

Report of Head of Finance and Principal Legal Officer

Report to Director of City Development

Date: 19 September 2017

Subject: Headingley Stadium redevelopment

Are specific electoral wards affected? If yes, name(s) of ward(s): Headingley	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
Are there implications for equality and diversity and cohesion and integration?	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
Is the decision eligible for call-in?	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Does the report contain confidential or exempt information? If relevant, access to information procedure rule number: 10.4(3) Appendix number: 1, 2, 3 & 4	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No

Summary of main issues

1. In April 2017 Executive Board approved the principle of the Council entering into arrangements to facilitate the redevelopment of Headingley Stadium by acting as the tenant for the redevelopment of the North/South stand and entering into lease arrangements with Yorkshire County Cricket Club (YCCC) and Leeds Cricket Football and Athletic Company (LCFA).
2. Agreement of the final terms of the arrangements and the relevant documentation was delegated to the Director of City Development in conjunction with the Chief Officer – Financial Services and in consultation with the Leader of the Council, the Executive Board Member for Transport, Regeneration and Planning, and the Opposition Group Leaders on Executive Board.
3. Officers from City Development, Finance, and Legal Services have been in negotiations with the other parties involved in the various transactions and approval is now sought as to the terms which have been agreed and to the necessary documents being entered into.

Recommendations

4. Subject to all other parties obtaining the necessary approvals to enter into the documentation, that the Director of City Development, in conjunction with the Chief Officer Financial Services, approves the terms of the arrangements outlined in this

report and authorises the necessary documents to be entered into so as to facilitate the redevelopment of Headingley Stadium.

1. Purpose of this report

- 1.1 This report seeks approval to the terms of the arrangements which officers have, in principle, agreed with the other parties involved in the transaction, and to enter into all necessary documentation. This is to facilitate the redevelopment of Headingley Stadium, with the Council acting as tenant and entering into lease arrangements with YCCC and LCFA.

2. Background information

- 2.1 In April 2017 Executive Board approved the principle of the Council entering into arrangements to secure third party investment for the redevelopment of the North/South stand at Headingley stadium by entering into lease arrangements with Yorkshire County Cricket Club (YCCC), Leeds Cricket Football and Athletic Company (LCFA) and a third party investor.
- 2.2 Agreement of the final terms of the arrangements and the relevant documentation was delegated to the Director of City Development in conjunction with the Chief Officer – Financial Services and in consultation with the Leader of the Council, the Executive Board Member for Transport, Regeneration and Planning, and the Opposition Group Leaders on Executive Board.
- 2.3 Pursuant to the Executive Board approval, the Council has already entered into agreements with LCFA and YCCC in relation to the confidential nature of the negotiations and the conditional underwriting of LCFA's planning and design fees up to a maximum of £500,000 should the scheme not progress.
- 2.4 Officers from City Development, Finance, and Legal Services have been in negotiations with the other parties involved in the various transactions and have now reached a point where terms have been agreed subject to the approval of the Director of City Development.

3. Main issues

- 3.1 Terms have now been agreed in principle with the other parties involved in the various transactions, as summarised in Confidential Appendix One to this report.
- 3.2 In summary, the third party investor will fund the construction of the new North/South stand. The clubs will lease the site of the stand to the third party investor at a peppercorn, and the third party investor will simultaneously lease the site of the stand to the Council at a rent which will, over 40 years, repay the third party investor's funding and provide them with a return on that funding.
- 3.3 On practical completion of the construction of the stand, the Council will lease it back to the clubs (via newly formed subcos) at a rent which mirrors the rent payable to the third party investor plus a premium. It should be noted that the rent under the lease to the Council will not commence until August 2019 and that the Council will be entering into agreements with the clubs under which they will be liable to pay their rent from the same date, regardless of whether the construction of the stand has been completed or not.
- 3.4 Executive Board approved the Council entering into these arrangements and delegated approval to settle the final terms to the Director of City Development on the basis of agreed heads of terms. The agreed arrangements as detailed in this report and the Confidential Appendices are consistent with that approval.

