Report

Cabinet

Part 1

Date: 13 February 2019

Item No: 11

Subject **Newport Market update**

Purpose To update Cabinet on the progress to date on the regeneration proposals for Newport Market.

Author Head of Regeneration, Investment and Housing

Ward City Wide

Summary In July 2018, the Council's Cabinet approved a £12 million redevelopment proposal from the development company – Loft Co, to regenerate and revitalise Newport Provisions Market. The Cabinet approval was subject to detailed due diligence work by the Council's Head of Finance and Head of Law & Regulation. This due diligence work is now complete, and Council officers are currently negotiating heads of terms with the developer on the basis of a 250-year lease, and an associated funding agreement.

Proposal To request that Cabinet

(1) note progress made on the scheme to date and the satisfactory outcome of the Legal and financial diligence work;

(2) Confirm their agreement to the grant of the proposed development lease and loan funding on the terms set out in this Report;

(3) Authorise the Head of Law & Regulation and Head of Finance to finalise and complete the necessary legal and financial documentation

Action by Head of Regeneration, Investment and Housing

Timetable Immediate

This report was prepared after consultation with:

- Strategic Director - Place
- Head of Finance – Chief Finance Officer
- Head of Law and Regulations – Monitoring Officer
- Head of People and Business Change

Signed

Background

Current Context

The issues affecting the High Street are well documented, with the contraction of the High Street retail offer in direct response to sustained falls in demand for traditional retail opportunities also evident in Newport. Due to a range of locational, economic and demographic factors, areas of the city that are over-reliant on traditional retail models have inevitably been more deeply affected by the decline of High Street retail.

The solution, for cities such as Newport struggling to match demand for retail property with shopping demand, is to diversify the High Street and seek to encourage new uses that complement what retail provision remains viable in 2019 and beyond. In successful cities, greater office, housing and leisure provision now feature prominently in areas once dominated by shops.

Traditional indoor markets are even more vulnerable to the issues driving contraction of the High Street, with the market for convenience and food shopping now dominated by major chains who are able to provide these services 24 hours a day. Markets country-wide have struggled to continue to provide an offer relevant to consumers without significant investment and diversification of the offer, the trading environment and visitor experience.

As one of the most prominent and recognisable buildings in the city, the Council has previously invested in improving the commercial environment within Newport's Indoor Market, with a £1m refurbishment of the entrance and forum completed alongside extensive public realm enhancements to the adjacent High Street, in 2012/13.

Further investment was made in 2016, where a £500,000 Vibrant and Viable Places project jointly delivered by NCC and Newport City Homes saw 17 flats, comprising the Griffin House complex above the Market, refurbished. Key attractors such as Tiny Rebel, the Escape Rooms, Coleg Gwent and IndyCube have also been supported to take up space at the market buildings to diversify the offer, encourage footfall and expenditure.

However, despite these investments, the market continues to experience significant challenges. The building does not trade to its full potential with vacancy rates becoming a persistent issue and rental income declining. Twenty seven of the eighty six units are currently vacant, reflecting a 19% decrease in revenue income since 2015/16 and evidencing a continued decline despite ongoing efforts to sustain the existing offer. The cost of maintaining the structural fabric of the building is also commensurate with its age, further complicated by the building's listed status

It is therefore clear that the building requires an innovative solution, which generates the scale of capital investment required that also diversifies the offer within the market to secure a sustainable, viable future for the building.

Developer Proposal

In late spring 2018, the Council received interest from a developer – Loft Co, a South-Wales property development company, with prior experience in the re-imagining and re-use of heritage properties. The company's portfolio to date includes redevelopment of the Tramshed in Cardiff, Pumphouse in Barry and Jennings building in Porthcawl.

Loft Co approached the Council with a regeneration proposal for the Market, which would deliver a complete refurbishment of the building, whilst diversifying its future use. The development offer included the following key proposals:

- Continued provision of a high-quality traditional indoor market; although reduced in size by approximately 40 per cent (compared to the existing scale of provision), the market will still be able to support existing tenants and a number of new tenancies.
- A food court, sitting alongside the market stall provision
- Provision of incubation, start-up and collaborative business space on the mezzanine floor, with the aim of attracting knowledge-intensive businesses, and specifically digital and technology companies
- Provision of new, mixed-tenure 64 one and two-bedroom residential units
- Creation of 16 serviced apartments

Loft Co has given a commitment that all current market traders will be offered a unit within the new development, although they might be relocated within the building due to the current number of units being reduced to a more viable number. The developer has held discussions with the association and this will continue through the development and implementation phases. Assessments of market rental figures will be considered and negotiated by the developer, who has also committed to trading being able to continue during the development works.

