Part A

Report to:	Cabinet
Date of meeting:	8 October 2012
Report of:	Managing Director
Title:	Approval of Final Charter Place Land Transaction with delegated power to the Managing Director to enter into the necessary legal documentation

The Mayor has agreed that this report can be dealt with as a late report. The reason the report was not circulated at the time of agenda publication is based on the fact that commercial negotiations with Capital Shopping Centres (CSC) are still ongoing.

1.0 **SUMMARY**

1.1 This report provides an update across a range of specific issues that have arisen during commercial negotiations with CSC. This follows Cabinet approval on 18th June 2012 to abandon previous OJEU procurement and negotiate detailed terms with them. Further, an all members briefing was held on 27th September 2012. None of the changes are considered material enough to affect the overall recommendation to proceed with CSC. Discussions with CSC have, however, particularly further clarified their management and financial proposals in respect of the four 'satellite' car parks and it is preferable for WBC to take these back and manage them using a national car park management company.

The report is designed to highlight the new issues and considerations as possible pertinent to Cabinet to enable it to make strategic decisions on the recommendations below. However, in such complex commercial property transactions it cannot provide full commentary on all detailed negotiation matters.

1.2 Recommendations are made to finalise and complete the land transaction with CSC along with related transfer of management to them, and to enable a new management strategy for the Satellite Car Parks.

The property team have investigated and evaluated two options for Satellite Car Parks.

1. CSC's proposal to continue leasing the Satellite Car Parks, and
2. WBC taking back the car parks and procuring a car park operator to manage the car parks on behalf of WBC

Financial modelling strongly indicates that Option 2 is financially more attractive to

WBC in particular in the medium to long-term. It would also enable WBC to exercise greater control over tariffs and general management. The Satellite Car Parks are crucial in contributing to the future growth and prosperity of the town and provide core income to WBC to support service delivery budgets.

A further recommendation is made to support the principle of Compulsory Purchase, if this is necessary to enable the redevelopment, subject to a full cost indemnity with CSC.

2.0 RECOMMENDATIONS

2.1 The following recommendations effectively update those contained in the Cabinet report of 18th June.

It is recommended that the Managing Director be authorised to:

1. Complete negotiations and the suite of legal documents with CSC (including relevant subsidiary group companies) and to enter into a binding agreement for the land transaction.
2. Complete the transfer of management responsibility for the existing Charter Place shopping centre and Charter Market to CSC, including TUPE transfer of current Council staff to Europa (CSC's Facilities provider), as soon as possible linked to completion of binding lease agreements.
3. Agree commercial terms and complete legal documentation regarding CSC's surrender of the Satellite Car Parks in 2013, or if this is not achieved exercise the Council's March 2015 break notice option in the existing lease.
4. Subject to achieving a surrender on the CSC's lease of the Satellite Car Parks, to commence procurement of an external partner to manage the car parks (including structural maintenance) on WBC's behalf, if necessary taking appropriate external independent advice. In the event that a surrender cannot be agreed, to commence procurement so that a car park management contract is in place from the return of the Satellite car parks in March 2015.

Additionally, in order to facilitate the redevelopment and comply with the terms of the agreements with CSC, that:

5. Cabinet agrees in principle to support a Compulsory Purchase Order to acquire such land holdings and any rights affecting those land holdings as may be necessary for redevelopment of Charter Place and adjoining holdings on the High Street, if requested to do so by CSC, and subject to a full funding indemnity by CSC, which is to be provided as part of the suite of documents comprising the land transaction with them.

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Report approved by: Manny Lewis, Managing Director.

3.0 BACKGROUND

3.1 Activity since 18th June 2012

Since the previous Cabinet report, considerable work and negotiation has been undertaken refining the details of the Heads of Terms (HoTs) agreed between the parties. These outline the key points of the transaction but necessarily do not include more detailed legal and management issues. Charter Place is a complex building, reflected in the various legal rights and issues relating to it.

Legal and Property services have used the opportunity of the transaction with CSC to re-tender external legal advice, significantly reducing its cost by over £50k. Pinsent Mason, who have also been appointed to advise on Ascot Road, were appointed in July and have quickly and pro-actively 'got up to speed'.

As is normal for transactions of this type and scale, the Council has provided a range of 'due diligence' information to CSC. The draft suite of legal documents has been issued and detailed terms within these agreements are now being negotiated.

It was originally anticipated that CSC's lease of Charter Place, along with transfer of management responsibility, would take place on 1st October. This has not proved possible due to a small number of practical site management and related legal reasons particularly following various site inspections and surveys. Both teams remain optimistic that transfer will be achievable by the end of October.

