Report

Cabinet

Part 1

Date: 20 December 2017

Subject **Development Loan Facility: IAC Building**

Purpose To seek commitment from Cabinet to provide a loan facility (up to 12,000,000) to Garrison Barclay Estates to finance the regeneration of 22-29 Mill Street (the IAC building).

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Ward Allt -yr -yn

Summary The redevelopment of the IAC building (also known locally as the former sorting office) has long been a key regeneration site for the authority. The long-vacant building has a deleterious effect on the city centre due to its high visibility, dereliction, and adjacency to the main railway line. NCC is now at a point where a private developer has approached the council to seek a loan facility in order to redevelop the property as 'grade A' office space with an associated hotel facility. The opportunity to redevelop this premises will therefore address the poor impact the building has on the city centre, in addition to supporting the emerging strategic need to encourage the development of high-quality office and hotel accommodation in close proximity to major geographic transport nodes within the city centre.

Proposal

(a) **To approve a loan facility of up to £12 million for the redevelopment of the IAC Building by Garrison Barclay on commercial terms to be agreed by the Head of Finance and the Head of Law and Standards, subject to satisfactory due diligence and financial appraisal.**

(b) **To authorise the Head of Law and Standards and the Head of Finance to agree the terms of the Funding Agreement and to attend to the sealing and signing of all the appropriate legal documentation in relation to the loan and security.**

Action by Keir Duffin, Head of Regeneration, Investment & Housing
Head of Law & Regulation
Head of Finance

Timetable Immediate

This report was prepared after consultation with:

- Leader of the Council

- Strategic Director - Place
- Head of Finance (Chief Finance Officer)
- Head of Law and Regulation (Monitoring Officer)
- Cabinet Member for Regeneration and Housing

Signed

• Background

.1 The IAC building, also known as the former sorting office, is a large vacant property (circa 55,000 square feet) that occupies a key location within the city centre. Whilst the site on Mill Street is on the periphery of the centre, the stature of the building makes its vacancy and poor aspect highly visible to visitors to the city centre and particularly those arriving into the city via the railway station. The adjacency of the south Wales main line ensures the derelict property is visible even to those passing through Newport via train. Its ongoing lack of use thus paints an unfortunate view of the city centre and its offering.

.2 Newport currently has a wealth of vacant office space available, but as none of it within the city centre is of a high standard vacancy is prevalent. The tired accommodation is generally unappealing to potential tenants, particularly high-value, high-growth occupiers who prefer to be based in the more expensive but desirable office districts of Bristol and Cardiff. Nevertheless, the strategic location of the city centre and its relative affordability, improving quality of offer and transport infrastructure mean that it is an unexploited resource in terms of the development of high-quality office space.

.3 To maximise the economic growth potential of the city centre, the balance must tip back towards quality, in order that Newport can capitalise on developments around the railway infrastructure, city centre improvements and removal of the Severn Bridge tolls and furnish companies and investors with a suite of high-quality options that can be occupied quickly. Even though Newport is commercially very competitive with Cardiff and Bristol, the need for a quality working environment and a good standard of leisure and transport access close to the workplace is rising up the list of priorities for those companies seeking new office accommodation. The IAC building enjoys a favourable location in terms of providing this access, close to the rail station and motorway network.

.4 A number of candidate sites have been proposed that could support this requirement, of which the IAC is one. The property was recently acquired by Garrison Barclay Estates (GB), a credible private developer with a successful history of developing high-quality office and commercial space across the south Wales area, particularly in Cardiff and Swansea. Garrison Barclay has been in negotiation with the council for the last six months around various ways the Council might support the redevelopment of the building post-acquisition.

.5 A number of scenarios initially modelled in which the Council would act as head lessee in order to finance the development; if a full lease was taken out by NCC covering the entirety of the refurbished floor space over a long term, the Council’s triple A covenant would allow the developer to lever additional private borrowing into the scheme. Unfortunately, these leasehold mechanisms would carry unacceptable risk, in that the Council would be required to sub-let the redeveloped property to recuperate its leasing costs, along with the incumbent costs of commercial advertisement and management of the premises. Whilst the Council is taking ongoing advice to clearly understand the demand for refurbished office space in the city centre, sub-letting can never be guaranteed and would also add layers of demand in terms of staff resources, even were the developer to provide assistance in kind with the costs of management and marketing.

