

Briefing Note for inclusion in Investment Board records – Friargate Scheme Assurance Process

Sean Pearce - Director of Finance

22 March 2018 - (Outcome of Special Meeting on 13 February 2018 prior to the Investment Board)

The meeting was needed to address questions of how the public sector funding of 100% of development costs for an office building through a 50/50 JV between a private company and CC. This was to cover the way the proposal is structured to ensure that the public sector sees significant upside / benefits and the private company does not earn significant profits given the extent of public sector funding.

1) Inclusion in the Original Devolution Deal 1

Confirmation has been provided that £51 million of WMCA grant funding for Friargate clearly formed part of the Coventry City South £150 million allocation within the first Devolution Deal agreed by gov't and the WMCA authorities in 2016.

Confirmed through Interim Chief Executive, FD and Monitoring Officers and demonstrated through Finance and Internal Schedules share with Local Authorities that the scheme is understood to be part of the Original Programme.

2) Agreement of Funding mechanism

a. Original proposal and agreement based on a Grant

The basis of the overall Investment Programme is on a Grant. The original outline proposal was for the £51 million to be made available as grant funding to the development however the proposal has evolved to the current proposal of a grant from WMCA to Coventry City Council (CCC) with a subsequent loan being made from CCC to the developer. In parallel, CCC is acquiring a 50% interest in the Friargate development JV.

Finance Directors for the WMCA and Constituent Authorities agreed earlier in 2017 largely the Investment Programme was to be based on a Grant that recognised the risk and reward of each scheme was held locally.

Coventry City Council in its Cabinet Approval in January 2018 stated that delegated authority was agreed to agree the grant with the WMCA to facilitate the scheme.

Each Investment in the Investment Programme secures additional business rates and other benefits as required to be documented in the current Assurance Framework. Estimated at £5.8 million per annum (assuming the buildings are fully let) or £93 million over the Business Case (25 years) for Phase 1 of Friargate.

The Technical Appraisal Panel and Investment Advisory Group Teams have developed, reviewed and assured an 80 Page Business Case in accordance with the WMCA Assurance Framework as part of this Project Approval.

The Project has been subject to 5 stages of review prior to a paper at the WMCA Board.

b. Grant Agreement arrangements

Remaining work on the Grant Agreement and Conditions Precedent post WMCA Board

Standard clauses around 'back to back' draw downs, links to the capital asset delivered and delivery of outcomes and hooks for review. In addition we have agreed to include:

- Retention of Funds within Scheme rather than leakage to Coventry City Council
- Review Clause prior to rolling over funding from Building 1 to Building 2
- Drawdown matched to pass through to JV

2) Clarity on how the issues raised/discussed at the Investment Board were resolved

a. Coverage in Special Session

CLlr Seccombe (Chair), Gary Taylor (GBSLEP), Sean Pearce (Finance Director), David Cockroft (CCC Development Director), Barry Hastie (CCC Finance and Corporate Services Director) and Oluremi Aremu (CCC Lawyer). A presentation was provided by David Cockroft and a walk through of key aspects of the Full Business Case that had been assured through the TAP and IAG process prior to the report to Investment Board. This covered:

1. Background – to ensure members of the Investment Board understood key aspects
2. CCC background presentation included information that showed that while Friargate is an excellent office location for a new CBD for Coventry, development of new office space is commercially marginal given construction costs and the current level of rent that could be commanded. The site is key to CCC's plan for the economic and special regeneration of Coventry City Centre. Structuring Options considered by the City Council (outlined in Section D and E of Business Case) This included options considered by CCC for bringing forward development e.g. CCC negotiated site purchase, CPO of site, Lease wrapper/income strip for first building, CCC forward funding of building, CCC guaranteeing min sale price for building.