The total cost of the proposed development is £11.5m (£12.3m including professional and finance fees), with a final GDV (gross development value) of £14.9m. To facilitate the development, Loft Co has requested from the Council:

- A 250-year lease, based on a 15 per cent geared rental return
- A loan facility of up to a maximum of £8.9 million, based upon a commercial rate of interest over a two year period. The final quantum of the loan is, however, dependent on the type of sale that is achieved for the apartments. Loft Co is in detailed negotiations with a housing association, who have indicated that they will acquire all 68 apartments. This would result in increased security for the Council and potentially a reduction in the size of loan required to approximately £3.30m.

The developer will pay a market rate of interest and this will need to be used to fund the Council's own cost of borrowing plus other costs related to accounting requirements.

Cabinet Approval & Progress to Date

In July 2018, Cabinet gave approval to the above proposal subject to detailed financial and legal due diligence. The approval also agreed that the Head of Finance and Head of Law & Regulation were given delegated authority to complete the due diligence work to support the development and negotiation of the associated lease and funding agreements.

The due diligence work has been completed; giving consideration to the economic and social regeneration benefits against financial risk for the Council, and has included a commercial review. The work has been undertaken by the Heads of Finance, Law & Regulation in consultation with Newport Norse. The due diligence work has also been validated by an independent consultant as set out below.

Since the original approval by Cabinet, Council officers have engaged in regular dialogue with the Market Traders Association, relaying any issues to the developer.

Due Diligence

Development Appraisal

Newport Norse reviewed the appraisal provided by the developer and concluded that:

- The income and yields were reasonable on current market evidence
- Void level allowance for market stalls considered prudent

- There is a lack of evidence of the demand for the collaborative working space as this is a new concept for Newport
- Construction costs are within the reasonable range expected although professional fees are lower than expected
- Adequate provision has been made for compensation for existing market tenants but no allowance for buy back of Griffin House

Overall the project is viable based on the information provided. Recent cash-flows provided by the developer following enhanced discussions with the Housing Authority show that the project costs are still projected to be in line with that included in the original appraisal.

Financial Appraisal

The redevelopment is to be undertaken as a joint venture involving DS Holdings (Penarth) Limited (DSHP) and WRW Developments Limited (WRW). Newport City Council finance staff undertook a high level review of both companies' accounts and their group companies, including carrying out credit searches on the appropriate directors. These did not show up any significant issues, and with discussions with the director of DSHP, we were able to resolve any items outstanding.

As well as this, a substantial independent financial review was undertaken on both parties of the joint venture, examining:

- The group structure and ownership
- Review of consolidated accounts
- Trading Review
- Balance Sheet and cash-flows
- Current borrowing facilities and securities the companies have

In summary the report found that:

DSHP

- DSHP have a clear track record for the development of, often listed, existing buildings and turning them into vibrant commercial, leisure and residential values.
- Developed a strong reputation for delivering with several councils in South Wales.
- DSHP currently has a strong balance sheet.
- The business is in process of disposing of several residential properties as it refocuses on commercial property development, this will further reduce debt and would improve the loan to value ratio.
- The business is operating and projected to operate within the current bank covenants.
- As DSHP is a privately owned business, NCC may wish to put restrictions on dividends being paid during the project construction period.

WRW

- WRW is well established family owned construction company with a broad range of contracts.
- Principal trading business is construction.
- The group has been profitable over the last few years and has seen turnover grow in line with or ahead of its peer group
- Growth has seen complexity and size of projects increase
- Strong pipeline of projects to underpin the projections
- In last 12 months some project issues have led to cash flow issues, but these have been addressed through additional funding which is being rapidly repaid.
- If expected projects come through and the current contract issues are in the past, the business should be profitable with cash flow improved from its current position.
- As with DSHP, NCC may wish to put restrictions on dividends being paid during the construction period.

In summary, both the internal finance appraisal and external appraisal did not highlight any significant issues, and gave indications of growing companies with strong balance sheets and sound track records of delivery.