.6 Alternatives around public on-lending were therefore tabled for discussion in order for NCC to provide the required financial support to the developer, whilst reducing its risk and exposure by ensuring a guaranteed repayment of the principle finance. The commercial lending scenario proposed in this report also provides confidence that the minimum public sector intervention has been ensured and compliance with State Aid legislation.

.7 A key requirement for the developer in accessing the required support from the Council is that Garrison Barclay demonstrates ambition and delivers a statement development commensurate with the renewed sense of confidence around the city centre. The public subsidy for this development is therefore considerable due to the need to achieve a high specification and be considered ‘Grade A’ office space. The proposed development includes both a very high standard of architectural improvements to exterior shell of the building, as well as the cost of improving the interior and fitting out ready for occupation.

.8 To improve the viability of the scheme, the developer is now proposing that part of the available space could be used to facilitate the development of a hotel. This would improve the viability of the scheme by potentially leasing a significant proportion of the developed floor space, and also provide a significant strategic staging point for the council in its requirement for developing additional hotel bed spaces in order to capitalise on and support the requirements of the Welsh International Convention Centre at the Celtic Manor.

- **Legal issues**

1. The Council has the legal power to provide the proposed loan facility to Garrison Barclay in exercise of its general “well-being” powers under Section 2 of the Local Government Act 2000. This gives the Council a wide ranging discretionary power to do anything that it considers is likely to promote or improve the environmental, economic and social well-being of the area and/or persons within the area. Section 2(4) of the Act specifically empowers the Council to provide financial assistance to any person and, in accordance with Welsh Government statutory Guidance, a commercial rate of interest can be charged for any loan finance, provided that this is incidental to the main redevelopment objectives and economic benefits of the scheme. In this case, the primary purpose of the loan would be to facilitate the redevelopment of this strategically important building and enhance the regeneration of this part of the City Centre, in accordance with corporate policies and objectives. Therefore, it would constitute a lawful and proper use of Section 2 powers.

2. The Council also has to ensure that the proposed Funding Agreement does not contravene European State Aid rules, to the extent that it uses public funding to secure an unfair commercial advantage for Garrison Barclay and is, therefore anti-competitive. If the Council was to provide low-cost funding on favourable terms that were not available in the private sector, which subsidised their development costs and enabled them to secure an increased commercial profit out of the scheme, then this could be unfair State Aid.

3. In order to avoid any State aid issues, it is essential for the Council to ensure that the terms of the Funding Agreement satisfy the Market Economy Investor Principle. The Council has to act in the same manner as a prudent private investor and, therefore, needs to be satisfied that the scheme represents an acceptable investment risk, that the returns on that financial investment would be acceptable to the lending market and that the rates of interest and other terms of the Funding Agreement are on commercial terms.

4. Therefore, in order to address commercial risk and avoid any state aid issues, the loan facility and Funding Agreement would be subject to:

   (a) satisfactory legal and financial due diligence;
   (b) satisfactory loan to property value assessments, with each tranche of the loan being drawn down in line with revised valuations and a maximum loan facility of £12 million;
   (c) agreeing a commercial rate of interest for the loan facility, commensurate with the covenant strength of the developers and the degree of risk involved;
   (d) the Council securing the loan by way of a first charge on the property;
   (e) further security being provided by way of a Debenture issued by the development Company;
   (f) the loan being conditional upon a satisfactory pre-let agreement with a hotel tenant and a secured level of rental income;
   (g) satisfactory terms for repayment of the loan and interest within 12 months of practical completion of the scheme or 3 years from the first loan drawdown, whichever is the earlier

5. These conditions and, in particular, the imposition of a commercial rate of interest under the Funding Agreement are considered to be sufficiently robust as to satisfy the Market Investor Economy Principle and comply with State Aid rules.

6. It is proposed that the final terms of the loan facility and the completion of the necessary funding and security documents are delegated to the statutory officers.