None of the options provided the necessary assurance or control to bring forward the whole 37 acre Friargate site. In addition, CCC was concerned that without a comprehensive approach involving the whole site, the developer could look to deliver a residentially led development that would not bring forward employment opportunities and future business rates.
3. Overview of Key Risks (Section C5 of Business Case) Key headlines of Grant Agreement including State Aid, Procurement and cost risk discussed
4. Legal Arrangements on the Joint Vehicle
 - Joint Vehicle (covered work delivered and planned on the agreement) including:
 - Covenant Strength check of JV Partner undertaken by Coventry City Council
 - JV covers interest in assets across the whole of the Friarsgate Development which extends to a total site area of 37 acres.
 - The City Council has achieved controls over JV Interest being sold down
 - If the JV Partner fails then the JV will be taken over by the City Council (through JV agreement or via exercising loan security) with the Assets of the whole site being passed to it
 - Partners tied into reinvestment of development proceeds into further parts of Phase 1 (offices).
 - Friargate LLP is putting in Land alongside the new financing. The Land contribution is subject to an independent Red Book Valuation. CCC is making a cash contribution equivalent to 50% of land value from internal CCC funding.
 - Loan (Senior Term Loan Facility)
 - Coventry City Council shared key commercial aspects of the Senior Term Loan Facility and Security over the JV (and JV Partner).
 - Profit on Loan provided by the City Council will be hypothecated to the payment of overheads to prevent leakage into the City Council of surplus
 - If risk is realised – e.g. rent not available to repay loan. The City Council will have a step in around the Loan Agreement should repayments not be able to be made

- Facility goes into Construction of Office Block. Equity from City Council and Friargate LLP is used to purchase the outstanding debt from the National Asset Management Agency to release the charge on title and take forward the development

In summing up, the Chair asked whether those concerns raised at the Investment Board had now been addressed to the satisfaction of those present and confirmation of this was received.

b. Lack of Market Analysis (Full Business Case within Section D2)

Assured by the TAP and IAG Process.

In summary this sets out forecast KPIs, assumptions on Rental Values, Supply and Demand Drivers and the results of Market Testing. This is supported by three reports, an Office Market Report in May 2017 by Lambert Smith Hampton and then by two specific scheme reports commissioned in September 2017 by Cushman and Wakefield and Savills.

This was discussed at Investment Board with specific challenge around the occupancy assumptions and rental assumptions. The assumption is a 30% occupancy in Year 1 with a 100% in the year after with specific rent free periods that were discussed as on market. This was again challenged at the Special Session.

c. Query on 100% Public Funding

The Funding Ratio for the first part of Phase 1 is set out in summary in the reports for the whole scheme and in detail within the Full Business case and is as follows:

- £51 million (72%) Grant from WMCA to enable a Loan into the Joint Vehicle
- £10 million (14%) Coventry City Council contribution into the Joint Vehicle
- £10 million (14%) Contribution into the Joint Vehicle from Friarsgate LLP which is part financed by a Loan from Coventry City Council
- - Land Contribution of the entire Friarsgate development (37 Acres) following the release of the Legal Charge by NAMA. This is being provided into the JV.
- £71 million Total

The total investment across the whole of Phase 1 (4 office buildings) is £223 million. The capital required for subsequent buildings is funded through the Revenue Streams generated from each building within the first phase (once it is let) which will be used as the funding stream for further borrowing.

d. Developer and Local Authority Relationship

The founders of Friargate LLP are CannonCannon Kirk. Confirmation was provided that there is no relationships that create a potential conflict of interest.

e. Relationship of Profit, Investment and the 50/50 Joint Vehicle

Background to developing the Joint Vehicle and the other potential procurement choices are set out in Sections A, D and E of the Full Business Case discussed.

CCC work undertaken showed that while Friargate is an excellent office location, development of new office space is commercially marginal given construction costs and the current level of rent that could be commanded. For the first office building, the likely future building value will provide security for the CCC loan facility. There is unlikely to be any significant development profit so the private sector partner will not make significant returns. Furthermore, the JV provides for all proceeds to be reinvested in future development phases such that any profit / surplus cannot be distributed until a substantial development programme is completed.

f. Provision of Commercially Sensitive Information

The Investment Board had previously received confidentially sensitive information on a separate project in December 2017 that had to be withdrawn.

To ensure that this did not reoccur a process was agreed to present a summary report that ensured the project was capable of approval that set out key information and the work of IAG and TAP in providing assurance across the detail of work.

It was clear from the January Board that this was too high level as set out in the minutes and changes were put into place for the February Board to present a more detailed summary report and then where required for the Full Business Case to be provided in Private.

The covering report to both the Investment Board and the WMCA board notes that all elements of the Assurance Process in relation to the Full Business Case have been satisfied.