

Cabinet - 27 July 2020

Lease for New Offices in Birkenhead Commercial District

Appendix 3- Report on the proposed Legal structure (less sensitive information) Transaction guide

Introduction

This transaction guide is intended to provide a broad explanation as to the documentation required for the development and letting to the Council of Phase 1 of the Birkenhead Commercial District ("**BCD**") by way of an annuity lease. Phase 1 will comprise two office buildings with a total square footage of approximately 150,000 sq ft.

The development is to be procured through the Wirral Growth Company LLP ("**WGC**") in accordance with the partnership agreement entered into by the Council. Funding for the development will be provided by a third-party investor, yet to be identified ("**Funder**"). That Funder will ultimately acquire WGC's interest in Phase 1 and will become the Council's landlord. The identity of the Funder and Council landlord cannot be controlled by the Council and it could be an off-shore entity or private equity investment vehicle.

The Council is in the course of acquiring the site for Phase 1 at Milton Pavements. The Council will agree to put the site into the partnership arrangements with WGC. WGC will agree a sale of the site to the Funder. The Funder will lease back the site to the Council and fund the construction of the new buildings which are to be arranged by WGC as per the partnership arrangements. The Council will pay rent for the buildings for a term of 35 years from the date on which the buildings are completed. This will provide the financial return to the Funder. Once that rent has been paid, the Council will have an option to collapse the arrangement and will own the freehold of Phase 1 with no continuing obligation to pay any more rent.

The annuity lease structure enables a capital sum to be generated for the LLP to enable other developments that may be approved and developed under the LLP Partnership Business Plan and Site Development Plan process.

The capital sum is partly factored on the rental income payable by the Council under its lease.

Option agreement

As part of the partnership arrangements to establish WGC, WGC have an option to acquire various properties owned by the Council. The Phase 1 site at Milton Pavements is in the course of being acquired by the Council. The option agreement will be varied so as to add in the Milton Pavements site, subject to the Council completing the acquisition. The development of Phase 1 will then be subject to the pre-agreed arrangements dealt with in the option agreement and the Partnership Agreement. WGC will need to satisfy a number of conditions before it is entitled to draw down the site pursuant to the option agreement. These include:

- satisfactory planning permission;
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- all other necessary consents and approvals having been obtained to commence the development;
- an agreed partnership business plan and site development plan;
- a Funder having committed to provide finance for the development;
- all building contracts and appointments of the professional team and the supply team in relation to the development of the site having been agreed;
- WGC and the Council having agreed the price for the site; and
- it being established that the return to be made by WGC from the development is in accordance with the agreed site development plan, or WGC having agreed to waive the return.

Agreement for lease

When the option is exercised an agreement for lease will be entered into governing the transfer of land arrangements and the provisions for development of two new office buildings. The agreement for lease will be entered into between the Council and WGC.

WGC would procure the development of the site, appoint the building contractor and the professional team (where not directly appointed by the building contractor). Assuming the Funder agreed with WGC to fund the development of Phase 1, the option, so far as it relates to Milton Pavements, would be transferred by WGC to that Funder and the Funder would enter into the agreement for lease instead of WGC.

The agreement for lease is a very important document as it is a document which the Council will negotiate and enter into in its capacity as tenant of Phase 1 (with all the usual obligations that a tenant has) rather than in its capacity as a joint venture partner in WGC.

The agreement for lease will only be entered into when the conditions under the option agreement have been satisfied. Immediately following the agreement for lease (i.e. a few seconds later) the Council will grant a long lease (circa 250 years - **“Long Lease”**) of the site to the Funder (see below). Immediately thereafter, the Funder will grant a short lease (circa 40 years - **“Short Lease”**) of the site back to the Council. Both the Long Lease and the Short Lease will be granted before any building works take place.

The Long Lease will be granted in consideration of a premium paid by the Funder for the site. This is the premium which will have been agreed with WGC as a condition to the exercise of the option. This is unlikely to be less than the amount which the Council paid to acquire the site from the current owner, although it has yet to be agreed.

Stamp Duty Land Tax

Ordinarily, when a lease such as the Short Lease is granted stamp duty land tax ("**SDLT**") is payable by the tenant. However, there are certain exemptions from SDLT and one of these relates to a situation where a landowner (here the Council) transfers the land to a third party (here the Funder) and that third party (here the Funder) immediately grants a lease back of that land to the landowner (here the Council). In those circumstances, the SDLT legislation is satisfied that the third party to which the land is transferred will pay SDLT and the landowner which transferred the land in the first place does not need to pay SDLT on the grant of the lease back.