- 3.5 In entering into the agreed arrangements, the Council is required to comply with both its fiduciary duties and the European Commission's rules as to the provision of State aid. Advice has been taken from both external solicitors (DWF) and a leading accountancy firm (Grant Thornton) as well as from leading counsel and the Council's own officers. A summary of that advice, which is that the agreed arrangements are lawful and compliant, is contained in Confidential Appendix Two and Confidential Appendix Three respectively.
- 3.6 In addition to the above, officers working with Grant Thornton have carried out extensive due diligence in respect of both LCFA and YCCC, including a review of both clubs' 40-year business plans and their financial status, as well as an appraisal of their ability to make the agreed payments to the Council. Based upon that work, which officers have reviewed and are comfortable with, and whilst recognising that the proposal is not without risk, the Chief Officer – Financial Services is of the view that, subject to the Council receiving acceptable security (for which see below), the clubs should, with a reasonable degree of confidence, be able to meet their payment obligations to the Council over the period of the proposed leases. A copy of Grant Thornton's report of the clubs' business plans can be found at Confidential Appendix Three.
- 3.7 Grant Thornton has also undertaken a sensitivity analysis of the clubs' expected income and expenditure, which has tested a number of scenarios. This concludes that there is sufficient headroom within the clubs' forecasts for them to be able to deal with a reasonable range of adverse situations (e.g reduced match day revenue), if not necessarily more extreme scenarios. However, even in the case of an extreme scenario, Grant Thornton's analysis shows that the clubs should have the ability over time to adjust their income and expenditure accordingly. The view has been taken therefore that, subject to the Council receiving acceptable security (see below), the clubs should be able to meet their payment obligations to the Council in all but the most extreme of situations. A summary of Grant Thornton's analysis can be found at Confidential Appendix Three.
- 3.8 The clubs have agreed to provide the Council with the security set out in Confidential Appendix One. This mitigates against default by the clubs and is considered to be acceptable security as referred to above. Grant Thornton has also confirmed that, in their opinion, the security package is sufficient for the Council's purposes. It should also be noted that, in the case of default by the clubs, in addition to enforcing the security, the Council would also have the option of forfeiting the lease of the defaulting club, thereby taking control of part or the whole of the stand depending upon the extent of the default.
- 3.9 LCFA and YCCC have both requested the ability to reduce their rental payments to the Council by making lump sum payments. This has been agreed by the Council on the basis that the lump sum payments will provide the Council with sufficient funds to invest to generate an income to continue to pay the rent to the third party investor. Officers from City Development and Resources and Housing have considered how much the Council would require in order to make a suitable investment (i.e. an investment that would match the lease payments to the third party investor going forward).
- 3.10 The lease payments which the Council is required to make to the third party investor are linked to RPI. On this basis, and assuming RPI at 2.5%, an illustrative schedule showing the payments which the clubs would have to make in those circumstances has been prepared and agreed with the clubs. Grant Thornton has also reviewed the schedule and the mechanism behind it and has confirmed that this is an

acceptable approach for the Council to take. A copy of the illustrative schedule is attached at Confidential Appendix Four.

- 3.11 The total cost of constructing both the shared North/South stand and the Rugby Ground South stand is estimated to be £40m. LCFA is providing funding of £5m. YCCC has applied to the LEP for funding of £4m but this has yet to be agreed. The third party investor has therefore been asked to provide funding of between £31m and £35m (plus transaction costs) to cover the possibility of no LEP funding being provided. The total amount of the third party investor's funding (including transaction costs) is capped at £37.415m. In addition the third party investor's transaction costs plus its lease yield will be included in the rent payable by the Council and the Clubs. This is in line with Executive Board approval.
- 3.12 The Council has previously commissioned an architectural review and cost assessment by Arcadis Design and Consultancy in relation to the new North/South stand. This concluded that the estimated costs were reasonable and represented good value.
- 3.13 Subsequent to Executive Board the Council has entered into an agreement with LCFA to the effect that if the redevelopment of the North/South stand does not proceed, the Council will underwrite LCFA's planning and design fees up to a maximum of £500,000. If the arrangements referred to in this report are approved and the necessary documentation entered into, this commitment will come to an end, without any call having been made against the Council's underwriting.
- 3.14 It remains the case that the new North/South stand must be completed before the start of the 2019 Cricket World Cup and that if the stand is not completed, YCCC's ability to stage test and international cricket matches at Headingley will be under threat in that YCCC will be unlikely to secure a staging agreement beyond 2019.
- 3.15 Based on information supplied by the contractor, Executive Board was advised that enabling work needed to start by the end of June 2017 in order to achieve completion in time for the 2019 Cricket World Cup. Whilst it remains the case that the new North/South stand must be completed before the 2019 Cricket World Cup starts, negotiations have been complex and have taken longer than expected with the result that construction work has yet to start. This has been discussed with the contractor, and whilst timescales remain critical, a revised schedule has been agreed and the Council has been assured that the works can still be completed in time for the 2019 Cricket World Cup, provided that work starts immediately following completion of documents.

