Note Documentation. This documentation sets out the terms upon which the two members, the Council and MSIL, provide loans to BDC. This covers different types of loans including the "*Advance Sums*" which MSIL inject into BDC to cover the cost of the pre-construction activity (feasibility, outline design, planning, detailed design and construction procurement).

15. As with all projects the size of the Winter Gardens, the financing arrangements are complex. It is not the purpose of this paper to explain the financing structure in detail, but to explain the different types of funding sources for the project. At this stage it is anticipated that the Winter Gardens project will be financed as follows:-

- Member Loans. These are loans made by the Council and MSIL
- Third Party Debt. This will cover the majority of the funding required and is typically set at 65 per cent of the total cost of the scheme. Most of the retail banks provide debt finance for development projects through specialist divisions operating in London
- Institutional funding. A number of the large pension funds provide funding for development projects and have a particular appetite for what is known as "*income strip deals*". Bournemouth Borough Council and BDC utilised this type of funding to deliver the Madeira Road Student Scheme
- Government Funding. Homes England (Former HCA) provide funding for residential projects both under grant and debt terms. BDC utilised HCA debt funding to deliver the 64 apartment Citrus Building scheme at Horseshoe Common
- Forward Sale / Forward Funding. This type of funding structure is used by Registered Providers and Institutional funds. Examples include the L&G funding

of the new cinema complex (BH2), and Radian Housing Association's funding of the 113 apartments at Berry Court targeted at the Build to Rent sector

- Mezzanine Funding. This type of funding bridges the gap between debt funding and equity funding. In the Project Documents this is referred to as *Additional Council Finance* and *Additional PSP Finance*

16. Following 12 months of market engagement by the BDC development team, the following funding sources are the most likely to be utilised in the delivery of the scheme:

- Member Loans (For Advance Sums / Cash Match including Additional PSP and Additional Council loans)
- Debt funding for the open market sales product and residential parking
- Forward Funding/ Sale for the Build to Rent and the senior living elements
- Forward Funding/ Sale for the public car park/ commercial and retail space

Member Loans

17. One of the complex issues to resolve is the priority order for repayment. In its simplest form, debt funding ranks in priority to equity funding (members loans).

18. Another issue to be resolved is whether the funding is structured on a recourse or non-recourse basis. In other words what rights do the different lenders have to seek recourse against the project assets and/or the assets of the delivery vehicle (BDC). These issues will be resolved as the different funders start to commit to the project and enter the "due diligence" phase. This is at least 6 months away from that process starting.

19. Under the terms of the LLP Members Agreement, members of BDC can make loans to BDC. The Council have loaned £3.4 million to Winter Gardens Development ("WGD") LLP, the development subsidiary set up to deliver the Winter Gardens development to purchase land / buildings situated near to the former Winter Gardens Concert Hall Site to enable comprehensive redevelopment. MSIL have made a similar loan to WGD, and also a loan to fund the *Advance Sums*.

20. The Council loan was set up as a five year loan with a fixed end date for its repayment with interest charged at 2.98 per cent. The below extract from the BDC Members Agreement sets out the order of repayment of debts:

7.13.4 *The LLP shall procure that the ranking of the debts and security to be granted by a Development Subsidiary shall be regulated by a deed of subordination and priority to be agreed by the Members and any Third Party Funders and reflecting the following priorities:*

- (a) *first, any funding provided by a Third Party Funder;*

- (b) *secondly, any Additional PSP Finance and/or Additional Council Finance; and*
- (c) *thirdly, the Development Subsidiary Loan Notes.*

21. Because the senior debt funder (*Third Party Funder*) for the project needs to be repaid first and have priority over the *member loans*, Council approval is required to amend the existing five year loan note to be an *Additional Council Finance loan note* with the relevant repayment terms set out in the Project Documents. This means that the order of repayment of the Council loan note is moved to after repayment of the senior debt. There is a risk for the Council, and this is explained further in the Financial Implications section of this report, however this change is in line with the BDC Member's Agreement.
22. It is therefore recommended that Cabinet approve the amendment of the existing loan for the purchase of Exeter Road to be an *Additional Council Finance loan note*. In doing so the loan will not be repaid until such time as the *Third Party Funder* (Senior Debt Funder) has been repaid.

Length of Lease

23. The BDC option agreement provides that the land interest BDC can "call upon" is a long lease rather than a freehold interest. At the time of setting up BDC and entering into the Project Documents, the market practice was to grant long leases with a minimum of 125 years. To allow some movement in the market place over the next 5 to 8 years, the Project Documents provided for a 150-year long lease term. In the past 3 years the market position has changed and funders/ investors require at least a 250-year lease. The Option Agreement provides that the lease term is 150 years as set out below.

"Lease"

means a lease for a term of 150 years of the relevant Site in the form attached at Appendix 2 to be granted by the Seller to the Buyer

24. Feedback from potential investors in the Winter Gardens residential element has identified that a 150-year lease is not sufficient to meet their investment requirements and have stated in a number of cases that 250 years is the minimum, however this may vary dependant on market conditions
25. Currently, for residential sales, the absolute minimum mortgage lenders accept is 125 years for a leasehold flat (250 years for a leasehold house). Whilst it has always been a standard term length for residential sales, now that the Law Commission has been focusing on leasehold properties, there is a growing view that it won't be long before this may be changed.

