

Report of Head of Commercial

Report to Director of City Development and Chief Officer Financial Services

Date: 4th July 2018

Subject: Merrion House Rent Advance

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

Summary of main issues

1. In October 2013, the Council entered into arrangements with the Town Centre Securities group of companies ("**TCS Group**") in relation to the major refurbishment and extension of the building containing the Council's offices at Merrion House, Merrion Centre, Leeds and the surrender and re-grant of the Council's lease of Merrion House (the "**Lease**").
2. As part of these arrangements, TCS Group and the Council incorporated a new 50:50 Limited Liability Partnership called Merrion House LLP (the "**LLP**") which is now the Council's landlord under these arrangements.
3. Refurbishment works at 170,000 sq. ft., ten-storey Merrion House reached practical completion on 6th February 2018, and the provisions of the new 25-year Lease (including in respect of rental payments) have applied since that date (with the Lease completing on 5th June 2018).
4. The Council and the LLP have discussed the Council making a discounted rent prepayment on or around 2nd July 2018 for the fixed, non-CPI, element of the Lease (the "**Rent Advance**"). The Rent Advance discount will provide the Council with annual rental savings.
5. The prepayment to the LLP will be distributed to the members in accordance with the LLP agreement (i.e. the Council and TCS Group).
6. This report seeks approval in respect of these proposals.

7. Recommendations

- i) The Chief Officer Financial Services is recommended to agree to the Council making the Merrion House rent prepayment.
- ii) The Director of City Development and Chief Officer Financial Services are recommended to approve entering into all necessary arrangements (including financial) to facilitate such Merrion House rent advance and distribution of the Council's share as an LLP member, in accordance with their respective schemes of delegation.

1. Purpose of this report

- 1.1 This report seeks approval to payment of the Rent Advance in relation to the Lease of Merrion House.

2. Background information

- 2.1 In October 2013, the Council entered into arrangements with **the TCS Group in relation to the major refurbishment and extension of the building containing the Council's offices at Merrion House, Merrion Centre, Leeds and the surrender and re-grant of the Lease.**

- 2.2 **As part of these arrangements,** TCS Group and the Council incorporated the LLP with equal 50% shares, which is now the Council's landlord under these arrangements.

- 2.3 Refurbishment works at 170,000 sq ft, ten-storey Merrion House reached practical completion on 6th February 2018, and the provisions of the new 25-year Lease (including in respect of rental payments) have applied since that date.

- 2.4 Under the Lease, the rent is comprised of:

- 2.4.1 A fixed, non-CPI, base rent (the **Base Rent**); and

- 2.4.2 a rent review every five years by reference to increases in CPI (but capped at a maximum of 2% per annum, compounded).

- 2.5 The rent is payable quarterly in advance on 1 January, 1 April, 1 July and 1 October.

3 Main issues

- 3.1 The Council and the LLP intend for the Council to make a discounted rent prepayment on or around 2nd July 2018 for the fixed, non-CPI, element of the Lease (the **Rent Advance**). The Rent Advance will be funded from the Council's balance sheet and the Rent Advance discount will provide the Council with an annual rental savings of c.£512,000. Confidential Appendix 1 contains full details of the proposed transaction, which is summarised above. The information in confidential Appendix 1 relates to the business affairs of both the Council and remains commercially sensitive at this stage, however it is anticipated that it will be capable of being published following implementation of this decision.

State Aid

- 3.2 The Council has received confirmation from Grant Thornton that the discount rate applied to the Rent Advance is an appropriate market equivalent debt rate within the range of what would be acceptable under these circumstances. Furthermore, the payment of the Rent Advance is effectively secured by the Council's rights pursuant to the Lease and further rights and buffers to be ascribed to the Council in respect of the Lease as a consequence of this proposed transaction. This is equivalent to the position that a private investor would seek, however (in terms of security) the Council is in the preferential position in:
- (a) having a continued use for Merrion House (it does not need to seek a purchaser of the asset to realise its security); and
 - (b) is a co-owner of the LLP (the landlord) and so has transparency and involvement in its operation and management (including procuring appropriate insurances for Merrion House).

Finally, there are direct obligations placed on the TCS Group parent company to use best endeavours to procure the reimbursement by the TCS Group of the Rent Advance in the circumstances described above. Consequently, it is considered that this transaction is state aid compliant, and satisfies the market economy investor principle.