Timing, funding and management options relating to the surrender of CSC's car park lease for the 'satellite' car parks (Palace (Charter), Gade, Sutton and Church) are discussed at section 4.5 below.

Options regarding provision, management and funding of a possible additional market are currently being explored in conjunction with the Market Working Group sub-group. WBC will need to consider whether to provide this additional market to accommodate possible demand from existing and new traders that cannot be met from CSC's 'new' indoor market. These options will be fully explored at the Market Working Group on the 9th October 2012 and in a subsequent Cabinet report currently programmed for November. It will be important to ensure that any new provision reflects realistic levels of demand from existing traders, as well as potential new ones to Watford.

4.0 DETAILED PROPOSALS

4.1 Key Heads of Terms

The core legal structure of the land transaction with CSC as previously advised to Cabinet comprised:

- a land transaction whereby WBC retains the freehold and grants a long lease to CSC for Charter Place, including the market, and the satellite car parks. The freehold of CSC's existing land interests on the High Street will also be transferred to WBC and in turn let to CSC.

- Pre-construction and during construction, a 'temporary' short lease is granted to CSC who would pay WBC an immediate rent of £1.8m pa (+VAT).

- Post construction, one overarching long-term (remaining term of the 999 year Harlequin Lease) head lease for Harlequin Centre, Charter Place and the car parks.

This legal structure and Key Heads of Terms have been refined during intervening negotiations. They now take into account “worst case scenarios” covering risks such as lengthy CPOs, potential Judicial Review and force majeure. The timescales are therefore NOT an indication of firm redevelopment timescales which remains as Christmas 2015 as the key target.

The legal structure is now as follows:

1. WBC grants CSC (or its nominated subsidiary) a temporary lease of 10 years to enable CSC to undertake vacant possession management and redevelopment of the site. The lease can be extended for a further 2 years should CSC be in the process of redevelopment when the lease expires

2. On granting of the lease, management responsibility for Charter Place would also then transfer to CSC who would then be responsible for all costs and receive all income from WBC’s existing tenants and market stallholders.

3. Both parties have the option to break the Temporary Lease after 5 years on 12 months notice (providing 12 months rental income)

4. The Council will receive a guaranteed income of £1.8m (+VAT) pre-construction, during construction and during the lease term. In respect of the £1.8m income, during pre-construction and construction, the rental income from BHS will be excluded from the figure and be paid direct to WBC. This is purely for technical reasons on their lease. After construction, BHS (and the income) will be included in the new long lease. Following the redevelopment, the Council will also receive an additional 7% of growth in net income.

5. Following redevelopment, WBC grants CSC (or its nominated subsidiary) two long-term leases (remainder of 999 year Harlequin Lease) on parallel terms, comprising a substantially modernised Harlequin lease (including the three Harlequin car parks – Kings, Queens and Palace (Harlequin)) and a separate lease for Charter Place.

6. As a land transaction, although there is no obligation on CSC to build the new centre, if it is developed the redevelopment must include:

    - High quality retail offer
    - Cinema
    - Enclosed market
    - Upgrade enhancement to Palace car park façade and ramp
    - Upgrade enhancement to Beechen Grove entrance
    - Enhancement to entrances to YMCA and rear of Poundland.

    Note: the revised first floor walkway should enable the Watford Women’s Centre to remain in situ.

7. Under the modernised Harlequin lease, and parallel Charter Place lease, current consent conditions for retailer lettings will be relaxed. At present, any retailer letting, lease assignment or rent review requires formal WBC consent. This is no longer considered necessary or appropriate because:

   - the Harlequin's and Charter Place's interests will be aligned rather than competing and
   - it creates an unnecessary level of control on CSC's activities as an expert owner and manager of shopping centres in the UK.

   WBC will continue to be advised of all retailer transactions and will require CSC's agents to confirm (with a duty of care) that the letting or transaction is the best obtainable consistent with market conditions and the retailer and asset strategy.

   Linked to the relaxation of consent conditions, WBC will have increased ability to challenge the 'net income' received from CSC, along with significantly improved general management information and income transparency. Previously presentation of income information by CSC along with resource constraints have meant that it has been difficult for the Council to challenge income received from CSC. New arrangements will include provision of improved income forecasting to WBC along with the ability for WBC to test and challenge using independent retail property experts if necessary.