A key principle of the proposal is that the up-front costs incurred by the Council are fully reimbursed by the clubs. In total, the costs incurred by the Council, are estimated to be circa £650,000 inclusive of Stamp Duty Land Tax estimated to be £427,000 (the exact amount will depend upon the date upon which the documents are entered into). The balance being financial and legal due diligence and surveyor fees.

As agreed by Executive Board, and as detailed in this report, the Council will receive an annual payment of £125,000 from the clubs in addition to their rental payments. In the first instance, this will be used to meet the Council's costs and thereafter could be used to build up a contingency fund to mitigate against any potential future default by the clubs.

4. Corporate considerations

4.1 Consultation and engagement

- 4.1.1 Council officers have been in detailed discussions with LCFA, YCCC and the third party investor as to the terms of the arrangements.
- 4.1.2 Confirmation is awaited that the agreed terms have been approved by the boards of LCFA, YCCC and the third party investor.
- 4.1.3 Executive Board's delegation of the agreement of the final terms of the arrangements and the relevant documentation was delegated to the Director of City Development in conjunction with the Chief Officer – Financial Services and in consultation with the Leader of the Council, the Executive Board Member for Transport, Regeneration and Planning, and the Opposition Group Leaders on Executive Board.
- 4.1.4 The Leader of the Council, the Executive Board Member for Transport, Regeneration and Planning, and the Opposition Group Leaders on Executive Board have all been consulted as to the arrangements set out in this report and are all in agreement with them.

4.2 Equality and diversity / cohesion and integration

- 4.2.1 An equality screening from was previously completed when the proposals were reported to and approved by Executive Board in April. No specific equality issues were raised and none have arisen since.
- 4.2.2 The design development of the facilities has assessed the current disabled provision and how this can be enhanced and improved from a spectator and carer point of view. Accessibility is the critical issue that has been resolved through the stand design. Entrances have been widened and access to all levels within the new North-South and South stands has been improved through the introduction of lifts to all tiers.
- 4.2.3 The South Stand as it is currently laid out has 30 disabled seats. The new design proposals provide a maximum of 48 disabled seats, with 50% of them (24) also capable of being made available for disabled helpers/companions if required.
- 4.2.4 The North-South Stand currently has no disability provision within it. The new design for the stand introduces 18 disabled seats and 18 disabled helper seats.

4.3 Council policies and best council plan

- 4.3.1 As reported to Executive Board in April, the agreed arrangements will make a significant contribution to both the Council's Vision 2010-2030 and the Best Council Plan.

4.4 Resources and value for money

- 4.4.1 The resource implications of the agreed arrangements are set out in body of and the confidential appendices to this report.
- 4.4.2 The Council has previously commissioned an architectural review and cost assessment by Arcadis Design and Consultancy in relation to the new North/South

stand. This concluded that the estimated costs were reasonable and represented good value.

4.5 Legal implications, access to information, and call-in

- 4.5.1 Appendices One, Two, Three and Four all contain information relating to the financial or business affairs of either the Council or third parties, and the release of such information would be likely to prejudice the interests of all parties concerned. Whilst there may be a public interest in disclosure, in all the circumstances of the matter, maintaining the exemption is considered to outweigh the public interest in disclosing this information at this time. It is therefore considered that Appendices One, Two, Three and Four of this report should be treated as exempt information under rule 10.4(3) of the Access to Information Procedure Rules.
- 4.5.2 The decision sought is neither a key decision nor is it subject to call-in as it relates to, and is consistent with, the implementation of a decision of Executive Board.
- 4.5.3 As reported to Executive Board, the Council has various powers to enter into the arrangements referred to in this report.
- 4.5.4 Section 19 of the Local Government (Miscellaneous Provisions) Act 1976 gives the Council the power to provide such recreational facilities as it thinks fit. This includes providing buildings and assistance of any kind and will enable the Council to enter into the arrangements outlined in this report on the basis that the Council is entering into them to facilitate the redevelopment of Headingley Stadium so as to ensure that the stadium is capable of hosting Test and International Cricket as well as improving facilities for spectators attending domestic cricket, rugby league and rugby union matches.
- 4.5.5 Section 120 of the Local Government Act 1972 permits the Council to acquire land for the purposes of any of its functions or for the benefit, improvement or development of the area, whilst Section 123 of that Act allows the Council to dispose of land in any manner it wishes, subject to obtaining the best consideration reasonably obtainable. Section 120 will permit the Council to enter into the underlease with the third party investor and Section 123 will allow the Council to grant sub-underleases to the clubs.
- 4.5.6 In addition, Section 111 of the Local Government Act 1972 gives the Council the power to do anything which is calculated to facilitate, or is conducive or incidental to, the discharge of any of its functions, whilst Section 1 of the Localism Act 2011 gives the Council a power of “general competence” to do anything that individuals generally may do. Taken together these powers will permit the Council to enter into the arrangements outlined in this report in so far as they fall outside the powers referred to above.
- 4.5.7 Legal Services are of the opinion that the arrangements referred to in this report are within the Council’s powers as outlined above – as outlined in the Executive Board report, the redevelopment of Headingley stadium will be of significant benefit to both Leeds and the wider City Region.
- 4.5.8 The Council is subject to the European Commission’s rules as to the provision of State aid. State aid occurs when state resources are used in a way which provides an undertaking which is engaged in commercial activities with an advantage which is likely to distort trade between EU member states.