The legislation around SDLT and sale and leaseback relief is very complicated and the application of the facts of each transaction to the law is also difficult. Each case is different. No guarantee can be made, principally because it always depends on the facts of each case and HMRC's interpretation of the situation. However, there is a very strong argument that no SDLT will be payable by the Council in respect of the grant of the Short Lease to the Council.

Building Design and development

At the time the Milton Pavements site is added into the option agreement, the detailed design for the development will not have been agreed. Accordingly, the Council will not be certain as to exactly what will be built pursuant to the agreement for lease and which the Council will be renting under the Short Lease. The option agreement will be varied to incorporate provisions as to the preparation of the detailed design and agreement between WGC and the Council. Once the agreement for lease is entered into, WGC will be under an obligation to procure that the building contractor carries out and completes those works in an appropriate fashion.

WGC would appoint a Contract Administrator to represent it as employer under the building contract. It will be the Contract Administrator who decides when the building works have been completed. This will be entirely the Contract Administrator's decision, although the Council will be able to make representations. The Council will have the benefit of a collateral warranty from the Contract Administrator and will be able to sue the Contract Administrator for damages if the Contract Administrator incorrectly certifies that building works have been completed.

WGC will be obliged to endeavour to procure that the building works are completed within an agreed period after the start date on site.

Once the detailed design has been agreed, WGC will not be allowed to make variations to the specification save for usual reasons such as changes required to comply with statutory requirements, variations which the building contractor is entitled to make under the terms of the building contract and so on.

Fit Out

Fit out of the building is a separate cost which the Council will need to pay. How it procures internal fit out is yet to be decided

Requesting changes to design

The Council may itself request variations to the building works, but extreme caution should be exercised in doing so. Inevitably, variations to works after a building contract has been signed will lead to significant costs which will be much higher than would have been the case had those variations been incorporated in the original design. If the Council do request variations then WGC will not unreasonably withhold or delay consent to any such request but will not be obliged to agree to any variation which may delay completion of the works beyond the target date or breach any other matters which are set out in the agreement and are viewed as "material". These include an alteration of the floor area by plus or minus three per cent, a material alteration of the layout of the works, a material alteration of the external appearance of the works or any increase (no matter how small) of the cost of the works (unless the Council agrees to pay that cost as a capital sum).

Rent payable

Once the works are completed, the buildings will be measured so as to determine the lettable area. The lettable area will then be multiplied by the agreed rate per square foot to arrive at the rent payable by the Council under the Short Lease.

Long Lease

The Council will grant the long lease to the Funder immediately after (i.e. a few seconds after) the agreement for lease is entered into.

The Long Lease will be for a term of 250 years with no rent payable, but the Council will receive a premium, which will be the price determined pursuant to the option agreement, as already mentioned.

Any obligations which are passed down to the Funder under the Long Lease will be passed back to the Council as tenant under the Short Lease. The role of the Funder under the Long Lease will, effectively, be to collect the rents from the Council for the agreed period of 35 years from the date of completion of the building works.

Once the agreed rents have been paid by the Council, the Council will have an option to acquire the Long Lease from the Funder and effectively collapse the leasehold structure.

Short Lease

The form of Short Lease is yet to be finalised. However, it will be granted for a term of 40 years, with rent payable for a term of 35 years from the date when the works to complete the buildings have been finished. It is likely that the buildings will be completed separately, so the rent payment period would be different for each building. The rent will be payable in equal quarterly payments in advance. The rent is set by the agreement for lease and depends on the final size of the building. The rent payable from the date of practical completion of the buildings is to be ascertained by multiplying the "agreed rate" by the agreed lettable area (as referred to above).

In addition, the Council will be obliged to pay running costs for the buildings, such as insurance and service charges. The Council will also pay all outgoings payable in respect of the buildings.

The other key terms of the Short Lease are:

- the Council will be obliged to keep the premises in good and substantial repair and condition;
- the Council will not be permitted to carry out any external or structural alterations or additions but will be entitled to carry out internal non-structural works without consent;
- the Council cannot use the premises for use other than as offices within Class B1(a) of the Town and Country Planning (Use Classes) Order 1987, although some limited relaxation of this is likely to be negotiated;
- for the life of the lease, the Council cannot assign the lease and must remain as tenant for the full term. The Council is, however, permitted to underlet whole or part of the premises with the landlord's approval. Underlettings are subject to certain requirements but it is expected that a number of these requirements suggested by WGC will be negotiated out. At the moment, if it is an underlease of part, the Funder has to approve the part. Underlease rent reviews cannot be agreed without Funder consent and all underleases have to be outside the 1954 Act; and
- it is the Council's responsibility to comply with all statutory requirements relating to the Property, whether existing or new.

The lease can be terminated by the Funder in certain circumstances. These include non-payment of rent, breach of the tenant's covenants and conditions in the lease or insolvency type events in relation to the Council.