- 3.3 In any event, the transaction will provide for the LLP to repay the Rent Advance and any interest, fines or costs in the instance of an adverse state aid finding. Again, the TCS Group parent company is directly obliged to use best endeavours to procure the reimbursement by the TCS Group of the Rent Advance in such circumstances.

SDLT

- 3.4 Stamp Duty Land Tax (**SDLT**) has been paid following completion of the Lease. The Lease has been entered into on the basis of rental payments being due, and SDLT has been paid accordingly.
- 3.5 The Council has confirmed to HMRC its view that no additional SDLT should be due as a consequence of paying the Rent Advance - i.e. the Council does not consider the Rent Advance to be a premium for SDLT purposes (which would result in a higher SDLT payment). The Council has sought clarification from HMRC as to whether it agrees with such view, or whether an additional SDLT liability will fall due upon payment of the Rent Advance? The difference in value between SDLT payable on rent and SDLT payable on a premium in this instance is £876,000.
- 3.6 At the date of writing, no response has been received from HMRC. As such there is a risk that the Rent Advance is viewed by HMRC as a premium and that the higher amount of SDLT is payable. The potential increased SDLT liability for the Council together with any applicable interest, penalties or costs incurred will be the subject of an indemnity from the LLP (underwritten by the TCS Group, and with a direct obligation on the TCS Group parent company to use best endeavours to procure such payment by the TCS Group). Advice has been taken from Legal Services and they are of the view that the transaction is not a property transaction and will not therefore affect SDLT.

LLP Distribution

- 3.7 The Rent Advance will be distributed to the LLP members (i.e. the Council and TCS Group) as a repayment of capital previously invested in the LLP. The LLP members' agreement to such distribution is a condition to payment of the Rent Advance.

Legal and Commercial Reports

- 3.8 A full report from the Council's external legal advisors (Pinsent Masons) setting out advice in respect of the legal implications and risks of this transaction is included at Appendix 2 of this report. This is information in respect of which a claim to legal professional privilege could be maintained in legal proceedings. As such, it remains confidential at this time.
- 3.9 A copy of the Market Equivalent Debt Rate report produced by the Council's external financial adviser (Grant Thornton) is included at Appendix 3 of this report. This advice is also confidential at this time.

4. Corporate considerations

4.1 Consultation and engagement

- 4.1.1 Consultation has taken place with Financial Services, including Procurement and Commercial Services. Advice has been provided by Pinsent Masons (legal) and Grant Thornton (finance).
- 4.1.2 Consultation with Members is as detailed in the Delegated Decision Notice to which this report relates.

4.2 Equality and diversity / cohesion and integration

- 4.2.1 It is not anticipated that the proposed Rent Advance transaction will give rise to any equality and/or diversity issues.

4.3 Council policies and best council plan

- 4.3.1 The proposed Rent Advance transaction supports the Council's "best council" ambition of being an enterprising and efficient council, supports the Council's best city priority of "inclusive growth" (including supporting growth and investment), and also supports the Council's value of spending money wisely.

4.4 Resources and value for money

- 4.4.1 The Council's costs in respect of this Rent Advance transaction (including external advisor costs) will be reimbursed by the TCS Group.
- 4.4.2 The consequence of the payment of the Rent Advance shall include that the Council will benefit from an initial saving of c.£512,000 per annum. While the Council intends to fund the Rent Advance from its balance sheet, if the Council was to borrow from the PWLB to fund the Rent Advance, the Council would still realise a saving of c£153,000 per annum.
- 4.4.3 The costs incurred by the Council (including external advisor fees) will be met by TCS.

