

Station Approach

Winchester Strategic Placemaking Consultant

V1 Chapter 3 Redacted



Disposal Options Report August 2019



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1 Introduction

1.1 Context

The Council has undertaken significant work developing the platform to unlock a transformational office led development at Station Approach.

An Outline Business Case prepared in March 2019 outlines substantial strategic and economic benefits associated with delivery of the scheme. For example, in relation to economic outputs, the Economic Case prepared by Grant Thornton (dated 14 March 2019) calculates:

- Gross additional jobs (direct and indirect) – 1,357
- Gross additional GVA (direct and indirect) - £81.3m
- Net present value - £569m (medium estimate)

The Outline Business Case and associated due diligence underpinned a Cabinet decision on 29th March 2019 which, amongst other things, authorised the Head of Programme to submit an outline planning application for the Carfax development scheme based on the RIBA Stage 2 Design Work.

This has led to a live outline planning application to deliver the following:

- Mixed use grade A office led scheme: B1: 17,972m²; A1, A3, A4 and D2: 1,896m²
- Up to 95 spaces associated car parking (reduced from up to 135 spaces originally)
- Minimum of 156 cycle parking spaces
- Retention of registry office
- Access off Gladstone Street
- Diagonal pedestrian route through the site to a raised table crossing on Sussex Street

It is currently anticipated that the outline planning application will be determined no later than the end of October 2019.

The Council has been successful in attracting a grant offer from the Local Enterprise Partnership for £5m of funding to deliver the public realm improvements, plus support certain abnormal costs associated with delivering the office-led development. We understand that the grant offer is subject to achieving spend by the end of March 2021.

The March 2019 Cabinet decision in parallel authorised the Head of Programme in consultation with the Head of Legal to investigate further the two preferred delivery approaches of income strip or sale with planning permission.

The Council now needs to determine the optimal route to move from the current position to scheme delivery. This paper sets out the commercial context influencing the decision and aims to support the Council make an informed choice.

2 Comparison of Disposal Options

2.1 Introduction

The Council analysed five potential disposal options as part of its Outline Business Case in March 2019. These are summarised below:

- **Do nothing** – the site remains as a public car park
- **Sell with outline planning consent** – the Council sells the site with the benefit of an outline consent, for development by a purchaser
- **Joint venture** – the Council invests its land in a joint venture alongside a development partner who finances and delivers the construction. (The Council’s analysis also assumed that the Council buys back ownership of the scheme upon completion. Typically, in joint ventures of this nature, this would not be the case; rather the Council and developer would share the profit generated by the scheme upon sale to an end investor, with the return distributed to the respective parties based on how much investment they had made)
- **Direct development** – the Council constructs the scheme and grants leases for the office/other accommodation
- **Income strip** – a developer delivers the scheme funded by a 40-year index linked headlease to the Council (after which the property reverts to Council ownership). The Council in turn is responsible for all letting/income risk during the term of their headlease

As part of its analysis the Council prepared the following SWOT analyses (in summary form):

2.2 Sale with Outline Planning Permission

Strengths	Weaknesses
Minimal Cost to Council (Beyond Cost of Obtaining Outline Consent) Lowest Demands on Officer Time No Procurement Issues if a Land Sale Reduced Adverse Political Risk Post Sale Quickest Process Lowest Risk	Relatively Small One-Off Capital Receipt Limited Ongoing Income Generation (Potential Ground Rent)
Opportunities	Threats
Quickest Financial Receipt Earliest Business Rates Generation Potential Ground Rent Income	Smallest Financial Reward Loss of Control (Except for Planning and Potential Landlord Rights) Market Conditions may Deteriorate and Render Development Unviable

2.3 Joint Venture

Strengths	Weaknesses
Council Shares Risk with a JV Partner	No Guarantee of Finding a Suitable JV Partner Time/Complexity/Cost of Establishing JV Potential for Future Friction between Council and JV Partner (e.g. Quality, Viability etc.)
Opportunities	Threats
The Council Achieving Proportionate Reward to Risk Commercial Skills and Resource Benefits to the Council	Issues with JV Partner Overtime i.e. Administration Council is Unable to Fulfil its JV Obligations

