STROUD DISTRICT COUNCIL

AGENDA ITEM NO 9

COUNCIL

22 FEBRUARY 2018

Report Title	**STROUD TOWN CENTRE - PROPERTY INVESTMENT BY THE COUNCIL**
Purpose of Report	To outline the basis for the Council to invest in a key property development in Stroud Town Centre and set out the terms and conditions associated with that investment. The investment has important public benefit by helping sustain and enhance the town centre. The proposal is for the investment to be made on commercial terms, thereby providing a commensurate financial return to the Council and ensuring there is no concern of 'state aid'.
Decision(s)	**The Council RESOLVES:** **(1) To provide a £2 million loan to Stroud Regeneration Ltd on commercial terms for a 5 year period to enable the company to purchase the Merrywalks Centre as part of the Council's continuing efforts to sustain and enhance Stroud town centre for the benefit of Stroud District** **(2) The loan offer is subject to specific conditions;** **a) that Dransfield Properties Ltd, through its subsidiary, Stroud Regeneration Ltd will invest £10m over 5 years in the centre's refurbishment and enhancement** **b) the loan is secured as a second charge on the property acquired by Stroud Regeneration Ltd and appropriate clauses included in the legal agreement that ensure no additional charges or conditions can be put in place without the Council's prior approval** **c) the public benefit identified in this report is delivered in respect of the town centre** **d) completion of due diligence in respect of the Dransfield company arrangement, its financial status and cashflow and the property valuation** **(3) That authority is delegated to the Chief Executive, Head of Legal Services and Acting Section 151 Officer, in consultation with the Chairs and Vice Chairs of Strategy & Resources Committee and Audit & Standards Committee to agree the rate of interest and terms of the commercial loan offered to Stroud Regeneration Ltd.**

Consultation and Feedback	Oral reports were made to Strategy & Resources Committee on 13th June 2017 and 18th January 2018. Regular updates have also been provided to the Investment & Development Panel and to Group Leaders. Dransfield Properties Ltd presented to the Investment & Development Panel on 15th January and to a Members Information Evening on 12th February. Because of the commercial sensitivities, the Council has not carried out any external consultation, with the exception of GFirst LEP (Gloucestershire's Local Enterprise Partnership). Dransfield Properties Ltd has already undertaken some consultation with town centre traders and users as part of its preliminary research and survey work. It intends consulting the Town Council, Chamber of Trade and Civic Society. Part of Merrywalks is in the town centre conservation area and the company is concerned to ensure there is an appropriate elevational treatment of the Kings Street frontage.
Financial Implications	The report sets out the proposed £2m commercial loan facility that would be provided to Stroud Regeneration Ltd for the acquisition of the Merrywalks Shopping Centre. In deciding whether to provide the commercial loan, members must weigh-up the financial risk that the Council would be exposed to, and the wider financial and non-financial benefits that may accrue to the District from the regeneration. The interest rate charged to Stroud Merrywalks Ltd over the loan term, should reflect the additional risk the Council is bearing as secondary charge on the asset. There is a risk of capital loss should the company not be in a position to repay the loan at the end of the loan term. Mitigation measures can be put in place (by setting aside an equivalent amount to the loan in an earmarked reserve for the duration of the loan term). However, this will impact on the level of resource available to support other council priorities over that same period It is proposed that the loan is financed from the Council's internal resources. External borrowing is not appropriate for this investment activity given recent updated statutory guidance from the government on Local Government Investments. This may displace internal funding allocated against the Council's Capital Programme, thereby increasing the need to borrow externally. This, in turn, would increase the revenue cost associated with financing the capital programme from those stated in the Medium Term Financial Plan. David Stanley, Accountancy Manager/Acting Sec 151 Officer Tel: 01453 754100 Email: david.stanley@stroud.gov.uk