4.2 Legal structuring issues relating to (Stamp Duty Land Tax) SDLT

The original proposal envisaged that the Harlequin Centre and Charter Place will fall under one lease. This will now be under two leases. The reason for this change is solely because the original structure would have resulted in a substantial SDLT (Stamp Duty) liability. There would have been no direct financial benefits or (other) costs to WBC from the single lease structure but it may have very marginally improved the value or saleability of CSC's interest. The two parallel leases structure retains many of the simplification benefits of a single lease through consistency of terms, but avoids unnecessarily crystallising the SDLT liability.

The two parallel leases structure also gives WBC the flexibility to sell one of its interests (i.e. Harlequin or Charter Place elements) independently. Each represents a substantial property investment asset. CSC have requested a right of pre-emption - i.e. first refusal at independently determined Open Market Value - if WBC wishes to sell one of the two interests but not the other at some point in the future. This is reasonable, since CSC would not wish to have two landlords for two halves of the same shopping centre, and has been agreed in negotiations.

It was also originally envisaged that the freeholds on the High Street of units currently owned by CSC would be transferred to WBC at the time of grant of the temporary lease. This would 'tidy up' legal interests although again without immediate financial benefit to either party. Further analysis has indicated that this would give rise to an SDLT liability to WBC of c£600k, which would be repeated if the redevelopment does not proceed and the units are transferred back to CSC.

Potential SDLT relief options have been investigated by both lawyers but at present it may not be possible to arrange the transfer without crystalising the SDLT liability. The parties have agreed to work around this issue within the suite of documentation and to arrange the transfer now if possible or in future providing this can be done without substantial SDLT liability.

4.3 **Guarantor**

At present, CSC take the view that it is not their policy to provide a parent company (CSC PLC) guarantor for the obligations of the Special Purpose Vehicle (SPV, such as 'CSC Watford Limited' or similar) which they will use to redevelop Charter Place. This will only be necessary, in reality, if redevelopment of Charter Place becomes commercially unattractive and/or CSC are unable to meet the land transaction conditionality conditions of

- 50% pre-lets
- planning consent
- vacant possession
- and funding

leading to the SPV being wound up. However, WBC's property and legal team will do everything possible to obtain a guarantor. A more detailed briefing is provided in the Part B report.

4.4 **Completion of management transfer**

The majority of practical and management issues relating to transfer of management of Charter Place from WBC to CSC are in hand or finalised, subject to minor additional due diligence. The on-site management have met with CSC, and CSC's facilities partner who manage all 'soft' services at the Harlequin (Europa), and have provided various due diligence information.

To facilitate a smoother financial transfer, and avoid any payment interruption difficulties with market and local retail traders, Shared Services Finance will agree a Service Level Agreement with CSC's finance team to collect income for between 1-3 months from the management transfer date. This will give time for banking arrangements and communication with traders to be undertaken in a timely way.

Arrangements are also in place regarding protecting WBC's current legal notices and requirements for vacant possession of two national retailers at Charter Place. These costs should be recoverable from CSC.

At the temporary lease commencement date, full management responsibility will transfer to CSC. This includes the market and dealing with tenant legal and vacant possession matters in line with their vacant possession strategy – e.g. negotiating with retailers with units potentially available in the Harlequin. It will remove all vacant possession risk and management responsibility from WBC, transferring it to CSC. They will also be responsible for empty rates and non-recoverable service charges, other void and short term letting costs, etc, which have been an increasing drain on the net income from Charter Place.

4.5 **Management of Satellite Car Parks**

CSC currently lease all four 'satellite' (i.e. to the Harlequin) car parks from WBC and manage them directly. Under the terms of the lease, CSC pay a rent of £868,000 pa plus a 50% share of any net profits. The lease contains a mutual break clause in March 2015. At the time of the June 18th Cabinet report both parties were still considering the best way to take management of the car parks forward but had agreed that this could be dealt with as a separate issue from the main redevelopment.

CSC proposed a partnership and profits distribution arrangement for managing the car parks. Under this arrangement, CSC would have undertaken structural works as well as internal refurbishment and ongoing management, but would have required a prior return on their capital expenditure before any profits distribution.

To support their proposals CSC provided some high level income and cost assumptions. To assess these and the best way forward for the car parks, the Property Team, supported by external advice from Jones Lang LaSalle, have undertaken a combination of:

- pre-procurement soft market testing with two major UK car park operators, and
- detailed financial modelling and cash-flow analysis based on current tariff income, CSC's current management costs and indicative refurbishment and structural expenditure.

A key factor in the analysis was the assumption regarding income growth, particularly following opening of the redeveloped shopping centre. This is particularly difficult to judge but a conservative hybrid assumption has been adopted which combines CSC's expectations on customer footfall growth with potential car park tariff income.