There are, as with any development projects risks associated with providing loan funding, but these are mitigated by undertaking the review of the project and the finances of the companies, and will be reflected in the interest rate charged. The Cabinet is now advised, that given the outcomes of this due diligence work, to support progression of the project in line with the previously agreed approval.

In any dispute, the SLT will conclude on whether the risk appraisals are of sufficient quality.

Risk	Impact of Risk if it occurs* (H/M/L)	Probability of risk occurring (H/M/L)	What is the Council doing or what has it done to avoid the risk or reduce its effect	Who is responsible for dealing with the risk?
Reputational risk if this scheme is not delivered	High	Low	Significant consultation and review processes have been put in place internally and externally in order that any risk is mitigated.	Head of Regeneration, Investment and Housing Head of Finance Head of legal
Risk that loan would not be repaid	High	Low	Funding will only be provided as the works are completed and on receipt of satisfactory invoices and QS reports. Significant independent review has been undertaken on the credit history of both companies, and show good history of repayment of previous loans including those made by another local authority. Newport Norse Ltd has carried out a project appraisal on the project costs and gross development value. Showing a scheme that has potential to finance the debt provided. The Council will have security for the loan facility in the form of a legal charge registered against the lease, together with "step-in" rights under the development agreement and the pre-sale agreements with the RSL, in the event of any default in repayment.	Head of Finance

* Taking account of proposed mitigation measures

Links to Council Policies and Priorities

It meets Newport's Corporate Plan through Thriving Cities and commitment 13 a regenerated City Centre.

It meets the well-being and Future Generations Act by enhancing Newport's prosperity and thus the prosperity of Wales

This Economic Regeneration Project fits with the City Centre Masterplan as part of the Regeneration of the Northern Gateway.

Options Available and considered

Option 1

To request that Cabinet

(a) note progress made on the scheme to date and the satisfactory outcome of the legal and financial diligence work;
(b) Confirm their agreement to the grant of the proposed development lease and loan funding on the terms set out in this Report;
(c) Authorise the Head of Law & Regulation and Head of Finance to finalise and complete the necessary legal and financial documentation

Option 2

That cabinet note the report and the outcome but do not agree to the grant of the proposed development lease and loan funding.

Preferred Option and Why

Option 1

To request that Cabinet

(a) note progress made on the scheme to date and the satisfactory outcome of the legal and financial diligence work;
(b) Confirm their agreement to the grant of the proposed development lease and loan funding on the terms set out in this Report;
(c) Authorise the Head of Law & Regulation and Head of Finance to finalise and complete the necessary legal and financial documentation

The proposal will result in the delivery of a significant City Centre Regeneration project, protecting the long-term future of the market, and acting as a catalyst for the regeneration of High Street.

Comments of Chief Financial Officer

There has been extensive and independent due diligence carried out for this scheme and no issues have been raised.

The Council will need to ensure it has appropriate levels of security and guarantees secured with the developer to safeguard its investment. There is an inherent risk linked to the making of any loans of this nature and these will continue and change as the project progresses. Similar to Friar's Walk, the Council will need to establish formal governance and project arrangements with the developer.

The Council must charge a market rate of interest, taking account of a number of issues, including risk. This will be dependent, to an extent, on the size of loan the developer will finally require, up to the maximum approved here.

Comments of Monitoring Officer

The proposed action is in accordance with the Council's legal powers under section 123 of the Local Government Act 1972 and section 2 of the Local Government Act 2000. The Council is able to grant a 250-year development lease to the Developer, subject to and with the benefit of the current Newport City Homes leases and the occupational market tenancies. The Council has a duty under section 123 to secure the best price reasonably obtainable for such a "disposal". Although there will be no capital premium payable for the grant of the lease, the developer will the take on all repairing and insuring obligations in relation to the market buildings and has also agreed to pay the Council a 15% geared rental based on the gross rental received, less loan interest payments. Norse have confirmed that this geared rental would secure market value for the grant of the lease, as the Council would effectively share in the future rental growth and, therefore, the terms of the lease are compliant with section 123. Because this is effectively a property-related agreement, rather than the Council procuring a development partner, then there is no requirement to undertake any competitive tendering or procurement process, provided that the negotiated terms represent value for money and the development is considered to be socially and economically beneficial.

