Report

Cabinet

Part 1

Date: 19 July 2017

Subject Sale of Friars Walk

Purpose To confirm the completion of the sale of Friars Walk and the repayment of the Council loan debt and to advise Cabinet about the detailed terms and conditions of the transaction

Author Head of Law & Regulation

Ward General

Summary The sale of Friars Walk was completed on 9th June 2017. Cabinet had previously agreed the preferred option of a sale to the Talisker Corporation, a Canadian equity investment company, on commercial terms, which represented the best market price obtainable for the scheme at the present time. This had been demonstrated by market testing and comparability with proposed sale terms offered by other potential investment purchasers. The Talisker proposals enabled the Council to discharge its primary loan debt and interest charges.

Cabinet have received a number of confidential Part 2 presentations, setting out the precise financial and legal implications of the Talisker deal, but that information has remained commercially confidential, whilst negotiations were on-going and pending completion of the transaction. Now that the matter has completed, this report contains a detailed analysis of the terms and conditions of the sale and, for the purposes of openness and transparency, confirms the financial and legal basis for the various decisions that have been taken.

The sale of Friars Walk involved a complex tripartite arrangement between the Council, Talisker and Queensberry, and their various group companies. The Talisker proposal was effectively a phased purchase scheme, with the Council receiving a capital sum £83.5 million from Talisker on completion, together with a further sum of £1.039m from the Friars Walk Rent Account, in settlement of the Queensberry development loan and interest. This capital payment was sufficient to discharge the Council principal debt of approximately £82 million.

In addition to the capital lump sum, the Council is also guaranteed an additional £7.5 million through a priority rent-share agreement with Talisker, giving a total repayment of approximately £92 million, although the time-scale for payment will depend on the future net operating income from the scheme. Although the Council was required to “write-off” the balance of the loan debt and rolled-up interest due from Queensberry, this will be recoverable in due course through the cash-flow “waterfall” in the Agreement between the Council and Talisker. In effect, the Council has converted the full interest payment on the Queensberry loan into a rent-share with the new owners going forward, so the full amount will be repayable.

Proposal **To note and endorse the contents of this Report regarding the terms and conditions of the sale of Friars Walk**.

Action by Head of Law & Regulation and Head of Finance

Timetable In accordance with the timescales set out in the sale documents

This report was prepared after consultation with:

- Leader of the Council
- Chief Executive
- Head of Finance
- Corporate Director – Place

Signed

Background

1. The sale of Friars Walk to the Talisker Corporation, a Canadian equity investment company, was completed on 9th June 2017. Cabinet have received a number of confidential Part 2 presentations, setting out the precise financial and legal implications of the Talisker deal, but that information has remained commercially confidential, whilst negotiations were on-going and pending completion of the transaction. Now that the matter has completed, this Report contains a detailed analysis of the terms and conditions of the sale and, for the purposes of openness and transparency, confirms the financial and legal basis for the various decisions that have been taken.

2. Chronology

2.1 On 30th 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.

2.2 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, with any project surplus or "profit" being shared equally between the Council and QRE. It was agreed that, if there was any surplus after the repayment of the development funding and the funder's return on their investment, the Council would then have a priority return in relation to its initial Seed Funding any further development profit would then be shared equally.

2.3 However, QRE were unable to secure private sector development funding on favourable commercial terms. Although bank funding was available, the rate of return on their investment meant that there would be little or no surplus for the Council or QRE. Also, the banks were not prepared to provide senior debt funding until Friars Walk was 60% pre-let and there was a risk that further delays could affect the timescales agreed with Debenhams, as the key anchor tenants.

2.4 Therefore, on 26th 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.

2.5 The Funding Agreement with QRE was completed on 13th December 2013, with the Council providing a loan facility up to £89,110,000 (inclusive of rolled-up interest) at a fixed rate if interest of 5.95% p.a., with the loan being repayable in full 12 months after Practical Completion of the Scheme or on 1st June 2017 (whichever was the earlier). Repayment of the Council loan was secured by a charge against the 250 year Head-Lease, Guarantees from the various companies within the Queensberry Group, debentures over the Company assets and direct agreements with the contractors, Bowmer & Kirkland, and the retail tenants. The Council had step-in rights to complete the development and forfeit the Lease in the event of any default during the construction phase.