26. The Government has announced that it will be bringing in legislation to reduce ground rents for new leasehold flats to zero and to ban leasehold houses. It is becoming clear that investors are now looking to grant 999 years as there is no point in granting shorter leases when there is no capital value. Approval to increase the lease term is therefore required from Members as set out in the Delegation Policy.

Advanced Sum Budget

27. The Advanced Sum budget previously approved by Bournemouth Council in October 2015 was for £3 million. Because the scheme has increased in size from a £120 million to a £150 million and costs increased during the planning period the Advanced Sum Budget set out in *the 2015 Site Development Plan* needs to be increased. The advanced sum costs have been set out below.

	Assumed construction budget	Advanced Sum (pre - construction fees) budget		Comment
Sept 2015	£77m	£3.0m		
June 2019 phased	£106m	£4.2m		Assumed 2 phases
June 2019 Single phase	£106m	£4.9m		Assumed single phase

28. The advanced sums are paid by MSIL to BDC via a member loan. By increasing the advanced sums budget the amount BDC has to repay to MSIL is increased. Member approval is required for the updated budget, therefore cabinet are asked to authorise the increase in the "Advance Sum" budget to the numbers set out in the table.

29. These are the amounts required to fund the feasibility, outline design, planning, detailed design and procurement processes. They are funded by the winter gardens individual development subsidiary company of BDC by an additional finance loan note from Morgan Sindall.

30. As an additional finance loan note these advanced sums are repaid before the distribution of any profit or loss on the development.

31. Morgan Sindall are charging interest of 5.5 per cent above the three month LIBOR (London Inter-bank Offered Rate) on this advanced sum, additional finance note.

32. In the event that the development does not proceed the additional finance loan note is rolled forward and the cost would need to be recovered by future developments undertaken by the Bournemouth Development Company. In the event of no further

developments the additional finance loan note is required to be discharged equally by the two partners.

33. Increasing the approved advanced sums from the currently agreed £3 million to £4.9 million is necessary for the delivery of a successful development. Members should be aware that the Council is ultimately responsible for 50 per cent of this cost.

Site Delivery Plan dates

34. Within the Option Agreement dated 17th February 2011 the “*Options Conditions Longstop Date*” states that in respect of the Site, it is the date 12 months after the date noted under the Execute Option Agreement within the Site Development Plan, or such other date as agreed by the Buyer (BDC) from time to time. It is recommended Cabinet authorises a change to the “*Option Execute Date*” to 36 months after the date planning consent was awarded (28 March 2019) in order to be able to deliver a project of this complexity.

Summary of financial implications

35. The establishment of the Bournemouth Development Company (BDC) as a joint venture between the council and Morgan Sindall Investments Ltd, in the form of a limited liability partnership, was designed to restrict the Councils exposure to the financial risk on residential and commercial developments on council owned land while simultaneously ensuring the council has a stake in the rewards of ownership.
36. Where relevant a separate individual development subsidiary company of BDC is established for each development focused on one of the 16 car parks that Bournemouth Council entered into the agreement.
37. The council’s contribution of land is valued and turned into a member loan note to the individual development subsidiary. This is then matched by a cash injection (advance sum) from Morgan Sindall which is also turned into a member loan note to the individual development subsidiary company. Any member loan notes by the two partners in the joint venture should be on equal terms (*pari passu*) otherwise one party could be seen to be taking on more risk than the other and, in the council’s situation, it could be deemed as providing aid to a private sector company.
38. In respect of the value of the member loan note associated with land the council will hold in the Winter Gardens as outlined at 37, this will not be determined until later in the process when the development proposal is signed off.
39. The BDC Members Agreement allows for provision by Morgan Sindall and the council of additional finance to an individual development subsidiary, at a rate to be determined. Any council finance is required to be provided on arm’s length and genuine commercial terms which are fully State Aid compliant. Further loans can be

provided by other third parties and institutional investors on terms agreed by the BDC.