Legal Implications	The arrangement outlined in the report is lawful subject to appropriate terms of the loan being agreed. In particular, it is essential that the proposal to provide a loan to the company is provided on market terms (including a market rate of interest) to avoid breaching State Aid requirements. Advice has been provided on the terms which the loan agreement could and should not include to meet such requirement and also to avoid the arrangement inadvertently falling within the realms of a public works contract for which there are specific procurement requirements. The level of risk associated with the loan arrangement (e.g. LTV and priority of the Council's charge against the property; basis of other external funding which might impact on the prospects of the development proceeding to completion) will also have an impact on the appropriateness of the loan terms. Karen Trickey, Head of Legal Services Tel: 01453 754369 Email: karen.trickey@stroud.gov.uk (Comment on legal implications from Legal Services)
Report Author	David Hagg, Chief Executive Tel: 01453 754290 Email: david.hagg@stroud.gov.uk
Risk Assessment	As with any property investment lending, there is a risk. Nevertheless, previous schemes undertaken by Dransfield Properties Ltd have been successful – as evidenced by the company's audited accounts, very high occupancy rates in its developments and the willingness of Lloyds Bank to finance successive schemes over 22 years. Without request, Dransfield Properties Ltd has provided full details of costs, rents and management arrangements for other schemes. Any loan involves risk. The Council is mitigating some risk by taking a second charge on the property. The Council will require appropriate clauses to be included in the legal agreement that ensure no additional charges or loan conditions can be put in place without the Council's prior approval, so reducing collateral risk. David Hagg, Chief Executive Tel: 01453 754290 Email: david.hagg@stroud.gov.uk
Options	The Council can decide to do nothing. This is private property and the Council could leave it to the property market to determine its future. By doing nothing, the risk is that the centre declines and/or lacks investment leading to a detrimental impact on the whole town centre. Currently, 45% of units in the centre are vacant and the leases of a further 16% expire in 2018/19. Without investment, c.60% of units could be vacant in a few years.
Performance Management Follow Up	The Council will, alongside Lloyds Bank, receive quarterly reports on the company's progress in carrying out the development programme as well as the company's overall financial position

Background Papers	No background papers were used in the preparation of this report

1. Merrywalks Centre, Stroud

1.1 Merrywalks is a 218,418 sq ft retail and leisure complex in the centre of Stroud. It has been owned by Streetlands Ltd, a subsidiary of Wrather & Co., for over 20 years. The centre was extended in 2003-4 to provide new retail floorspace, a six-screen cinema and bowling alley. Such leisure and entertainment facilities are not often found in a town the size of Stroud and its catchment area. 83% of the centre's income is secured against national covenants including Wilko, New Look, Argos, Home Bargains and Vue Cinema.

1.2 The Council has been concerned about Merrywalks for some considerable time due to its deteriorating condition, poor management and lack of investment. The nature and scale of Merrywalks means it impacts on the whole town centre. Its status and viability affect the nature of the town's shopping 'offer' and environment. It is also a critical ingredient in determining Stroud's comparative attractiveness and reputation as a retail centre.

1.3 The Council took over the management of the multi-storey car park in 2013 from NCP. It replaced the obsolete and increasingly inoperative ticketing machines and has carried out some limited work to the car park. However, the Council has been frustrated as car park operators as key investment decisions have not been taken by Streetlands Ltd. In addition, some new Merrywalks tenancies have created management and enforcement difficulties for the Council as car park operator. The Council's annual management fee has included an appropriate income sharing element.

1.4 Over the past three years, Merrywalks has been offered 'off market' to selected purchasers including the Council. In 2015, the Council was invited to consider acquiring the property 'off market' for an asking price of £20m. This figure reflected Streetland's substantial bank loans with Rothschild and Santander. The Council commissioned Carter Jonas who provided a valuation of £13-14m, albeit the retail valuation consultants were unable to obtain full information from the vendor. During 2016, Streetlands Ltd, through its agents Knight Frank, continued to approach those who may have an interest in purchase.