2.4 Direct Delivery

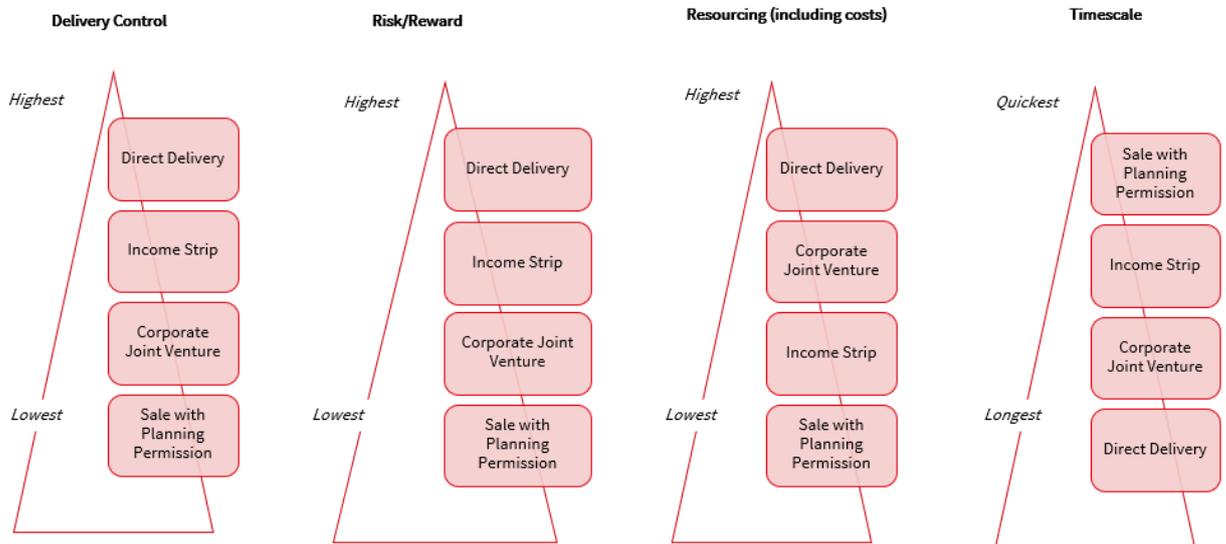
Strengths	Weaknesses
High Reward Ultimate Control Potential to Forsake Return in Lieu of Enhancing Design	Council Takes All Risk Council Procures All Elements Liable for All Void Costs Council Capacity Given All Other Council Projects/Commitments
Opportunities	Threats
Strong Message in Terms of the Council's Ability and Commitment to Deliver	Negative Changes to the Occupational Market and Resultant Inability to Secure Appropriate Pre-lets Holding Costs During Void Periods Greatest Pressure on Officers Highest Reputational Risk

2.5 Income Strip

Strengths	Weaknesses
Not Liable for Construction Costs Ownership Reverts to the Council at the End of the Period	Ownership is Passed to a Developer/Funder for a Fixed Period The Council Guarantees to Pay Rent Regardless of Whether it is Receiving Any Income i.e. Absorbs all Income Risk
Opportunities	Threats
Potentially Quicker Than a JV Model	A Negative Income Stream During the Lifetime of the Agreement (whereby income receivable from tenants does not match index-linked rental commitments under the lease)

2.6 Summary

We agree with the risks identified and the conclusions of this SWOT analysis. In simple terms, this can be summarised in the diagram below:



Leading on from the above SWOT exercise, the Council went on to score the respective delivery options. This again is summarised below (1 = highest score and 5 = lowest score):

	Do nothing – retain car park income	Sell with Planning Permission	Joint Venture	WCC Develops Site	Income Strip
Strategic Case	5	4	1	1	1
Economic Case (direct/indirect jobs and GVA; benefits realisation)	10	4	4	2	2
Financial Case (net cash flow; NPV; surplus/deficit on provision of services; business rates per annum)	14	13	7	10	5
Commercial Case	5	2	4	3	3
Management Case (control; speed of delivery; risk transference)	7	6	9	8	7
Total	41	29	25	24	18
Rank	5	4	3	2	1
Risk	5	1	4	2	3

The Council also undertook a risk moderation exercise in relation to the various options, as summarised in the final row above.

Based on this analysis, in March 2019 the Council decided that either a sale conditional on planning or income strip is preferred and should be appraised further.

2.7 Commentary on the Income Strip Approach

Most examples of income strips from around the country have been used to combat market failure – where the project is not viable on a traditional basis and the local authority has used its covenant, and accepted a long-term transfer of risk, to remove market failure and make a scheme happen which otherwise would not have been delivered. In addition, in relation to income strip arrangements involving office delivery, often the local authority taking the risk has also been an occupier in the scheme.

As per the section below, we do not believe that combating market failure is necessary in the context of Station Approach. This was supported by a recent market engagement exercise (June 2019) which indicated that there is enough market appetite to deliver a high-quality scheme at Station Approach without relying on the transfer of risk associated with an income strip.

Work previously undertaken for the Council sets out that the income strip approach has the potential to generate a higher overall financial (revenue) return to the Council when compared to sale with outline planning consent. However, that this comes with a significant long-term transfer of risk.

The Council has been clear that it does not want to pursue a delivery option which has the potential of becoming loss making in the future. On this basis, an income strip is not suitable (noting that the Council could mitigate but not eradicate this risk by establishing a sinking fund during the positive earlier years of the arrangement, to safeguard against potential negative income impact in later years).

