

CABINET**30 SEPTEMBER, 2019****TOWER ROAD SOUTH - OFFICE DEVELOPMENT: PUT/CALL OPTION**

Councillor Tony Jones, Cabinet Member for Regeneration and Growth said:

“It is increasingly important for us as a Council to ensure we are outward looking and creative in bringing in revenue to support the delivery of the vital public services Wirral residents expect, as the continuing impacts of austerity increasingly create financial pressures. Ensuring Wirral is open for business, ready to welcome investment and promoting positive development in the borough is an incredibly important part of this.

Supporting developers in bringing forward much-needed high quality office space while at the same time kick-starting development on this part of Wirral Waters delivers these objectives.”

REPORT SUMMARY

This report seeks Cabinet approval to the Council entering into a PUT/CALL option with Peel Land and Property to enable Peel to nullify the risk of them constructing Tower Road South (TRS) a speculative 3,116sq.m Grade ‘A’ office building on Tower Road South. From a Council perspective this major thoroughfare through Wirral Waters has been identified as providing significant growth opportunities.

Specifically Peel’s construction of TRS delivers:

- A BREEAM Excellent rated Grade ‘A’ office building in the Four Bridges neighbourhood of Wirral Waters;
- Potential to create 280 gross direct and indirect jobs;
- 1 acre of brownfield land developed
- 150 college students assisted in their skills development and;
- Support for the development of the Mersey Waters Enterprise Zone by attracting new occupiers to Wirral Waters.

The PUT/CALL arrangement works by both parties entering into an option agreement that allows for Peel to require the Council to purchase from them after an agreed period of time (in this case three years from practical completion of TRS) the building at the pre-determined purchase price (the PUT option) or for the Council to require Peel to sell them the property in the same timescale at the pre-determined price (the CALL option). The completed value of the building has been determined by a detailed scheme appraisal carried out by the Combined Authority as part of Peel’s application for SIF grant support for TRS. The

triggering of the PUT/CALL option is not obligatory on either side and will have a definitive end date for accountancy purposes because if during the 3 years post practical completion period TRS is valued at a sum equal or greater than the PUT option price then the Council's obligation to Peel immediately falls away. Notwithstanding this scenario and depending on valuation Peel can only trigger the PUT option at 3 years from practical completion of the building. The Council has however negotiated the right for it to exercise its CALL option anytime during the 3 years and without the obligation falling away. This means that if market conditions strengthen over this period and the value of the completed development increases, the Council has the right to purchase the asset from Peel for the lower pre-determined price.

The strategic case for the acquisition is set out below in the report. However the commercial details of the proposal are contained in the attached business case which has been approved by the Investment and Change Board and which is exempt from publication due to commercial sensitivity considerations under Schedule 12A of the Local Government Act 1972.

RECOMMENDATION/S

1. That the Council should seek to enter into a PUT/CALL option with Peel Land and Property for the reasons outlined in the attached Business Case and on terms consistent with the advice contained in the report of Cushman and Wakefield so as to ensure compliance with the rules on State Aid
2. That delegated authority be given to the Director of Housing and Economic Growth in consultation with the Director: Governance and Assurance to negotiate and agree the terms of the Put/Call option with Peel Land and Property.

SUPPORTING INFORMATION

1.0 REASON/S FOR RECOMMENDATION/S

- 1.1 To allow Peel to commit to the construction of TRS as the PUT/CALL option gives the certainty that they can recoup their original investment in the building at 3 years from practical completion even if its book value may have fallen at that date due to weakening market conditions. From a Council perspective the arrangement allows for the regeneration of Tower Road South to commence and critically begin to grow revenue streams by widening the rates base. It also allows the Council the option of purchasing the building within 3 years from its practical completion for a consideration less than its potential value at the time if the property market in Wirral Waters becomes established and values have increased.

2.0 OTHER OPTIONS CONSIDERED

- 2.1 There are a number of option open to the Council to secure the construction of TRS. These are considered in the Full Business Case (FBC) that is attached as an appendix to this report.

3.0 BACKGROUND INFORMATION

- 3.1 Peel approached the Council in 2018 to enquire as to whether the Authority would be prepared to help to share the risk of them constructing Tower Road South, a speculative Grade 'A' office development on Tower Road that, given its speculative nature, would be commercially unviable even with the support of SIF grant.
- 3.2 Recognising the need to kick start the regeneration of Wirral Waters and grow our revenue stream by widening our rates base the Council agreed to explore a variety of options that could be made available to Peel to nullify the risk of building speculatively in a location where traditionally developments were unviable as end values were less than the actual costs of development.
- 3.3 Critically ensuring that there was a potential demand for the proposed office development was a key issue for the Council before any commitment could be given to enter into a PUT/CALL option. In response to this, and to support their SIF funding application, Peel Land and Property commissioned property experts GVA, now renamed Apleona, to refresh a Wirral Office Market Review that they originally completed in March 2017. Apleona concluded that due to the strong employment growth from 2013 there has been an increase in occupier demand and transactional activity for new office space which has coincided with the economic upturn. There are also other drivers of occupier demand such as merger acquisition activity, building obsolescence and shorter-term leases which have resulted in an increase in occupier demand. Where new office schemes have been developed in Birkenhead Town Centre speculatively, such as Queensgate, they have been successful in attracting occupiers. The report concluded by stating that the majority of office take up in the future is likely to focus on Birkenhead Town Centre and Wirral Waters. This expert opinion was critical in the decision-making process and provided the Council with the market intelligence needed to commit to the PUT/CALL option.