1.5 Streetlands Ltd has found it difficult to sell Merrywalks. The property value has been affected by general retailing trends and the post Brexit impact on this particular type of retail property. The initial asking price has been reduced over the past two years from £20m, to £17.5m then to £14m. We understand offers in the order of £12m were being sought late last year.

1.6 Members of the Investment & Development Panel (previously the Housing & Development Panel) have been informed and updated over this period. The Investment and Development Panel's membership includes the four Group Leaders (Cllrs. Cornell, Cooper, Tucker and Whiteside). Throughout, the Council has respected the commercial confidentiality requested by Streetlands Ltd and its agents and recognising the potential reputational damage to the town of what has been a long drawn out process by Streetlands Ltd and the banks. The Council's concerns about the management and investment of Merrywalks and its impact on the town centre have not lessened throughout this time.

2. Dransfield Properties Ltd

2.1 Dransfield Properties Ltd (DPL), is a Sheffield based family company with 25 years experience of regenerating town centre schemes. The company's website www.dransfield.co.uk provides details of the company and the town centre schemes it has undertaken.

2.2 In undertaking many of these town centre developments, DPL has worked closely with local authorities. In the case of Fox Valley, Sheffield, and Penistone One, Penistone this has involved public funding in the form of a European Regional Development Fund (ERDF) grant. With the Gainsborough town centre development, DPL has formed a joint venture company with West Lindsey District Council.

2.3 DPL was introduced to Merrywalks in early 2017 by Rothschild, one of the lenders to Streetlands Ltd. DPL first approached the Council in March 2017.

2.4 Media coverage of Dransfield's interest in acquiring and developing Merrywalks received local media coverage. The company submitted an objection to out-of-town retail developments which was referred to at the Development Control Committee meeting.

2.5 As part of its preliminary assessment, DPL met the Council and GFirst LEP in May 2017. Following this, DPL made a proposal to the banks who decided instead to undertake further marketing of Merrywalks.

2.6 DPL approached the Council and GFirst LEP about financing and the potential for joint venture. A meeting was held in November 2017 between the parties. DPL made an application to GFirst LEP for a £4m capital grant. The Chief Executive provided a letter of support (attached).

2.7 Mark Dransfield and some of his senior team presented the company's track record in town centre regeneration and its plans for Merrywalks to an Investment and Development Panel on 15th January and answered Panel members' questions. A Members Information Evening was held on the 12th February at which DPL provided an outline of the company, its proposals for Merrywalks, and the investment timescale. This was followed by a question and answer session.

2.8 Knight Frank, on behalf of Streetlands Ltd and the banks, has accepted DPL's offer to purchase Merrywalks. This offer is subject to surveys and due diligence.

3. Funding Request

3.1 The GFirst LEP Board will consider DPL's application for £4 million of financial support at its meeting on 20th February. At the time of preparing this report, it is known that the application has been looked upon favourably for an indicative allocation. If successful, the allocation would be subject to the normal due diligence processes. A further report to the GFirst Board on 27th April would confirm that the due diligence has been completed and the necessary legal agreements are in place for completion. The Chief Executive of GFirst LEP will provide an update on the status of the application following the 20th February meeting and ahead of our Council meeting.

3.2 At its meeting on the 31st January, Lloyds Bank's Credit Committee approved £12m loan facilities to Dransfield. Lloyds Bank has previously provided loans for other DPL schemes and for these to be with a company specifically set up by Dransfield Properties Ltd to acquire and manage the property. A subsidiary company will be set up to acquire and manage Merrywalks. One of Lloyd's conditions is that there is public funding in the form of the GFirst LEP capital grant.