We also note that where Station Approach is successful, the Council may decide to unlock further office-led development in the city – for example on its Cattlemarket site. Should this be the case, then the occupational market for high quality office accommodation on the scale of Station Approach would be better proven. Arguably this may provide a better evidence base on which to base a decision whether to undertake the level of risk transfer required via an income strip.

2.8 Commentary on the Sale with Outline Planning Permission Approach

The main threats associated with this delivery option set out by the Council involved a lack of control and lower financial return, coupled with an inability to generate an on-going income stream if the land was disposed of on a freehold basis.

The due diligence undertaken to produce the Cabinet paper dated March 2019 did not stipulate if the land would be disposed of on a long leasehold or freehold basis. The Council has now further examined the potential for the sale of a long leasehold interest up to 250 years.

Sale of a long leasehold interest versus a freehold interest directly responds to two of these key threats. Firstly, the ongoing role of the Council as landlord does provide an extra layer of rights which are included in the lease. Secondly, it provides the ability to generate an ongoing revenue stream. For example, the consideration (price) related to a sale of a long leasehold interest in the site could include both an appropriate geared ground rent and a capital premium (or either/or).

Subject to viability (see below), this would give an opportunity for example to seek a capital sum to repay an amount of costs incurred by the Council to date, and a geared ground rent to support loss of car parking income on the site.

Sale with outline planning consent remains on balance the market's preferred approach (again as evidenced by the market engagement exercise in June 2019). There was a preference for a freehold disposal, but also good appetite for a long leasehold acquisition.

Moreover, a sale remains the lowest risk approach, and the swiftest to implement.

Therefore, on balance we would endorse the Council's position that a sale of a long leasehold interest (250 years) in the site with outline planning consent is the optimal disposal option.

The following sections builds on this analysis and discusses market interest, viability and a proposed approach to implementing the sale of a long leasehold interest in the site.

3 Market Interest and Viability

4 Proposed Disposal Approach

4.1 Introduction

The previous sections of this report underpin the following main findings:

- A sale of a 250-year leasehold interest with outline planning consent best meets the Council's considerations in respect of risk, reward, resourcing, and timescales. This option also enables the Council, as freehold land-owner, to exercise rights which secure delivery of the scheme in accordance with its overall objectives.
- There is significant market interest surrounding the Station Approach opportunity and that now is an appropriate time to bring the opportunity to the market
- Given recent changes to the scheme, including for example a reduction in car parking required by the market and the resultant opportunity for cost saving and improved scheme cash flow, that viability has improved
- That a disposal process which seeks to drive competitive tension is anticipated to result in a high quality and deliverable scheme coming forward

The following section defines our recommended disposal approach.

Please note that this is written from a commercial perspective only and will need to be informed/verified by your legal advisors to ensure a compliant approach. This is particularly relevant in regard to OJEU procurement legislation.

Based on our discussions with the Council, the objective of the disposal process is twofold:

- To proactively market the opportunity to maximise appetite and interest and therefore optimise competitive tension
- To identify a purchaser which is best placed to deliver the Council's key scheme objectives. To date we would summarise these as the delivery of a scheme which:
 - Demonstrates best practise in low carbon
 - Is high quality in terms of design and build
 - Delivers a financial return
 - Can be delivered efficiently (for example to support spend of the LEP grant before the end of March 2021)

4.2 Approach

Based on the above, we set out below a summary of our recommended disposal approach. Please note that this is a high-level approach which will require further detailed discussion and refinement with the Council prior to launch.

The below anticipates that a Cabinet decision will be made in late August 2019 on the agreed way forward.

Step 1 – Documentation (August 2019 to October 2019)

There is a significant amount of information/documentation to be prepared before the disposal process commences. This is summarised below. It is important to ensure that this information is robust as it underpins the sale process:

- Establish a data room to include a full suite of property and supporting information; the Council already has a good level of property data given its work on the site to date
- Preparation of a very high-quality sales brochure defining the opportunity and sale process (including the approach to evaluation set out below)
- A full package of legal documentation which defines the contractual basis of a long leasehold sale subject to planning

Step 2 – Evaluation Criteria (August 2019 to October 2019)

Working with its advisors, the Council will need to agree its evaluation criteria which both give transparency to the market and allow the Council to select a best-fit purchaser.

