

# Report

## Cabinet

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### Part 1

Date: 21<sup>st</sup> December 2016

Item No:

**Subject Friars Walk**

**Purpose** To confirm the rationale for the Cabinet decision taken at the special meeting on 28<sup>th</sup> October 2016, to update Cabinet on the progress made to date, and also confirm the fall-back position in the event that the proposed sale does not proceed

**Author** Head of Law & Regulation

**Ward** General

**Summary** Cabinet meeting on 28th October 2016 received a confidential Part 2 presentation regarding a number of options for the sale or re-financing of Friars Walk. Having considered the detailed legal and financial implications of the various proposals, Cabinet agreed that there were only two viable options at the present time – a sale to the Talisker Corporation, a Canadian equity investment company, or a re-financing of the loan by the Council.

Cabinet agreed that the preferred option was a sale to Talisker, on commercial terms, which represented the best market price obtainable for the scheme at the present time. This was clearly demonstrated by the market testing carried out by QRE and comparability with proposed sale terms offered by other potential investment purchasers. The Talisker proposals would enable the Council to discharge the primary loan debt and interest charges. Therefore, officers were instructed and authorised to agree the detailed terms and finalise the necessary documentation for the delivery of the proposed sale to Talisker, with a target completion date early in the New Year.

However, Cabinet recognised that, if the Talisker deal did not complete, for whatever reason, then the fall-back position for the Council would be to take control of the asset itself, re-finance the debt and utilise the net operating income from the scheme to service that debt until such time as a new buyer could be found.

Such a decision to re-finance the Council debt and take control of the property would be a decision for full Council, not Cabinet, because it would fall outside the terms of the original funding approved for this scheme, which was to secure the completion of the development. Therefore a report would need to be taken to Council in due course, should it be necessary, to consider the default position.

**Proposal** To note the Report and endorse the default position of reporting back to full Council with a recommendation that the Council takes control of the asset and re-finances the loan itself, in the event that the preferred sale does not proceed.

**Action by** Head of Law & Regulation and Head of Finance

**Timetable** In accordance with the timescales set out in the Report

This report was prepared after consultation with:

- Chief Executive
- Head of Finance
- Corporate Director – Place

**Signed**

## Background

1. Cabinet meeting on 28<sup>th</sup> October 2016 received a confidential Part 2 presentation regarding a number of options for the sale or re-financing of Friars Walk. Having considered the available options and having regard to the confidential legal and financial advice set out in the presentation and accompanying documents, Cabinet resolved:-
  - (a) That the preferred option for the sale of Friars Walk be agreed on the basis of the proposals outlined at the meeting;
  - (b) That the Head of Finance and Head of Law and Regulation be authorised to agree the detailed terms and finalise the necessary documentation for the delivery of the preferred option.
2. Although the terms of the proposed sale remain strictly commercially confidential, this Part 1 Report confirms, for the purposes of openness and transparency, the rationale for the Cabinet decision, updates Cabinet on the progress made to date, and also confirms the fall-back position in the event that the proposed sale does not proceed.
3. On 30<sup>th</sup> September 2011, the Council entered into a conditional Development Agreement with the preferred bidders for the Friars Walk redevelopment scheme, Queensberry Real Estate (Newport) Limited ("QRE"). The heads of terms for the Development Agreement were approved by Cabinet, following a competitive procurement process
4. The Development Agreement provided for the grant of a 250 year development lease from the Council to QRE at a peppercorn rent when various pre-conditions were satisfied and the Agreement went unconditional. The Agreement and Lease required QRE to complete the approved development in accordance with the agreed programme of work. The Agreement and Lease also required QRE to use their reasonable endeavours to maximise development profit upon the sale of the asset and to secure market value.
5. On 26<sup>th</sup> November 2013, full Council agreed to provide QRE with development funding to deliver the scheme, on commercial terms to be agreed by the Head of Finance and the Head of Law and Standards and subject to satisfactory due diligence and financial appraisal. The Head of Finance was authorised to prudentially borrow up to £90 million for this purpose.
6. The Funding Agreement with QRE was completed on 13<sup>th</sup> December 2013, with the Council loan being repayable 12 months after Practical Completion of the Scheme. Repayment of the Council loan was secured by a charge against the 250 year Head-Lease. This Head Lease was completed in January 2014 and granted to Friars Walk Newport (Limited) ("FWN") a separate special purpose vehicle and subsidiary company of QRE. The Council loan charge has been secured against the registered title to the Head Lease.
7. Practical Completion of Friars Walk was achieved in December 2016, following a phased handover and sectional completion of the work. Therefore, under the terms of the Funding Agreement with the Council, the full amount of the loan, becomes repayable in December 2016. Failing this, QRE will be in default under the Funding Agreement and security documents and the Council will be entitled to enforce its legal rights under the charge over the Head Lease.
8. QRE have been marketing the scheme with potential investors for the past 12 months and also looking at the options for re-investment. The scheme is now 86% let and negotiations are at an advanced stage with another major retailer in relation to the one remaining major store unit which would then take the letting value up to 96%.
9. The original development loan was approved by the Council in exercise of its general powers of "well-being" under Section 2 of the Local Government Act 2000. The primary purpose of the loan was to secure the wider social and economic benefits of the scheme in terms of regeneration,

inward investment and employment. This has been achieved in that the Scheme has been built and 86% let, over 1200 new jobs have been created and it has delivered a significant step-change in the regeneration of the City Centre. Therefore, the one remaining issue is to secure the best terms for the repayment of the Council loan