Financial Summary

<u>Impact on the Council's own budget/accounts</u>

7 The HoF proposes to deal with the principal element of the 'loan' as capital expenditure, which is allowable under Local Government accounting regulations. In effect, when the Council makes drawdown loans to GB, they will be treated as capital expenditure in the Council's budget/accounts, and funded from a deferred/future 'capital receipt' representing the repayment due from GB in due course.

The interest payable by GB and the Council's own interest elements on its own loans must be treated as a revenue cost

From this point to the loan repayment date – there will no impact on the Council's revenue budget and accounts. This is because:

- Whilst the Council will pay 'interest' charges on its own borrowing, GB will also be charged interest on their loan from the Council. This will generate a surplus as the interest chargeable to GB, at a commercial rate, will be higher than the Council's own interest charges. This is clearly a short term benefit only. There will be a small 'cash-flow' cost but this is relatively small and will be absorbed within the Treasury Management overall budget

- There will be revenue consequences stemming from IFRS9 accounting standards, just implemented, which obliges the Council to make an up-front provision for bad debt provision against this loan. This will not allow for 100% risk mitigation but just a relatively *small* contribution to this issue in recognition of the inherent risk in making of a loan. This will need to be assessed in due course and the HoF proposes to use the interest surplus to fund this to ensure no impact on the overall Council revenue budget.

- Any further interest surplus is proposed to be put into a specific risk reserve, in the same way as was done for the QRE loan. This is an important 'risk mitigation' arrangement.

- This loan will be accounted as 'capital expenditure' and in normal circumstances; a provision for the repayment of debt (MRP) is ordinarily required. Because this will be expected to be repaid back in short time, we will account for a deferred/future capital receipt (the repayment) from GB, therefore a net nil cost in terms of Capital expenditure to the Council. Therefore, there should be no MRP costs payable, similar to the previous Friar's Walk loan arrangement. This will need to be discussed and agreed with the external auditors but no issues are expected here.

- Whilst the Councils accounts will show more borrowings over the 3-4 years, it will be netted off with a debt owed to the Council.

8 The Council's own borrowings will be drawn down in monthly/quarterly tranches as needed to match the monthly payments (loans) made to GB. The loan and interest due to the Council will be repayable together at the earliest of 12 months following practical completion or 3 years after the first loan facility drawdown. Earlier repayments will be allowed.

Funding Agreement – risks

9 In approving this loan facility to GB, the Council would be entering into a ‘commercial risk’, dependant on a future value for the scheme on which the loan is secured against. This carries inherent risks. It is not possible to quantify all risks as there is no certainty in how/when certain risks will materialise or how they will be resolved. In approving this loan, the Cabinet will need to do so understanding the risks and crucially, accepting the risks and potential financial consequences that result from those risks materialising. In broad terms, the risks relate to the Council ultimately not being repaid the full/all of the loan made and therefore having to pick up the costs of any shortfall if that were to happen – which would be a cost to its revenue budget.

10 In saying the above, the due diligence and loan security which the Head of Law and Regulation and Head of Finance will need to undertake should minimise the risks to the extent possible. The use of any interest surplus to establish a small risk reserve for this will provide some cover/mitigation. External advice will be sought where necessary when reviewing their financial appraisal and loan security arrangements.

11 In brief, the risks relate to those which may occur between (i) approving the funding agreement and completion of the scheme and (ii) those which then occur at the repayment date of the funding agreement.

12 In the case of the former, key risks are cost overruns and/or unforeseen events resulting in significant delays in completion of the scheme which in itself could lead, ultimately, to losing existing agreed tenants.

13 In the case of the latter, key risks are that (i) the scheme does not realise its target value and GB do not receive sufficient funds to repay the Council or (ii) are unable to sell/re-finance the scheme at all.