Based on discussions to date, we advise that criteria in the following areas are utilised:

Quality

- Track record (by way of relevant examples in the last 3 or 5 years)
- Team and expertise (details of the specific team and advisors)
- Funding (ability to deliver, and confirmation in relation to use of the available grant funding)
- Programme (with anticipated key milestones and supporting rationale/evidence, including the recommended phasing of both buildings)
- Sustainability/low carbon (knowledge and commitment to implementing best practise solutions including by reference to examples; to cover car parking)
- Quality (knowledge and commitment to implementing a high-quality design and build including by reference to track record)
- Planning approach (delivery in accordance with the Outline Application/Consent, or a supporting rationale of benefits underpinning an alternative approach)
- Key stakeholders (approach to consultation)
- Risks (a commentary on key risks and how they are overcome)
- Occupiers (details of known pre-let interest and approach to securing high quality tenants)
- Speculative development (confirmation of position in relation to speculative versus pre-let development)

The underlying thinking in relation to Quality is to identify the purchaser with the best approach to delivery of the scheme, but not so as to specify the scheme under the terms of the land disposal (recognising that as a land disposal not subject to OJEU, that is not possible). These criteria will provide assurance that the right purchaser is selected, aligned with the Council's objectives.

Consideration (Price)

- Financial appraisal (submission of full appraisal to understand assumptions and robustness)
- Non-returnable deposit on exchange (to be put forward by bidders under competitive tension)
- Lease gearing (commitment to a fixed level of gearing to provide an on-going rental income to the Council; level of gearing to be determined but initial thinking is at 5% of overall rental income)
- Capital premium (to be put forward by bidders under competitive tension, and taking account of the requirement for a fixed level of gearing and a non-returnable deposit)
- Overage (to be put forward by bidders under competitive tension, reflecting the above)

The underlying thinking in relation to consideration (price) is to identify financial offers which both seek to provide an income, recognising the loss of car park income, and a capital sum, given the investment made by the Council to date.

Commercial

- Any commentary on the issued suite of legal documentation

We will need to work with the Council to refine these criteria and apply relative weightings.

We will also reserve the right to interview a selected number of bidders to clarify any relevant matters.

Step 3 – Proactive Marketing (launch end of October 2019 to coincide with planning application decision)

As above, the intention is to maximise appetite and interest and therefore optimise competitive tension by prospective purchasers.

We will work with the Council to define a marketing process to achieve this. As a minimum we anticipate that this will include:

- Preparation of a very high-quality sales brochure and data room
- Widespread advertising of the opportunity via recognised property channels e.g. Estates Gazette etc.
- Inclusion of the opportunity on JLL's website
- Discussion of an appropriate launch event
- Ongoing market engagement during the sales process period

We will monitor, with the Council, the economic climate associated with plans to leave the EU and reserve the right to, if circumstances dictate, reassess the optimal time to launch the marketing process.

Step 4 – Evaluation (January 2020)

We anticipate that the marketing process will commence at the end of October 2019. We then recommend giving prospective purchasers circa 10 weeks with bids due back in early January (January 10th).

The last three weeks of January will be used to assess bids received. This period will also be used to interview a number of the best bids received (for example up to four).

This process will allow us to select our preferred purchaser by the end of January 2019.

Step 5 – Contract (February/March 2020)

We have set aside up to two months for all legal documentation to be agreed, and for a conditional sale contract to be exchanged.

Other Matters

Please note that the Council can reserve a right to terminate the disposal process at any stage. Therefore, it is not obliged to select a purchaser and sell the site if at the end of the marketing process it should decide not to.

From a delivery perspective, we note that an OJEU process involves more stages and would therefore likely take longer than a single stage sale disposal process.

For example, a Restricted OJEU procedure would involve two stages (Pre-Qualification Questionnaire and Invitation to Tender) and Competitive Dialogue involves a further stage (Invitation to Participate in Dialogue) which can vary in length depending on the number of dialogue rounds. In our experience, an OJEU Restricted procedure could take up to three months longer than the Leasehold Disposal process described above and an OJEU Competitive Dialogue process could take up to six months longer.

From a market perspective, our experience is that developers and investors would prefer a non-OJEU process due to the perceived additional time and resource commitments that an OJEU process would command.

5 Conclusion

The conclusion of our report is summarised below:

- A sale of a 250-year leasehold interest with outline planning consent best meets the Council's considerations in respect of risk, reward, resourcing, and timescales. This option also enables the Council, as freehold land-owner, to exercise rights which secure delivery of the scheme in accordance with its overall objectives
- A rental value of £35.00 per sq ft will set a new prime rent for the location. There are regional examples where in excess of £35.00 per sq ft has been achieved, notably in Reading. An opportunity exists for a new office development in Winchester to set its own rental tone as there are no existing new build benchmarks for the area.
- There is significant market interest surrounding the Station Approach opportunity and that now is an appropriate time to bring the opportunity to the market
- Given recent changes to the scheme, including for example a reduction in car parking required by the market and the resultant opportunity for cost saving and improved scheme cash flow, that viability has improved
- That a disposal process is anticipated to result in a high quality and deliverable scheme coming forward
- An efficient single stage disposal process of a 250-year leasehold interest in the site subject to planning can drive competitive tension and identify a best-fit purchaser by the end of March 2020



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