2.6 The 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 was secured against the registered title to the Head Lease.

2.7 As a consequence of the Council providing development funding for the scheme, the original profit-share arrangements in the Development Agreement with QRE were amended to provide a greater share for the Council, to reflect the public investment. In terms of the distribution of the sale price, the Council had priority for the repayment of its loan and rolled-up interest, and first call on any further monies in relation to repayment of demolition costs and seed funding. Any remaining project surplus was then to be shared between the Council and QRE in the following proportions:-

First £4 million – 80% Council, 20% QRE;
Next £4-8 million – 60% Council, 40% QRE;
Above £8 million – 50% Council, 50% QRE

2.8 Practical Completion of Friars Walk was achieved on 12th November 2015, although there was sectional completion of the various phases, with the last phase being signed off on 8th December 2015. Therefore, the Council's loan, together with rolled-up interest became repayable in full on or before 8th December 2016. Failing this, QRE would have been in default under the Funding Agreement and security documents and the Council would have been entitled to enforce its legal rights under the charge over the Head Lease. As at the repayment date in December 2016, the total QRE debt to the Council amounted to approximately £91 million, although the Council only borrowed and loaned to QRE approximately £82 million of primary debt, with the remaining £9 million being accrued interest charges.

3. Sale and Re-financing options.

3.1 QRE began marketing the scheme with potential investors immediately following the opening of Friars Walk in November 2015 and also considered the options for re-investment and re-financing of the loan, to repay the Council debt.

3.2 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 had been achieved by November 2015, in that the Scheme had been built and 86% let, over 1200 new jobs had been created and it had delivered a significant step-change in the regeneration of the City Centre. The commercial rate of return on the Council's loan, both in terms of interest payments and profit-share under the Development Agreement, were secondary issues. However, in terms of the Council's fiduciary duty, it was still necessary to secure the best possible terms for the repayment of the public funding.

3.3 QRE initially advertised Friars Walk for sale and agreed heads of terms with the Talisker Corporation early in 2016, for a phased purchase of the scheme. However, the Council was informed by QRE that those negotiations had fallen though and they intended to take the scheme back to the market in July 2016, following Brexit. In the meantime, the Council received a direct approach from Talisker to confirm that it was still interested in purchasing the scheme, albeit on revised terms.

3.4 Informal Cabinet meeting on 28th October 2016 then received a confidential Part 2 presentation regarding a number of options for the sale or re-financing of Friars Walk. The options were based on the Talisker proposals that had been submitted directly to the Council and alternative proposals identified by QRE following a second market testing exercise. There were essentially five potential options:-

(a) Sale to Talisker;
(b) Sale to [Investor A];
(c) Sale to [Investor B];
(d) Re-finance with QRE;
(e) Re-finance by the Council.

3.5 The sale to Investor A was discounted because it provided less than the Talisker offer and, therefore, could not be regarded as "best value" for an immediate sale of the scheme. Although it was a cash purchase, using equity funding and not dependent on any bank loan, the amount guaranteed was only £77 million and this was insufficient to cover the Council's primary debt of £82.2m. Any future profit-share was entirely dependent on sale values and, based on the proposed yields, the maximum that the Council would receive was £83 million, which was less than the sums recoverable under the Talisker proposals

3.6 The sale to Investor B was also discounted because it was effectively a "sale and re-purchase" agreement, with the Council retaining all risk in terms of management and rental income. In return for £83.5 million, the Council would have to enter into a non-assignable 35-40 year equity strip lease, guaranteeing an indexed linked rent of £3.5 million per annum. Although the Council would have the benefit of the remaining rental income from the scheme, it would have retained all the financial risk and could not dispose of the asset. It provided a secured income and a good covenant for Investor B, but an expensive and risky option for the Council to secure funding to discharge its development loan. It was more cost-effective for the Council to take ownership of the asset and re-finance the borrowing itself.