- **Risks**

.1 The key risks are as follows:

Risk	Impact of Risk if it occurs* (H/M/L)	Probability of risk occurring (H/M/L)	Mitigation	Who is responsible for dealing with the risk?
Increase in Project Cost	M	L	This is a risk for GB but would subsequently increase risks for the Council Robust due diligence and review of financial appraisal Close working relationship with GB during construction phase A loan to value ratio will need	 HoF, HoL&S, HoRIH

			to be agreed so that the loan is not above scheme valuation	
Loan is not repaid	M	L	Use of risk mitigation reserve Security against building / scheme Close working relationship with GB	As above

- **Links to Council Policies and Priorities**

.1 The redevelopment of the IAC building has the potential to act as a key economic anchor and catalyst for further regeneration and investment. The redevelopment will add significant value to the Council's strategic Priorities and Policies for continued regeneration of the City Centre. City development and regeneration remains one of the Place priorities under the Improvement Plan. The development of the IAC building will create significant jobs in the local construction supply chain, reduce the deficit office and hotel bed spaces and improve the accessibility of the walking route to the city centre It will maintain confidence in the city centre and encourage further development to take place, as well as encouraging high-growth financial and professional services companies to take up space within the city centre, creating a virtuous circle of economic activity.

.2 The office units delivered will be of exemplar standard and provide bespoke accommodation for such businesses to move into the city centre of Newport. Provision for this demographic is of high strategic importance given the pressures around declining ability of a retail offer to support the activation of premises and the need to support the diversification of the city centre economy and employment base.

.3 The project supports Newport City's Economic Growth Strategy, which sets out a ten year programme for delivering growth across the city centre through capital redevelopment, upskilling, training and business support. The Council's new Corporate Plan aims of a Thriving City offering modern, sustainable and high-value employment opportunities are also supported.

.4 Funded by Newport City Council and Welsh Government, a number of key projects have been developed within the nearby city centre vicinity, including the National Software Academy within the Information Centre, 123 – 129 Commercial street and the redevelopment of Newport Market Arcade key live projects building on the Vibrant and Viable Places programme projects completed. These projects will provide a further uplift to the area but the proposed scheme is considered to be a key element in driving forward the longer term vision of an area of momentum around office and tech aspirations development.

- **Options Available and considered**

.1 To approve the in principle financial loan commitment from Newport City Council to support the redevelopment of the IAC building (22-29 Mill St).

.2 To not approve the principle financial loan commitment from Newport City Council, leaving the redevelopment of the IAC building (22 – 29 Mill St) unable to proceed.

- **Preferred Option and Why**

.1 To agree the on loan arrangement in principle. As mentioned above, the redevelopment of the IAC building is a significant investment that is critical to the future of the city centre. It will bring a key economic anchor to the Northern end of the city, stimulating the creation of further high-quality office space and encouraging further investment and footfall into the city centre. Ancillary benefits include the creation of construction jobs, training opportunities, and financial benefit to local construction companies. The property is obsolete in its current manifestation and serves little purpose other than to demean perceptions of the city centre to its visitors. If Newport is to maintain the momentum generated by the regeneration of the city centre then it is vital that aspirational and transformational developments such as the proposal for the IAC building are secured and delivered.

- **Comments of Chief Financial Officer**

The main financial issues have been set out in the report, including the financial risks which, ultimately, are that the Council does not recover some/all of its loan, resulting in a cost against its revenue budget. Due diligence and loan security are yet to be completed / agreed but these should ensure that risks are mitigated to the extent they can.

There should be no financial impact on the Councils budgets from this point to the loan repayment, assuming that no MRP costs are chargeable against this loan. This was achieved for the Friar's Walk loan and therefore we anticipate that it should apply here again.

It will be important to mitigate financial risk wherever possible and it is recommended that any surplus interest is put into a risk reserve for this loan, following a similar practice for the Friar's Walk loan. As this loan is very much smaller – it will be a relatively modest amount but will still nonetheless provide some risk mitigation.

- **Comments of Monitoring Officer**

The Legal issues relating to the loan are set out in the body of the Report. The proposed action and funding arrangements are in accordance with within the Council's discretionary legal powers under Section 2 of the Local Government Act 2000 and are entirely consistent with strategic regeneration policies and corporate objectives. Having regard to the regeneration benefits of the development in terms of economic "well-being" and the proposed safeguards and securities within the proposed Funding Agreement to mitigate the financial risks involved, it would not be unreasonable for the Cabinet to exercise its discretionary powers in this way to approve the loan funding.