10. The presentation to Cabinet on 28<sup>th</sup> October 2016 set out a number of potential options for the sale of the scheme or re-financing of the Council loan. Having considered the detailed legal and financial implications of the various proposals, Cabinet agreed that there were only two viable options at the present time – a sale to the Talisker Corporation, a Canadian equity investment company, or a re-financing of the QRE loan by the Council.
11. Cabinet agreed that the preferred option was a sale to Talisker, on commercial terms, which represented the best market price obtainable for the scheme at the present time. This was clearly demonstrated by the market testing carried out by QRE and comparability with proposed sale terms offered by other potential investment purchasers. The Talisker proposals would enable the Council to discharge the primary loan debt and interest charges. Therefore, officers were instructed and authorised to agree the detailed terms and finalise the necessary documentation for the delivery of the proposed sale to Talisker, with a target completion date early in the New Year.
12. However, Cabinet recognised that, if the Talisker deal did not complete, for whatever reason, then the fall-back position for the Council would be to take control of the asset itself, re-finance the debt and utilise the net operating income from the scheme to service that debt until such time as a new buyer could be found. The alternative options for seeking private sector re-finance for the loan debt were discounted on the basis that it would be more cost-effective and involve less financial risk if the Council took control of the asset and re-financed the borrowing itself.
13. Since the Cabinet decision, further negotiations have been on-going between the Council, QRE and Talisker and signed heads of terms were exchanged, subject to contract, on 17<sup>th</sup> November 2016. This grants exclusivity to Talisker in terms of the sale process, subject to legal and financial due diligence. The precise terms of the proposed transaction remain strictly commercially confidential pending completion of the sale. The work is now continuing with a view to finalising terms and completing the legal documentation early in the New Year. If the sale is concluded satisfactorily, then FWN and the head-lease of Friars Walk will be sold by QRE to a special purpose vehicle company, owned by Talisker, and the purchase price would be utilised to discharge the Council's primary debt and loan charges.
14. If, for any reason, the sale to Talisker does not complete, then QRE would be in default of the Funding Agreement by not repaying the development loan by the due date and the Council would then have a number of options in terms of enforcing the debt and its legal charge over the Friars Walk Head Lease. Cabinet recognised that the alternative option of the Council re-financing the loan itself would be the default position if the preferred sale fell through.
15. The default option would involve the Council enforcing its security under its charge and taking control of the asset, in order to safeguard the value of its investment. The net operating income from the rents payable by the tenants would be used to finance the Council's loan charges until the asset could be sold.. The confidential financial appraisals reported to Cabinet confirmed that this was a viable default position for the Council, given the levels of rental income being generated by the scheme
16. However, such a decision to re-finance the Council debt and take control of the property would be a decision for full Council, not Cabinet, because it would fall outside the terms of the original funding approved for this scheme which was to secure the completion of the development.

## Financial Summary

17. The financial implications of the proposed sale and the default position remain commercially confidential at this stage. However, both options are considered to be financially viable and sufficient to discharge the Council's fiduciary duties in relation to the use of public funding.

## Risks

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?
The preferred sale to Talisker does not complete	L	M	The fall-back position would be a Report to Council recommending taking control of the asset and re-financing the loan debt, pending a future sale of the scheme.  The rental income from the scheme is sufficient to service the Council debt charges, pending a future sale	Head of Law& Regulation and Head of Finance
There is insufficient rental income to service the debt	L	L	The scheme is already 86% let and negotiations are on-going for a further major letting which would secure 96% of the rental income.	Head of Law& Regulation and Head of Finance

\* Taking account of proposed mitigation measures

## Links to Council Policies and Priorities

The redevelopment of the City Centre as an attractive place for shopping, leisure and tourism is an essential component of the Corporate Plan in terms of making Newport a Safer City and a better place to live for all our citizens.

## Options Available and considered

- (1) To note the Report and endorse the default position of reporting back to full Council with a recommendation that the Council takes control of the asset and re-finances the loan itself, in the event that the preferred sale does not proceed.
- (2) Not to note and endorse the approach outlined in the Report.

## Preferred Option and Why

To note and endorse the approach outlined in the Report, as this represents the most viable option for the Council and safeguards the Council's financial interest in the scheme.

## Comments of Chief Financial Officer

Finance comments are contained in the report. Further due diligence will need to be carried out by the Council if the asset was to be re-financed by the Council.

### **Comments of Monitoring Officer**

Set out in the Report.

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

This section **MUST** be completed by the Head of People and Business Change. This must be done before the report is submitted to any elected member for consideration. The Head of People and Business Change will discuss any staffing, performance, or policy matters along with the Well Being of Future Generations requirements. (See the section on this Act below)

You will have consulted the Head of People and Business Change to complete the 'Background' section above. This section should confirm that has been done and that the Head of People and Business Change is comfortable with the proposals.

### **Comments of Cabinet Member**

The Leader has approved this Report for consideration by Cabinet.

### **Local issues**

The matter is of general importance.

### **Scrutiny Committees**

Not applicable at this stage.

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

There are no equalities implications.

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

There are no implications specifically for children and young people.

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

The proposed action is in accordance with the sustainable development principle and, in particular, the longer-term financial and regeneration objectives of the Council, in terms of social and economic well-being.

### **Crime and Disorder Act 1998**

There are no specific crime and disorder implications.

### **Consultation**

Not applicable

### **Background Papers**

The background papers remain commercially confidential at this stage.

Dated: 8<sup>th</sup> December 2016