- 4.5.9 The Council has obtained specialist State aid advice from one of the UK's leading State aid lawyers and from a leading QC to confirm State aid compliance of the proposals.
- 4.5.10 The essential thrust of the proposals is to ensure that, at the level of investment into the North/South stand, the Council will act as would an ordinary market investor in terms of the rent it will pay to the third party investor and the rent it will charge to LCFA and YCCC. In State aid law this is known as the market economy investor principle or "MEIP". When a public authority acts in accordance with MEIP, it confers no State aid on the basis that there is no advantage to the undertaking concerned.
- 4.5.11 MEIP compliance rests on the notion that an ordinary market investor in the same or similar circumstances would seek a commensurate premium against the risk involved (for the Council) in undertaking the transaction, which means recharging the rent paid, but also adding a premium to that for profit. Determining a deal in compliance with MEIP requires detailed financial considerations and in this regard the Council has retained leading accountancy firm Grant Thornton.
- 4.5.12 Grant Thornton has worked with the Council and the clubs in order to establish what a reasonable level of premium would be for a market investor (acting in the Council's place) to secure on the rent to be paid to the Council by the clubs. The level of the premium arrived at takes into account all known facts at the time of entering into the deal such as the relevant market, the level of security afforded and the risk ratings of the clubs. It is long established law that the views of independent expert analysis of this nature are very difficult to overturn in any legal challenge.
- 4.5.13 Grant Thornton are the opinion that before taking into account the proposal for the provision of operating aid outlined below, the entirety of the arrangements which the Council in entering into is in compliance with MEIP.
- 4.5.14 By way of a separate transaction, LCFA and YCCC have claimed that the existence of the premium will make it difficult for them to sustain the operation of the North/South stand in a profitable manner and have asked the Council to reduce the amount of the premium accordingly. In this way the clubs have applied to the Council for annual operating aid against their respective future operating losses for the North/South stand for so long as a premium is payable.
- 4.5.15 The proposal is for operating aid (aid against day to day running costs) to be provided to the clubs by way of a reduction in the amount of the premium they have to pay to the Council.
- 4.5.16 Article 55 of the European Commission's General Block Exemptions ("GBER") allows for operating aid to be given in respect of sports and multifunctional recreation infrastructure. The key limits within Article 55 are that the aid should not exceed €2m per annum and should not exceed the operating losses for delivery of the services provided by the infrastructure in question, which in this case is the North/South stand. It should be noted that any funding from the LEP for the project will be classed as "investment aid" for the purposes of Article 55, and will not therefore count against the limit of €2m for "operational aid" as referred to above.
- 4.5.17 Article 55 allows aid to be determined against such operating losses by means of a reasonable projection of income and expenditure. Thus the Council is proposing to award operating aid to the clubs within the confines of Article 55 on the basis of a reasonable projection of operating losses over a period of 10 years. This approach has been verified by both DWF and Grant Thornton as being compliant with Article 55, and will ensure that the aid cannot exceed the limits of Article 55.