The basis of a management contract arrangement would be the Council receiving all tariff income (and having control of tariffs) whilst paying the contractor a fixed annual fee, subject to RPI based increases, based on a 25 or 30 year contract, which will of course have all the appropriate KPIs and quality systems and standards. The Council can specify the exact contract scope and specification with the initial capital refurbishment and structural investment amortised over its duration. Analysis has been undertaken which also includes regular cyclical maintenance within the scope so that the car parks are managed and maintained to a consistently high standard throughout the life of the contract.

The outcome of the analysis clearly showed that a management contract could be much more financially beneficial to the Council than CSC's proposal, particularly in the long term. This was the case even allowing for the cost of structural, refurbishment and maintenance costs.

Whilst the council technically takes all income risk, providing tariffs are set carefully tariff income is expected to grow at least in line with inflation and more strongly following completion of the redevelopment.

A well-designed management contract model will also ensure that the car parks, their users, and the council, benefit from ongoing investment and operational best practice – keeping the car parks attractive and safe. In short, the Council will be in control.

By agreeing an early surrender with CSC, refurbishment and structural works can commence in late 2013/early 2014. This is well before the redevelopment opens and will help maintain the best possible 'welcome mat' into Watford whilst Charter Place is closed. Further information is provided in the Part B report.

4.6 **Relocation of Town Centre CCTV**

CSC have agreed to bear 50% of the CCTV relocation costs up to a cap of £250,000. Further information is provided in the Part B report.

4.7 **Compulsory Purchase Order (CPO)**

To facilitate redevelopment, CSC may need WBC to assist with the acquisition of various land interests on their behalf by CPO. A CPO allows public bodies to acquire land compulsorily where negotiations have failed to reach an agreement.

Further work needs to be carried out to identify all interest required for the redevelopment and Cabinet will be asked in the next few months to resolve to make a CPO.

If this is the case, the acquisition costs, fees and Stamp Land Duty Tax (SDLT) will be paid by CSC under an indemnity agreement which is part of the suite of documents currently being agreed.

As present, therefore, it is recommended that Cabinet agree to the principle of CPO linked to such an indemnity agreement. This will support negotiations by CSC.

5.0 **IMPLICATIONS**

5.1 **Financial**

The Head of Strategic Finance comments that the proposals within this report are wide ranging and complex. The intention of the proposals is to seek in the short term to protect the commercial rent portfolio (including car parking income) of the Council whilst enhancing the future long term income stream.

As the final details of any agreements are reached then they will be reflected within the Council's budgets and medium term financial strategy.

5.2 **Legal Issues** (Monitoring Officer)

As set out in the body of this report, this is a land transaction between the Council and CSC (or a subsidiary), there will also need to be a number of parallel agreements regarding novation or assignment of contracts. The Council has instructed external solicitors to assist with drafting and negotiation of the transaction. Also, WBC will continue to seek Counsel's advice on the legal documentation to minimise the risk of any legal challenge. In addition those staff currently employed at Charter place will be subject to TUPE.

5.3 **Equalities**

5.3.1 There are no specific Equalities impacts relating to the proposals in this report.

5.4 **Potential Risks**
Summary risks relating to the items in this report are indicated below.

Potential Risk	**Likelihood**	**Impact**	**Overall score**
Non-delivery of key (physical and transformational) objectives due to Land Transaction and lack of contractual control over design	1	3	3
Loss of car park income	1	3	3
Poorer tenant mix due to lack of WBC control	1	3	3

5.5 **Staffing**

5.5.1 Arrangements are now in place for Charter Place staff to be transferred to Europa, CSC's national soft services (Facilities Management) partner provider under TUPE. Due diligence is being undertaken on Europa, who are a national company with over 3000 employees and contracts including those with local authorities. Consultation is ongoing, WBC's HR team and Unison are fully involved in the transfer. There is an issue on pensions in respect of the transfer which all parties are seeking to resolve.

5.6 **Accommodation**

5.6.1 No implications in this report

5.7 **Community Safety**

5.7.1 The redevelopment, including the opportunity to incorporate state of the art shopping centre management technology, improved car parks, increased opening hours (I.e. including restaurants and leisure) are all likely to improve community safety – particularly for families and in the evening.

5.8 **Sustainability**

5.8.1 Whilst some of the proposed scheme is in the existing 1970s built Charter Place and there are some limitations as to improving sustainability (particularly energy consumption), all new build elements will be subject to modern building regulations and be highly energy efficient. Car park improvements are also expected to have energy efficiency benefits.

Appendices

None

Background Papers

Charter Place Redevelopment - Additional information – Part B Not for publication (Para 3, Schedule 12A)

File Reference

None