3.7 QRE also put forward proposals for a re-financing arrangement to enable them to retain ownership of the scheme, with a combination of Council and bank funding. This would have entailed the Council providing continuing funding of £33 million at 5.95% interest, but this would have ranked in priority behind senior bank funding for the balance of the debt. In effect, the Council would have become an unsecured subordinate lender, retaining all of the risk in terms of its £33 million loan, with the bank charge having priority over the value of the asset. Because of the level of risk, Cabinet were advised that an interest rate of £5.95% was likely to constitute unlawful state aid, as any other commercial lender providing mezzanine funding would be charging rates in the region of 10-15%. However, this option was not economically viable for QRE at a higher interest rate because there was insufficient rental income to cover the full loan repayments to both the bank and the Council and they were not putting in any equity funding themselves. Therefore, Cabinet agreed that there were fundamental legal and financial problems with this option and it should, therefore, be discounted.

3.8 This meant that the only two viable options were either a sale to Talisker or the Council re-financing the loan itself and taking ownership of Friars Walk.

3.9 Re-financing was a viable alternative option, as shown in the estimated rental values and financial appraisal, if the Council wished to retain the investment and sell the asset at a later stage when the property and financial markets had recovered sufficiently from Brexit. This would have entailed the Council effectively to "writing-off" the entire £91 million debt due from QRE and agreeing to convert this into a capital investment asset, going forward. The net operating income from the lettings would be used to finance the Council's loan charges over a period of years until the asset could be sold when the investment property market improved.

3.10 From a purely commercial viewpoint, re-financing and a future disposal could have generated a higher sale price, but Cabinet recognised there were inherent financial risks with this option. The re-financing would also have required the consent and authorisation of full Council as it fell outside the purpose of the original loan, which was to secure the completion of the development, rather than commit to any longer term investment.

3.11 Therefore, 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. Accordingly, officers were instructed and authorised to agree the detailed terms and finalise the necessary documentation for the delivery of the proposed sale to Talisker.

3.12 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. This default position was confirmed by Cabinet, following consideration of a public report, at a subsequent meeting on 21st December 2016.

4. Talisker sale

4.1 The Talisker proposal was effectively a phased purchase scheme, with a gross purchase price of £83 million and the Council receiving a net sum of £81.6 million upon completion, following deduction of committed development costs, capital incentives and transactional costs. The guaranteed minimum payment was sufficient to discharge the Council principal debt of £82 million.

4.2 In addition to the capital lump sum, the Council was also guaranteed an additional £9.1 million through a priority rent-share agreement with Talisker, giving a total repayment of £90.7 million, which was sufficient to pay off the QRE loan debt and rolled-up interest of £91 million.

4.3 The Talisker deal was more complex from a legal perspective as it involved the company purchase of FWN from QRE and with it the Head Lease, a re-assignment of the Head Lease to a Talisker special purposes company and the creation of an equity strip lease with another Talisker Company at an index-linked rental of approximately £820,000 per annum. The purchase price would be paid through a combination of Talisker equity and bank funding secured against the remaining rent under the Head Lease.

4.4 The additional £9.1 million rent-share would be paid over a number of years, depending on the net operating income generated by the scheme. The net rent income would be allocated according to the rent-share “waterfall” in the legal agreement between the Council and Talisker. Talisker would take the first £4.5 million of net rent as a priority return on their investment, with the Council receiving the next £9.1 million. Talisker would then receive the next £15 million and thereafter the rent would be shared between the Council and Talisker on a 30:70 split. Talisker would have the option of buying out the Council’s 30% rent share at a fixed yield of 6%, provided that the Council received at least £9.1million.

4.5 This required a tripartite arrangement between the Council, Talisker and QRE/FWN. QRE would sell FWN and the Head Lease to Talisker and the Council would discharge QRE from all further obligations and debt under the Development and Loan Agreements in consideration of the initial £81.6 million. Although the Council would have to “write-off” the balance of the loan debt and rolled-up interest due from QRE, that would be recoverable in due course through the cash-flow “waterfall” in the Agreement between the Council and the Talisker subsidiary Company that would take ownership of Friars Walk. In effect, the Council would be converting this interest payment on the QRE loan into a rent-share with the new owners going forward, so the full amount of debt and interest would be repayable, although the time-scale for payment would depend on the future net operating income from the scheme.