- 4.5.18 Based on the work done by Grant Thornton and a capital cost of £37.415m, and assuming no LEP funding, the amounts of the gross premiums for the first year of the arrangement will be £410,781 for Rugby and £355,809 for Cricket.
- 4.5.19 The minimum annual payment for Rugby will be £66,981.83. On this basis, the value of State aid provided to Rugby will be £343,799.17. Using the official EU exchange rate this converts to €372,698.19. The estimated operating loss for Rugby for the first year of the arrangements after application of the premium is £484,000 (€524,684.00).
- 4.5.20 The minimum annual payment for Cricket will be £58,018.17. On this basis, the value of State aid provided to Cricket will be £297,790.83. Using the official EU exchange rate this converts to €322,822.49. The estimated operating loss for Cricket for the first year of the arrangements after application of the premium is £859,505 (€931,753.14).
- 4.5.21 In the first year the combined amount of State aid given to the clubs will be £641,590 (€695,520.67) and the combined estimated operating loss for both clubs is £1,343,505 (€1,456,437.14). This is within the financial limit of Article 55, and whilst the amount of aid may increase during the life of the arrangements, it should never exceed those limits but in any event the agreement between the Council and the clubs will prevent this from happening, by limiting the amount of aid given to the maximum amount permitted by Article 55.
- 4.5.22 For the second ten years of the arrangements, and periodically thereafter, a reassessment of operating losses will be carried out to ensure the continued need for and compliance of the aid. In the event of no projected operating losses at that time, the aid would cease.
- 4.5.23 External legal advice has confirmed that the above structure is legitimate, not fundamentally flawed, and can be implemented in compliance with State aid law. However, it must be recognised that the structure proposed is novel and without a precedent that the Council or its advisers have been able to determine. It therefore naturally contains an element of risk, as do all public sector interventions of this nature, but the advice taken has confirmed that there should be nothing inherently wrong with the structure proposed to leave the Council (or the clubs) particularly exposed in State aid terms.
- 4.5.24 The Council also has a duty to the council tax and ratepayers of Leeds to ensure that, in entering into arrangements such as the one now proposed, it makes prudent use of the Council's resources, has due regard to the possible financial consequences of its decision, strikes a fair balance between the interests of the council tax and ratepayers of Leeds on the one hand and the interests of the community on the other, and acts in good faith at all times.
- 4.5.25 External legal advice has been obtained from Queen's Counsel and they are of the opinion that the proposed arrangements would not be open to challenge as a breach of the Council's fiduciary duty to the Council tax and ratepayers of Leeds.

4.6 Risk management

- 4.6.1 As reported to Executive Board, the agreed arrangements are not without risk to the Council.
- 4.6.2 The principal risk to the Council is that LCFA and/or YCCC will not be able to afford to make their rental payments to the Council. Even with the benefit of the extensive due diligence which has been undertaken, including external legal and financial

advice, there can be no absolute guarantee that the clubs will be able to meet their financial obligations throughout the period of 40 years. To mitigate against this, the Council is taking the security as referred to above and in the confidential appendices to this report. Ultimately, the Council could also seek to forfeit the clubs' leases of the stand for non-payment of rent.

- 4.6.3 Both LCFA and YCCC have asked for the ability to be able to reduce their rental payments by making a lump sum payment to the Council in lieu of future rent. This has been agreed on the basis that the amount of the lump sum payment will be sufficient for the Council to invest and generate an income to continue to pay its rent to the third party investor. Whilst the Council does not have a similar right under its own lease, the third party investor has agreed that it will consider a request from the Council and that if it ever seeks to sell the lease it will give the Council a right of first refusal to acquire it.
- 4.6.4 The third party investor has agreed to provide funding for the redevelopment against a contract price of £40m. The contract for the redevelopment has been awarded on a fixed price basis. Any risk of cost overrun will therefore sit with the contractor.

5. Conclusions

- 5.1 The agreed arrangements remain the only viable option to ensure that the redevelopment work takes place in time for the 2019 Cricket World Cup.
- 5.2 Whilst the agreed arrangements are complex, and are not without risk to the Council, the advice which the Council has received from both its internal and external advisers is that the arrangements are lawful and within the powers of the Council. Furthermore, they represent a satisfactory resolution to delivering the aims of the parties.

6. Recommendations

- 6.1 Subject to all other parties obtaining the necessary approvals to enter into the documentation, that the Director of City Development, in conjunction with the Chief Officer Financial Services, approves the terms of the arrangements outlined in this report and authorises the necessary documents to be entered into so as to facilitate the redevelopment of Headingley Stadium.

7. Background documents¹

Arcadis report.

8. Confidential Appendices:

1 – Terms of documents and security.

2 - DWF and Counsel advice.

3 - Grant Thornton advice.

¹ The background documents listed in this section are available to download from the Council's website, unless they contain confidential or exempt information. The list of background documents does not include published works.

4 – Paydown Methodology and Schedule.