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

- 4.5.1 Advice has been sought from the Council's external legal advisors (Pinsent Masons) in respect of the proposed Rent Advance transaction. The legal report is attached at Appendix 2 to this report. Appendix 2 and the information contained in it is confidential, being information in respect of which a claim to legal professional privilege could be maintained in legal proceedings, and where the public interest in maintaining the exemption outweighs the public interest in disclosing the information at this time.
- 4.5.2 The information relating to the "Main Issues" of this transaction contained in Appendix 1, the Grant Thornton Market Equivalent Debt Rate report contained in Appendix 3 and the Bartlett and Company insurance summary contained in Appendix 4 each relate to financial and business affairs of the Council, the LLP and the TCS Group and are commercially sensitive, with the public interest in maintaining the exemption outweighing the public interest in disclosing the information at this time. However, it is anticipated that Appendix 1 will be capable of being published following implementation of this decision.
- 4.5.3 It is considered that this Rent Advance transaction is state aid compliant (see above). It is considered that appropriate SDLT payments have been made, however legal protections will be incorporated into the transaction if HMRC should ultimately take the view that additional payments are due.
- 4.5.4 The Council is entering into this transaction pursuant to the Lease - this is made clear on the face of the transaction documents. The transaction documents are supplementary to the Lease, and provide the Council with additional rights and protections to those currently contained in the Lease. As such it is considered that the Council has power to enter into this document (subject to the necessary authorisations being received in relation to the recommendations of this report) on the same basis as it entered into the Lease, including pursuant to sections 120 and 132 of the Local Government Act 1972. In addition, pursuant to s111 of the Local Government Act 1972, the Council is able to do what would facilitate or is incidental to the exercise of such functions (and there are similar common law rights). The positive economic benefit of the proposed Rent Advance is also noted at paragraphs 3.1 and 4.4.2, and as such it is considered that by making the Rent Advance in this way the Council is discharging its best value duty in relation to the Lease and its fiduciary duty to its taxpayers in making good use of the public purse.
- 4.5.5 In respect of the decisions to be made in relation to the recommendations in this report, pursuant to Section 3E of the Council's constitution (Officer Delegation Scheme), the Director has delegated authority in relation to asset management including:
- strategic management and development of the Council's land and property portfolio;
 - leasehold acquisitions; and
 - any other dealings with land or any interest in land,

and the Chief Officer has responsibility for ensuring the Council's effective financial management, including:

- managing the Council's borrowing and investment requirements;
- managing and monitoring the Council's revenue budget and capital; and
- managing the Council's tax affairs.

4.5.6 This decision is a key decision which is subject to call-in. All appendices are exempt under Access to Information Rule 10.4(3) as they all contain commercially sensitive information.

4.6 Risk Management

4.6.1 The payment of the Rent Advance is effectively secured against Merrion House and the Council's rights pursuant to the Lease. The Rent Advance transaction does not adversely impact on the Council's existing rights under the Lease, and the Council has also negotiated further appropriate amendments to protect against the potential that the Council does not have access to Merrion House as a consequence of damage, or that forfeiture of the Lease should potentially arise, or if the LLP should become insolvent etc. A comprehensive suite of insurances relating to Merrion House are in place and will be maintained throughout the term of the Lease. A summary of the insurance provisions and how they would respond to protect the Council is provided by the LLP's insurance brokers in confidential Appendix 4.

4.6.2 SDLT and state aid reimbursements (if necessary) have been incorporated into the transaction documents.

4.6.3 Whilst the Council's funding envelope is reducing it is still anticipated to have sufficient balance sheet fund strength to fund the prepayment over the 25 years that it relates to. In addition, the Council will have the use of the savings generated year on year.

4.6.4 The Council has conducted due diligence on the TSC Group (undertaking Creditsafe checks on the TCS company that is an LLP Member and Town Centre Securities PLC) which confirms a credit rating of "very low risk" for both entities.

4.6.5 As a 50% member of the LLP, the Council is effectively its own landlord, and has visibility and control over the affairs and actions of the LLP (e.g. in respect of forfeiture of the Lease, and in procuring insurances for and maintenance of Merrion House).

5. Conclusions

5.1 The proposed Rent Advance transaction will provide the savings to the Council outlined above. In addition, it will allow for distribution of capital by the LLP to support the TSC Group's further developments in Leeds.

5.2 It is considered that this Rent Advance transaction is state aid compliant, and that risks associated with the payment of Rent Advance have been appropriately addressed.

6. Recommendations

- 6.1 The Chief Officer Financial Services is recommended to agree to the Council making the Merrion House rent prepayment.
- 6.2 The Director of City Development and Chief Officer Financial Services are recommended to approve entering into all necessary arrangements (including financial) to facilitate such Merrion House rent advance and distribution of the Council's share as an LLP member, in accordance with their respective schemes of delegation.

7. Background documents¹

- 7.1 None.

8. Appendices

All of the appendices are exempt under Access to Information Rule 10.4(3).

- 8.1 APPENDIX 1 – Main Issues
- 8.2 APPENDIX 2 – Legal Adviser Report
- 8.3 APPENDIX 3 – Market Equivalent Debt Rate Report
- 8.4 APPENDIX 4 – Insurance Summary

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.