4.6 Nevertheless, QRE would have to be discharged from their liability to repay the balance of their loan. Cabinet were advised that the discharge of the balance of the debt in relation to QRE would not constitute unlawful state aid because there was no commercial profit being made by the developers due to the sale price of the asset. The shortfall between any market sale price and the amount of the outstanding loan was always identified as a commercial risk and that would be the same for any lender. There were no assets within the Development Company to enforce the balance of the debt and the only asset against which the debt could be enforced was the Head lease itself.

4.7 Cabinet were also advised that the sale to Talisker would discharge the Council’s fiduciary duty to its Council tax payers regarding the use of public money. The Council had to act reasonably, having regard to all relevant factors when taking any decision regarding the use of public funds. However, it was evident from the other potential offers and the advice of the Council's external experts, Sanderson Weatherall, that the Talisker offer represented the best price reasonably obtainable in the open market for the sale of the scheme at the present time. Therefore, it was entirely reasonable for the Cabinet to accept the Talisker proposal and it also discharged QRE from their obligation to secure market value for the sale of the scheme in accordance with the Development Agreement with the Council, albeit that there was no surplus profit to be shared. The Talisker proposal was the only sale option which enabled the Council to effectively discharge its primary debt upon completion and guaranteed payment of the total loan debt and interest over a period of years. It removed any financial risk and was consistent with the original purpose of the development loan agreed by Council.

5. Sales Process.

5.1 Following the Cabinet decision in October 2016 and the acceptance of the Talisker proposal as the preferred option, further negotiations were concluded between the Council, QRE and Talisker and signed heads of terms were exchanged, subject to contract, on 17th November 2016. This granted exclusivity to Talisker in terms of the sale process, subject to legal and financial due diligence.

5.2 The original target completion date was at the end of December 2016 and provisional figures had been calculated as at that date. However, because of the complexity of the transaction, the various company structures and tax issues that had to be resolved and the extent of the due diligence that had to be completed, the timescales for completion slipped until March 2017. In the meantime, QRE were technically in default under the repayment terms of the Funding Agreement, but the Council agreed not to take any action to enforce the outstanding debt, pending completion of the Talisker sale.

5.3 In March 2017, further discussions were held between the Council and Talisker regarding the estimated rental values used as the basis for calculating the purchase price and rental share terms. The due diligence process with QRE had identified a significant shortfall of approximately £500,000 per annum between the estimated rental values and the net operating rents being received, because of vacancy provisions and turnover rent calculations. Talisker were confident that the deficit could be turned around in the short term once the vacant units were fully let and turnover increased and they remained fully committed to the purchase. However, their bank was unable to provide the necessary gap-funding, based on the security of the current net rental figures. Talisker were prepared to increase their own equity funding and to reduce the amount of borrowing to help bridge the gap, but they needed assistance from the Council in the form of an investment subsidy agreement in order to secure the balance of the bank funding.

5.4 The investment subsidy arrangement was based on the Council agreeing to pay up to a maximum of £500,000 per annum for a fixed period of 15 years, to effectively guarantee the level of net rental required to secure the full purchase price and the bank funding. This was to be paid on a quarterly basis in advance, but subject to retrospective quarterly and annual reconciliations, so that all or part of the subsidy would be repaid to the Council if the actual net rental from the scheme increased and eventually reached the minimum required levels. The financial projections indicated that this subsidy would not be required after the first few years because of future lettings, rent reviews and growth in the scheme. In the meantime, the net interest payments received from the loan had been set aside in an earmarked reserve and this could be utilised to offset the investment subsidy. Therefore, the financial implications of the subsidy payments could be managed and mitigated, without having any significant budgetary consequences for the Council. In the event of Talisker buying-out the Council's rent-share at any time during the 15 year term, then the investment subsidy agreement would automatically terminate.