3.3 DPL has requested a £2m commercial loan from us towards acquisition costs. The overall funding package is as follows;

<u>Purchase of Merrywalks</u>

Funder	Amount	Notes
Lloyds Bank	£6m	Maximum 60% loan to value and first charge
Stroud District Council	£2m	Contribution to purchase and second charge
Dransfield Properties Finance Ltd	£2m*	Funding for acquisition
Total	£10m	

**DPL will meet other costs additional to its £2m. These include Stamp Duty Land Tax (£300,000), Due Diligence (£250,000), Legal and other costs (no estimate provided)*

<u>Development (Works to multi-storey car park, retail units and access, frontages to King Street in conservation area)</u>

Funder	Amount	Notes
Lloyds Bank	£6m	Maximum 60% loan to value and first charge
GFirst LEP	£3m grant £1m loan	Capital grant and loan. Loan provided on basis of third charge. GFirst LEP Board to approve 'indicative allocation' on 20th February
Total	£10m	

4. <u>The Basis of a Commercial Loan by the Council</u>

4.1 It is important for Members to recognise that this is a loan at a commercial rate. It is not a capital grant, nor is it at the expense of the projects included in the

Council's capital programme approved in January. Finance of this nature cannot be used for revenue budgets.

4.2 The Council has not previously provided a commercial loan though it is not uncommon for councils to do so. Under the recently published 'Statutory Guidance on Local Government Investment' (Ministry of Housing, Communities and Local Government, 2nd February 2018) a loan is now classed as an investment.

4.3 The Council has taken external advice about the terms and conditions of a loan offer and also taken independent advice regarding the property valuation. Our Treasury Management advisers, Link Asset Services, view a commercial loan as high risk for a number of reasons;

- The Council is a secondary charge on the asset
- Lack of a parent company guarantee in the event of a capital shortfall
- Stroud Regeneration Ltd being a newly formed company with limited or no collateral
- Loan repayment or financing dependent on 5 year capital asset growth

Depending on the level of collateral, Link Asset Services indicate an interest of 4.73%-10.73% would be appropriate. This advice has been provided without the benefit of an assessment of cashflows or likely asset values over the course of the project.

4.4 There is a risk with any loan. The nature and form of this are set out elsewhere in this report but by taking a second charge some of this is mitigated. The level of interest charged by the Council will have regard to the additional risk faced by the Council as a secondary charge on the asset.

4.5 The Council is recommended to deal with this loan facility as;

- a service based investment
- apply a commercial rate not less than that provided by Lloyds Bank and with a premium in recognition of it being a second charge, so mitigating concern about 'state aid'
- apply appropriate arrangement expenses to the loan agreement
- apply the appropriate treasury management and capital accounting measures

4.6 The Council can generate a net income from the loan; the precise amount depending on how the Council finances the loan and the interest rate charged. In treasury management terms, the loan is likely to be made using internal resources. It is therefore important to deduct the interest forgone on Treasury activities (say 0.50%) from the interest gained on the commercial loan. The net income to the Council is estimated to be in the order of £400,000 over the five year period (£80,000 per annum).

4.7 Against this must be balanced the risk of capital loss. In treasury management terms and to mitigate this, an equivalent amount to the loan will be set aside in an earmarked reserve for the duration of the loan term.

4.8 The public benefit includes;

- Investment in key town centre development (the fortunes of Merrywalks are linked to the success of the whole town centre)

- Resolving longstanding drawbacks with the centre which hamper public access, including pedestrian connectivity between Merrywalks and King Street and overall centre management
- Upgrading the multi-storey car park with benefits in respect of personal/community safety
- Providing an uplift to the appearance of the conservation area and the public realm
- Introducing an improved shopping offer and retailer mix that complements independent shops as against greater competition
- The conversion of King Street upper floors to housing and the potential for new affordable housing units in the three storey part of the centre
- Reversing the centre's continuing decline
- Additional jobs, footfall and business rate income (in DPL's bid to GFirst LEP, an increase of 1,000 jobs and £20m gross added value to the local economy have been cited)

4.9 The Council is recommended to approve a £2m commercial loan on terms set out under Decision at the start of the report.