40. Developments are therefore completely funded by debt. When they are completed and sold the proceeds are first used to repay any third-party debt. After that any additional finance loan notes to the council and Morgan Sindall are repaid, as explained at 21 in this report. Finally, the council and Morgan Sindall member loan notes issued against the land value (as match by MS) are repaid. Only then is any surplus (profit) or deficit (loss) potentially shared equally (50/50) between the council and Morgan Sindall.
41. In respect of the Winter Gardens individual development subsidiary the council and Morgan Sindall have already issued, on equal terms, a loan to enable the £6.8 million purchase of the connected Exeter Road site. The £3.4 million loan from each partner being at 2.98 per cent for a fixed five-year period which meant it was repayable before the project's completion and therefore outside of the established and normal debt structure as per the Member's Agreement.
42. This loan was issued on the basis that it would be repayable in five years from the date of drawdown, in August 2022.
43. The recommendation of the report is to reclassify the loan as an additional finance loan note and therefore now payable on completion of the scheme after any third-party debt, as explained at point 21. This means the council is now taking on a higher level of risk. This higher level of risk obligates the council to consider a higher interest rate to ensure the loan is still state aid compliant. However, as the private sector company are happy to continue to invest their £3.4 million at 2.98 per cent, then the Council can continue at this rate as it is deemed to be State Aid Compliant.
44. That said, any additional finance loan notes or member contribution loan notes are unsecured and will potentially not be repaid if the development is not successful. The Winter Gardens scheme is a large (circa £150 million GDV) development and therefore there are a number of risks that need to be managed and are outlined the risk assessment section of this report. Councillors therefore need to understand when and how they have received assurance on the scheme's overall viability as ultimately this £3.4 million of Council Tax payer's money is now being permanently invested in the scheme alongside the value of the winter gardens car park land.
45. Should the Council decide to invest this £3.4 million into the long-term viability of the scheme then it will be required to ensure its Non-Treasury Asset Investment Strategy discloses the material long-term, illiquid nature of this holding.
46. The reclassification of this £3.4 million loan also obligates the council to adhere to the latest statutory guidance for such arrangements rather than those in force when the original loan was drawn-down. By reclassifying this loan, the council will now treat the loan as capital expenditure financed by borrowing within its accounts. In turn this

means the council is required to set-a-side a minimum revenue provision (MRP) payments for the prudent repayment of the debt, which in accordance with the councils approved MRP policy equates to £136,000 per annum (4 per cent).

47. Provision has been made as part of the proposed 2020/21 budget for this £136,000 annual payment. Any resources set aside annually as part of this process should be available for redistribution when the loan is eventually repaid.
48. The increase in the Advance Sums will be met from a loan to BDC from MSIL. This does not have an impact on the Medium Term Financial Plan (MTFP). The increased budget and cost of build could erode the *Site Lease Value* (Council's Land Value) and the Council's profit expectation, however it is too early to predict whether this is actually the case and as these payments are not included in the MTFP, there is no adverse impact.
49. The change to a *Council Additional Finance Loan* means that the loan will not be repaid on a set date. Instead the loan will be repaid once the *Third Party Funder* is repaid in full. The Council will however be entitled to receive interest until such time as the loan is repaid.

Summary of legal implications

50. The legal obligations of the Council and Morgan Sindall Investments Ltd as members of BDC are set out in a Limited Liability Partnership Members' Agreement which was negotiated as part of an EU Procurement Process undertaken in 2009/2010. The Delegation's Policy contained in the LLP MA identifies the decision to be taken at "LLP *Member*" level. Any increase to the Advance Sum Budget set out in the adopted SDP and amendments to the Project Documents need to be approved by the members of BDC. In the case of the Council, this is the Cabinet.

Summary of human resources implications

51. BDC has board representatives from the Council and also from Morgan Sindall Investments Ltd. The board representatives are responsible for delivering the Winter Gardens Development. BDC has appointed Morgan Sindall Investments Ltd as the Development Manager to manage the day to day development activity. The Development Manager is tasked with implementing BDC Board decisions and reporting on progress.

Summary of environmental impact

52. None – this is a technical report relating to contractual and financial processes.

Summary of public health implications

53. None - this is a technical report relating to contractual and financial processes

Summary of equality implications

54. None - this is a technical report relating to contractual and financial processes

Summary of risk assessment

55. The Town Centre Vision, as a major programme of the Council, has been subject to a full Risk Assessment.

56. Members should ensure they have considered matters relating to the risk, security, liquidity and proportionality associated with the proposal. They should also satisfy themselves that the potential returns are consistent with the level of risk.

57. Members also need to be aware of the reputational and financial consequences of the default on any additional finance loan note or in respect of amounts applied into BDC by way of Member loan notes.

58. The Council's Non-Treasury Management prudential borrowing indicators impose a £3.4 million restriction on loans to the BDC. The reclassification of this loan will not impact on this restriction.

59. Requests for finance loan notes or additional Member contributions from the Council could be seen as a more cost-effective way of financing the development. That said, it could also be seen to be a sign that, at least initially, the development cashflow is under pressure.

60. Investment Risk: including the risk that the development is non-profit making. This risk can, for certain elements of the development, be mitigated if parts of it are pre-sold. In other words, parts of the scheme are sold to institutional investors before construction works on site commence. The Residential element of the scheme does however expose BDC to significant market risk. By undertaking the residential element in stages, it is intended that this market risk can be mitigated to avoid creating an oversupply and building units that meet end users/purchaser's requirements

61. Pre-Construction Risk including planning, design and funding risks. If BDC fails to achieve funding then the costs incurred will be abortive. Any abortive costs will need to be rolled over to another scheme which will make that scheme either less viable or generate a reduced profit.

62. Construction Risk including late completion and cost overruns. BDC will enter into a fixed price lump sum contract with the building contractor to mitigate the effects of such risk being held by BDC.