5.5 These proposals were considered by Cabinet at an informal meeting on 20th March 2017. Cabinet were advised that the investment subsidy agreement was within the Council's legal powers and it would not constitute unlawful state aid. Although the Council has the legal power to enter into financial guarantees under Section 2 of the Local Government Act 2000, if this promotes general well-being and is consistent with corporate plan priorities, this arrangement was not a rental guarantee, as such, but a contribution towards Talisker's financing costs and a commercial arm's length arrangement intended to protect the Council's investment in the asset. For the same reason, the subsidy payment would not constitute unlawful state aid because the Council was acting in the same way as a private investor in a market economy, so it satisfied the market economy investor principle. The subsidy would be repaid in whole or part once the net rental income for the scheme reached the minimum required levels.

5.6 The investment subsidy also protected the market value of the asset and preserved the sale price and the Council's rental-share. Based on agreed yields of 6%, a £500,000 reduction in net operating income effectively reduced the capital investment value of the asset, at current figures, by approximately £8.3 million. Therefore, without the agreed subsidy, the capital sum payable on completion would have been reduced to £75.2 million. Even if the full amount of the subsidy was paid for the full 15 year term (which is highly unlikely, given the scope for additional lettings, increased turnover and rent-reviews), this would only cost the Council £7.5 million, by comparison. In reality, the subsidy is only intended to cover any rental shortfall for the first few years of trading, but the additional security provided by this side agreement would safeguard the full sale price. In essence, it represented a commercial joint venture arrangement, with Talisker and the Council sharing the risk and the rewards of future investment growth.

5.7 Cabinet was also advised that, even allowing for this investment subsidy, the Talisker deal still represented best value for the Council. The comparative proposals put forward by other potential investors back in October 2016 were, again, based on the higher estimated rental values provided by QRE and the figures quoted, at the higher yields, would also have been significantly reduced because of the shortfall in net operating income. The guaranteed capital sum and future rental share provided by Talisker was still significantly higher than the alternative proposals. Although the Council still had the option of re-financing and taking ownership of the scheme itself, the reduced rental income meant that this significantly increased the inherent financial risks of this option.

5.8 Therefore, Cabinet agreed on 20th March 2017 that the Council should proceed with the Talisker deal and enter into the investment subsidy agreement.

5.9 Talisker and the bank subsequently completed their due diligence and, once the suite of legal documents had been signed-off by all of the various parties, the funding was secured and the sale was finally completed on 9th June 2017.

6. Legal Documents.

6.1 There were a large number of inter-related legal documents required to complete the transaction, because of the complex nature of the tripartite agreement between the Council, various group companies established by Talisker and QRE/FWN. The asset was owned by FWN, but was subject to a charge in favour of the Council in relation to the loan funding, while the debt was due from QRE as the developers. The corporate structure within the Talisker group and the on-going contractual relationship with the Council in relation to the rental share and subsidy arrangements also required separate legal agreements.

6.2 Talisker and QRE

(a) Share Purchase Agreement
QRE sold their shares in FWN to Friars Walk Holdings Ltd ("FWHL") (a special purpose company established by Talisker) for a nominal sum.

(b) The 250 year head-lease with the Council transferred with FWN, together with the apportioned rents received for the period following completion.

(c) The consideration for the company transfer also required Talisker to pay a capital sum of £83.5 million directly to the Council, to discharge the Council loan debt and to settle the inter-company debt between FWN and QRE.

6.3 QRE/FWN and the Council

(a) Deed of Release
This released Queensberry from their obligations as Guarantors for the Council loan and discharged the shares and other securities provided in respect of the debt;

(b) Discharge of registered charge DS1
The Council discharged its registered charge against FWN's legal title to the 250 year head lease, in consideration of the purchase monies settling the outstanding loan debt;

(c) Deed of Settlement and Release
The Council accepted the purchase monies and the balance of the monies held in the FWN Rent Account in full and final settlement of the loan debt due from QRE, discharged QRE from their obligations in the Development Agreement in terms of securing best value, and discharged QRE and FWN from all further obligations under the Funding Agreement. This effectively meant the Council "writing-off" the balance of the loan debt and accrued interest due from QRE.

The Agreement further provided for a contingency sum of £250,000 to be transferred from the FWN Rent Account to the QRE Project Account, to be used to settle any residual developers' liabilities in relation to Friars Walk. All payments would require prior approval by the Council and any unused funds would be returned to the Council as soon as possible after 6 months.