- 3.4 In terms of the support needed from the Council to support the Peel proposal it was agreed that entering into a PUT/CALL option was the most effective way of ensuring that the new development was constructed. The attached FBC provides a full option appraisal and outlines why entering into a PUT/CALL option was deemed to be the most efficient way of supporting the development of the project.

4.0 FINANCIAL IMPLICATIONS

- 4.1 The attached FBC details the financial appraisal that has been undertaken on the project.
- 4.2 If the PUT option is exercised by Peel, the Council will be required to purchase the building for the agreed price of £4.98m. This will need to be included in the Council's capital programme. At this stage it is not known whether this option will be exercised so inclusion in the capital programme will not be considered until the year preceding the potential purchase unless robust data can be provided before then that would indicate that the option will be exercised. This is a prudential approach so as to not overstate the capital programme in advance. The same impact on the capital programme would apply if the Council were to exercise the CALL option and chose to purchase the building.
- 4.3 The potential revenue impact of a PUT option being exercised could be negative as it is assumed that Peel would not exercise this option if the market is strong and the building is occupied. This could present a pressure to the Council of between £0 and £444k per annum. At this stage it is not known whether this option will be exercised so inclusion in the Medium Term Financial Strategy (MTFS) will not be considered until the year preceding the potential PUT option being exercised unless robust data can be provided before that would substantiate this. This is a prudential approach so as to not overstate the pressure in the MTFS before then.
- 4.4 The potential revenue impact of a CALL option could be favourable for the Council as the Council would exercise this option if the market is strong and the building is occupied. The financial impact of this option would generate a net income for the Council of between £1 and £401k in a most likely scenario. At this stage it is not known whether this option will be exercised so inclusion in the Medium Term Financial Strategy (MTFS) will not be considered until the year preceding the potential PUT option being exercised unless robust data can be provided before that would substantiate this. This is a prudential approach so as to not overstate the income in the MTFS before then.
- 4.5 If either PUT or CALL options are exercised the Council would be liable to pay a one-off payment of Stamp Duty Land Tax (SDLT) in the year of purchase.
- 4.6 The market position and occupancy levels of the building will be monitored on a half-yearly basis to determine the potential outcome of the PUT/CALL scenarios and the MTFS and Capital Programme will be updated as necessary during the three years following completion.

5.0 LEGALS IMPLICATIONS

- 5.1 A legal requirement of the PUT/CALL option is that it has to be Market Economy Operator Principle compliant (MEOP) to satisfy State Aid. MEOP is a concept which

determines whether a transaction entered into by a public sector organisation gives a selective advantage to a private sector organisation and therefore falls within European State Aid rules. In broad terms an economic transaction carried out by a public sector body does not constitute State Aid if it is in line with normal conditions and a market operator, of similar standing, could have been prompted to enter into the transaction on the same terms. The Council, to ensure compliance, commissioned independent property experts Cushman and Wakefield to assess the project and they have confirmed that the appraised PUT/CALL value for TRS is MEOP State Aid compliant. This conclusion has been further endorsed by the state aid expert at legal firm DWF LLP.

- 5.2 The legal support to complete the appropriate documentation will be provided in-house. Further details of the legal implication of the project are covered in the FBC.

6.0 RESOURCE IMPLICATIONS: STAFFING, ICT AND ASSETS

- 6.1 The proposed transaction may place the Council in the position of commercial Landlord and appropriate management of the tenant will be needed.

7.0 RELEVANT RISKS

- 7.1 The main risk to the Council of entering into a PUT/CALL option with Peel Land and Property is based on a downturn in market conditions and/or low demand for the office space once it has been constructed. Under the terms of the PUT/CALL option this would commit the Council to purchase the building from Peel at a value that could be less than its then market price (conversely if the market does strengthen, as expected, it will give the Council the opportunity to purchase the building for a sum less than its then market value). The risk can be managed by a range of measures that the Council can undertake with Peel including entering into a joint marketing strategy for the office building that would allow the Council to work alongside Peel to ensure that the building is fully let. In addition this project is one of a number that will be commenced along Tower Road and Dock Road over the next 2-5 years which will help to establish and then grow the property market. Members are aware that the Legacy project has now been approved with a start on site expected by November Peel has also submitted detailed planning consents for The Belong Village and a 347 unit residential scheme designed by Urban Splash. It is expected that these projects, taken together, will create a critical mass of development that will drive market confidence leading to strengthening property values as the area becomes established.
- 7.2 The attached FBC provides a further analysis of the risks associated with PUT/CALL option alongside the mitigation measures that will be put in place to ensure that they are appropriately managed.
- 7.3 To mitigate the risk of an unplanned revenue pressure, market conditions and the building occupancy will be reviewed on a six monthly basis. If at any time it is deemed that there may be a potential revenue pressure at the end of the three years, the MTFS will be updated to reflect this
- 7.4 If the PUT option is exercised the Council will exercise its option to opt to tax, which means that rental payments to tenants will include VAT. If this has not been the policy in the three years preceding the PUT option is exercised, this will increase the rents

to tenants by 20% and could result in tenants vacating their rental agreements at the appropriate time and the risk of the pressure on the MTFS being realised.

8.0 CONSULTATION

8.1 This is a sensitive commercial transaction and so no consultation has been undertaken.

9.0 EQUALITY IMPLICATIONS

9.1 There are no equality implications arising out of this report.

10.0 PLANNING IMPLICATIONS

10.1 Tower Road South secured detailed planning consent June 2019.

REPORT AUTHOR: Ray Squire
Economic Development Manager
0151 691 8096
raysquire@wirral.gov.uk

APPENDICES – APPENDIX 1 – TOWER ROAD SOUTH: FULL BUSINESS CASE.

BACKGROUND PAPERS

No background papers have been used in the preparation of this report.

Council Meeting	Date