Cabinet has also agreed, in principle, to the Council providing development funding in accordance with its "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. It is for the Council to decide whether any particular action would be likely to achieve this. In exercising this power to promote well-being, the Council must have regard to its community strategy and any statutory Guidance issued by the Welsh Government. Although the Council cannot use its section 2 powers to raise money under section 3(2), it is able to charge interest on any loan funding, provided that the financial return to the Council is incidental to the main purpose of the loan.

The Council also has to ensure that the proposed loan funding does not contravene European State Aid rules, to the extent that it uses public funding to secure an unfair commercial advantage for the developers and is, therefore anti-competitive. If the Council was to provide low-cost funding to the developers on 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. 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 (MEIP). 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.

To satisfy the MEIP requirements, a commercial rate of interest will need to be charged for the loan funding, which is commensurate with the degree of investment risk involved. In assessing the degree of "return" on the Council's investment, the "profit-share" built into the geared rental under the lease can also be taken into consideration, as well as the payment of interest. The scheme has been independently valued and, although the value will not be realised until the development has been completed, adequate security can be provided for the funding by way of a first charge on the lease and step-in rights under the development agreement and the pre-sale agreement with the RSL. This would ensure that, if there was any default, the Council could step into the shoes of the developers in order to secure the repayment of its loan funding.

The proposed terms of the loan agreement and the priority return and "profit-sharing" arrangements in the Lease are considered to be sufficiently robust as to satisfy the MEIP requirements and comply with State Aid rules. The lower the amount of development funding required by the developers, because of capital receipts secured through the pre-sale agreements for the housing units with an RSL, then the lower to commercial risk to the Council and a lower rate of interest can then be justified for the loan.

In the circumstances, having regard to the benefits of the development and the safeguards to mitigate the attendant financial risks involved, it is not considered to be unreasonable for the Council to exercise its discretionary powers in this way.

Therefore, it is recommended that Cabinet agree to the completion of the necessary legal and financial documentation, on terms to be agreed by the Head of Law & Regulation and Head of Finance. The development agreement, lease and funding agreements will all be conditional upon satisfactory planning and listed building consent being obtained for the scheme.

Comments of Head of People and Business Change

The report sets out proposals for the regeneration of the Market intended to secure a sustainable and viable future for this key city centre asset. Whilst the proposal would change the use of the building the core trading function would be retained in addition to new housing units, office space and visitor accommodation. These developments would make a significant contribution to the economic, social, cultural and environmental wellbeing of the city, are consistent with the City Centre Master Plan and sustainable development principles.

There are no human resources implications arising from this report.

Comments of Cabinet Member

I am satisfied that the requirements to proceed to the next stage have been met including appropriate stakeholders trading within the Market. It is essential that this process continues as a key for the successful regeneration of the "Newport Gateway" including the High Street as an essential component of the continuing regeneration of the city.

Cllr Mark Whitcutt Deputy Leader and Cabinet Member for Assets and Member development

Local issues

City Wide Programme.

Scrutiny Committees

Performance Scrutiny Committee reviewed the City Centre Masterplan

Equalities Impact Assessment and the Equalities Act 2010

FEIA Newport Market v0.2.docx

Children and Families (Wales) Measure

Newport City Council does not for see any negative impact on children and young people

Discussions have been undertaken with the potential developer who will look to engage any potential audience in gaining their views

Wellbeing of Future Generations (Wales) Act 2015

Long Term – This offer provides a sustainable future for a key City Centre building that is listed and provides a different and important offer within Newport

Prevention – The Market building has listed status and any potential development will include considerable upgrade of those key elements and will remove the current maintenance backlog.

Integrated – The City Centre Masterplan denotes the Northern Gateway and the Market building as a key economic anchor. This potential offer will have a positive impact on integration and wider Regeneration.

Involvement – throughout the process there has been significant consultation with Key Stakeholders. The Market Traders Association has acted as a key conduit for that engagement alongside wider groupings within Newport.

Collaboration – Newport City Council have worked in partnership with a number of organisations to develop this potential offer, amongst these are Newport City Homes, SMEs, Market Traders, Market Traders Association and Welsh Government.

Crime and Disorder Act 1998

Not applicable

Consultation

This project was part of a city wide consultation based around the City Centre Masterplan

Background Papers

Presentation to cabinet

Dated: 31/02/19