(d) Side agreement in relation to any personal tax liabilities.
The Directors of QRE required an indemnity from the Council is respect of any personal tax liabilities that may be charged by HMRC in relation to the "write-off" of the balance of the Council debt. Advice from tax consultants had already confirmed that no such corporation tax liability was likely to arise and the new owners of FWN would be primarily responsible for any such charge. However, QRE were insistent on a personal guarantee from the Council.

(e) Side agreement relating to the recovery of SDLT
QRE agreed to reclaim an advance payment of Stamp Duty Land Tax which was paid out of the Council funding as an allowable development costs but is now recoverable due to the amendments to the head lease and the fact that there is no development profit-sharing. Therefore, a further sum of approximately £50k will be repayable to the Council in due course.

6.4 Council and Talisker

(a) Deed of Variation and Assignment of Head Lease
The existing 250 year head lease with FWN was varied to remove the original profit-share provisions contained in the Development Agreement. Landlord's consent was given for the head lease to be assigned by FWN to the new Talisker holding company, FWHL.

(b) Consent to Sub-Lease
This enabled FWHL to create the equity strip lease in favour of another group company, Friars Walk LH Ltd ("FWLHL") at a fixed rental of £825,000 per annum (index linked). FWLHL receive the rents payable by the tenants at Friars Walk under their sub-leases and, after paying the fixed equity rent, retain the balance of the net income from the scheme.

(c) Investment Subsidy Agreement
The Council agreed to pay a subsidy of up to £125,000 per quarter (£500k per annum) for a period of 15 years to an associated company within the group, Friars Walk Finance Limited.

The subsidy is to be used to top-up the net rental income from the scheme to meet the minimum financial appraisal required as security by the funders.

(d) Income share agreement.
This Agreement, between the Council and FWLHL, sets out the rental share "waterfall" and the obligations in relation to the investment subsidy payments and future capital incentives. It was based on the priority returns agreed by Cabinet in October 2016, but updated to reflect the subsequent subsidy arrangements and additional Talisker equity funding. In summary,

(i) The Council received a capital sum of £83.5 million.

(ii) There is a requirement for the Council to make a £1.6 million contribution towards any capital incentives payable by FWLHL during the next 5 years in respect of letting the one vacant major store unit. This had previously been netted-off the original Talisker offer because it was assumed that the expenditure would be incurred before completion, but the Council now elected to take the money up front and to repay the capital contribution if it was required. If the £1.6 million is called upon, then it is added to the Council's priority return under the "waterfall".

(iii) FWLHL receive the first £4.25 million of net operating income;

(iv) The Council then receives the next £7.5 million of net rental income (or £9.1 million if the £1.6m capital contribution is paid out)

(v) FWLHL receive the next £15 million rental as the return on their investment;

(vi) Thereafter, all net operating income continues to be shared, with FWLHL receiving 70% and the Council a 30% share;

(vii) If the parties have not received their priority returns within the first 5 years, then the income is shared on a 70:30 basis until the Council has received its £7.5 million (or £9.1m as the case may be), to reflect the fact that Talisker require a return on their equity investment within this period. The "waterfall" then resumes afterwards, with FWLHL receiving the balance of their return.

(viii) In addition, there is a quarterly and annual reconciliation of the net operating income and, in the event that the investment subsidy of £125k is not required, then FWLHL have an obligation to reimburse the Council within 20 working days.

(ix) The rental-share agreement will bind any successive owners of the equity strip lease and there is an obligation to secure a direct deed of covenant with the Council to secure this obligation.

(x) FWLHL have the option to "buy-out" the Council's rent share at any time after 3 years, at an agreed rental yield of 6%, provided that the Council received a minimum of £7.5m (or £9.1m, as the case may be).

(e) Side agreement relating to tax indemnity
FWLHL gave an undertaking to ensure that any corporation tax liability in relation to the writing-off of the balance of the QRE loan debt will be paid or off-set against capital allowances, so as to avoid the need for any call on the Council guarantee provided to QRE (see paragraph 6.3 (d) above).