- **Comments of Head of People and Business Change**

The proposed development is situated in a key gateway location highly visible to train passengers arriving in the city centre. The existing building is obsolete and has no productive purpose or contribution to the local economy. The proposed development would address the identified need for high quality modern office space and hotel accommodation and its city centre location would help to support the continued regeneration of the surrounding area, building on the Friars Walk development and also complementing the Market Arcade scheme, the National Software Academy, and the International Convention Centre at Celtic Manor. The proposed scheme is also very much in line with the Economic Growth Strategy, the City Centre Masterplan and draft Local Wellbeing Plan. Paragraph 24 of this report summarises the positive implications for wellbeing and sustainable development, particularly in terms of employment opportunities, economic growth and the regeneration of a key brownfield site.

- **Comments of Cabinet Member**

Cabinet Member for Regeneration and Housing has approved the report.

- **Local issues**

Allt-yr-yn members have been consulted.

- **Scrutiny Committees**

Not applicable

- **Equalities Impact Assessment and the Equalities Act 2010**

The Equality Act 2010 contains a Public Sector Equality Duty which came into force on 06 April 2011. The Act identifies a number of 'protected characteristics', namely age; disability; gender reassignment; pregnancy and maternity; race; religion or belief; sex; sexual orientation; marriage and civil partnership. The new single duty aims to integrate consideration of equality and good relations into the regular business of public authorities. Compliance with the duty is a legal obligation and is intended to result in better informed decision-making and policy development and services that are more effective for users. The development proposed at the IAC building will meet the requirements of modern, accessible employment and hotel space in full and therefore comply with an identified need for people with protected characteristics in a sustainable and accessible location. It is therefore considered that the development would have a positive impact.

- **Children and Families (Wales) Measure**

Not applicable.

- **Wellbeing of Future Generations (Wales) Act 2015**

.1 The Well-being and Future Generations (Wales) Act seeks to improve the social, economic environmental and cultural well-being of Wales. Public bodies should ensure that decision take into account the impact they could have on people living in Wales, in the future. The 5 main considerations are:

- Long term: Funding regeneration schemes in the short term will enable the local economy to grow and sustain jobs and new housing in the longer-term, leading to a more prosperous and resilient Newport with cohesive communities and a more prosperous Wales.
- Prevention: Regeneration will prevent further decline in key parts of the City. Resultant new job creation will help reduce unemployment rates leading to a more prosperous and resilient Wales.
- Integration: Improving the physical environment will make the City more attractive to investors and residents. Creating more jobs and office space will improve the well-being of Newport's residents by providing access to a range of business opportunities. This will create more resilient and cohesive communities who are well served by suitable housing and employment opportunities.
- Collaboration: We work closely with other Council departments and external partners including Welsh Government to deliver regeneration priorities in Newport. This leads to a more prosperous and resilient Wales with more cohesive communities.
- Involvement: All the recommendations in this report fully support the findings of the recent Your Newport Survey. This helps develop a more prosperous, resilient Wales with sustainable and cohesive communities.

.2 The proposal is in line with the Council's well-being objectives published in March 2017. Specifically, these proposals contribute to the following well-being objectives:

"Promote economic growth and regeneration whilst protecting the environment"
"To enable people to be healthy, independent and resilient"
"To build cohesive and sustainable communities"

- **Crime and Disorder Act 1998**

.1 Section 17(1) of the Crime and Disorder Act 1998 imposes a duty on the Local Authority to exercise its various functions with due regard to the likely effect of the exercise of those functions on, and the need to do all that it reasonably can to prevent, crime and disorder in its area. Regeneration of the city centre has been shown to reduce the impact and incidence of crime and anti-social behaviour. The proposed uses will ensure the building has a 24 hours per day activation along with facilitating improvements to connectivity and the challenging subway route into the city in particular, which has been the location of serious criminal activity.

Consultation

Consultation is ongoing through the Newport City Centre Masterplan

Background Papers