Financial Summary

7. On completion, the Council received:-

	£
Purchase Price Balance of Rent Account (less transaction costs)	83,500,000 1,039,980
Settlement Sum The difference between the settlement sum received and the total loan debt and interest due from QRE (approximately £7.5m) was effectively “written-off”.	**84,539,980**
Sums paid out on completion:- Advance payment of bus station rent Apportioned investment subsidy payment from 9.6.17 to 23.6 17.	 15,000 21,978
Net Sum	**84,503,002**

This was more than sufficient to pay off the Council’s primary debt, interest on prudential borrowings and MRP provision (approximately £82m).

In addition, a repayment of **£50k** SDLT will be made by QRE once this has been recovered from HMRC.

Any unused funds from the **£250k** contingency will also be returned by QRE to the Council as soon as possible after 6 months

Under the income-sharing arrangements with FWLHL, the Council is due a minimum additional payment of **£7.5 million** (making **£92 million**, in total), although the timing of the payments will depend on the profitability of the scheme, future turnover and rental values.

The Council has agreed to make a capital contribution of up to **£1.6m** towards specific letting costs incurred by FWLHL within the next 5 years but, if this is called on, then it is added to the rental return (giving a £9.1m priority), so the Council still receives a minimum of £92m.

The Council has also given a commitment to pay an investment subsidy of **£125k** a quarter (£500k per annum) for the next 15 years, but this will only be utilised if net operating rental income fails to reach minimum agreed levels.

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?
Rental income for the scheme fails to reach minimum levels and the Council subsidy of £500k has to be paid for the next 15 years.	M	L	There is an “open book” agreement with FWLHL to scrutinise rental income and to agree future lettings. Letting the remaining vacant units and increased turnover in the short term should improve rental income sufficiently to avoid the need for the subsidy. On a worst-case scenario, the total subsidy payments of £7.5 million are less than the £8.3m reduction in the purchase price, if the subsidy had not been provided	Head of Finance Head of Law & regulation
Rental income for the scheme fails to deliver the Council’s additional £7.5 million (or £9.1m if the capital contribution is required)	M	L	The Council will still have received a sufficient capital sum to discharge its primary debt and interest. The profit-share effectively guarantees the Council a share of net rent until the additional £7.5m has been received and an on-going 30% share if the option to buy is not exercised. The risk is really one of timing rather than not receiving the additional payment. Rent-reviews will eventually ensure that rental income increases over a period of time, but the Council may have to wait a number of years before it receives the full amount of its rental share. The “open book” arrangement with FWLHL will enable the Council to scrutinise rental income and agree future lettings. Letting the remaining vacant units and increased turnover in the short term should improve rental income.	Head of Finance Head of Law & regulation

* 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

To note and endorse the contents of this Report regarding the terms and conditions of the sale of Friars Walk Text here

Preferred Option and Why

To note and endorse the contents of this Report regarding the terms and conditions of the sale of Friars Walk

Comments of Chief Financial Officer

The financial outcomes and risks from the sale to Talisker are set out in the report. The sale to Talisker represented best value at the time of sale and all options available were assessed on the ability to repay the principal debt and rolled up interest and the future risk to the Council.

The initial sale price enabled the principal debt to be repaid in full and an element of the rolled up interest to also be repaid, with the remaining amount being replaced by a debtor in relation to future income generation.

There is a potential future payments in relation to the investment subsidy, however this is based on a maximum amount over 15 years of £7.5m, and as detailed in the report with future lettings, rent reviews and growth in the scheme it is unlikely that this subsidy will be payable after a number of years.

Throughout the process the surplus net interest receivable from the loan made to QRE has been set aside in an earmarked reserve, for any potential future risks arising from the scheme. This will be able to be utilised to offset any provision required in relation to the investment subsidy, therefore not cause any additional pressure on the MTFP.

Comments of Monitoring Officer

Set out in the Report.

Comments of Head of People and Business Change

There are no specific staffing or policy implications.

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 legal documents and agreements set out in paragraph 6 of this Report, to the extent that they do not contain commercially confidential information.

Dated: 19 July 2017