

Overview & Scrutiny Regeneration & Skills Jan 18

- PART 1** **Overview – Pre-bid and Post-bid**
- PART 2** **Commercial & Financial Transaction**

PART 1 – An Overview

- Legal Relationship pre-purchase
- Market Offer
- Powers to Act/Policy context
- Treasury Management/Capital Strategy
- Timeline of Events, 3 stages
- Critical Decision-making Factors
- Advisors
- Diligence process
- Conclusions
- Corporate Holding Structures
- Cabinet approvals
- Investment finance
- Taxes
- Management Arrangements

Legal Relationship Pre-purchase

Sefton MBC owned the freehold of the Strand Shopping Centre

- was entitled to receive rent under the Headlease
- owed obligations to LuxCo under the covenants contained within the lease

LuxCo (G.L.Europe S.a.r.l)

- Derived an income from the subleases
- Owed obligations of the landlord under the subleases

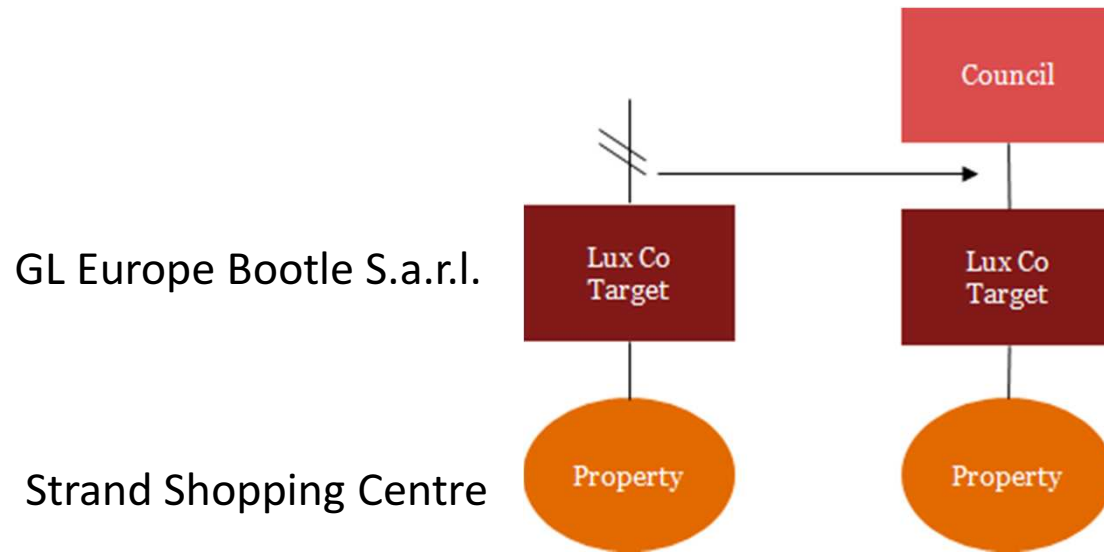
Marketing of the Strand

The Market Offer

- *The entire share capital of GL Europe Bootle Sarl, the holding company for the property, of **£35,000,000 (Thirty Five Million Pounds)**.*
- *A purchase at this level reflects a net initial yield of 8.73%, assuming purchasers costs of 1.80% on the basis of a corporate purchase.*
- *Current gross passing rent of £4.845.8m*
- *Net passing rent of £3.111m*
- *The property is held on a long leasehold basis from Sefton Metropolitan Borough Council expiring in 2138 (121 years unexpired).*
- *Asset has recently undergone refurbishments benefiting for £4.1m capital expenditure spend in last 2 years*

Market Offer

Market Offer – Acquisition of Entire Share Capital



Powers to Act/Policy Context

MTFP (Framework for Change) – approved by full Council

Vehicle through which Council will achieve its stated objectives and remain financially sustainable

“generate a financial return on new property assets and a revenue stream for the Council”

Framework for Change

Deliver against stated objectives including financial stability

Programme 4 Strategic Investment – Invest to Thrive

Programme 1 Economic Growth – create and grow new revenue streams for the Council

Local Government Act 2003 Section 1 – The Council has the power to borrow money:

“For any purpose relevant to its functions under any enactment or

For the purposes of the prudent management of its finances”

The relevant function of regeneration is relied upon.

Bootle Town Centre Investment Framework Dec 2015– approved by Full Council

Purpose – stimulate economic regeneration

Strand owner’s intent becomes clear – short period of ownership, instruction to sell

QC Advice - Conclusions

Power to Acquire

SMBC has the power to enter into either transaction:

- the head-lease (the asset)
- all of the issued shareholding of the LuxCo.

Section 1(1) of the Localism Act 2011- **General power of competence** to both pay the bid price and borrow the requisite funds

Primary motivation of the acquisition is “regeneration”, with ancillary benefit of improving Sefton’s finances i.e. importance of the centre in the regeneration of Bootle

Decision Maker

Section 9C of the Local Government Act requires the Executive (Cabinet) of the Authority to make the decision

This is expressly confirmed by the Capital Strategy 2017-20 which recognises:

- Regeneration as a priority
- That where it is appropriate to do so, Sefton can acquire strategic property for regeneration purposes
- Capital can and will be raised by Prudential Borrowing

Treasury Management

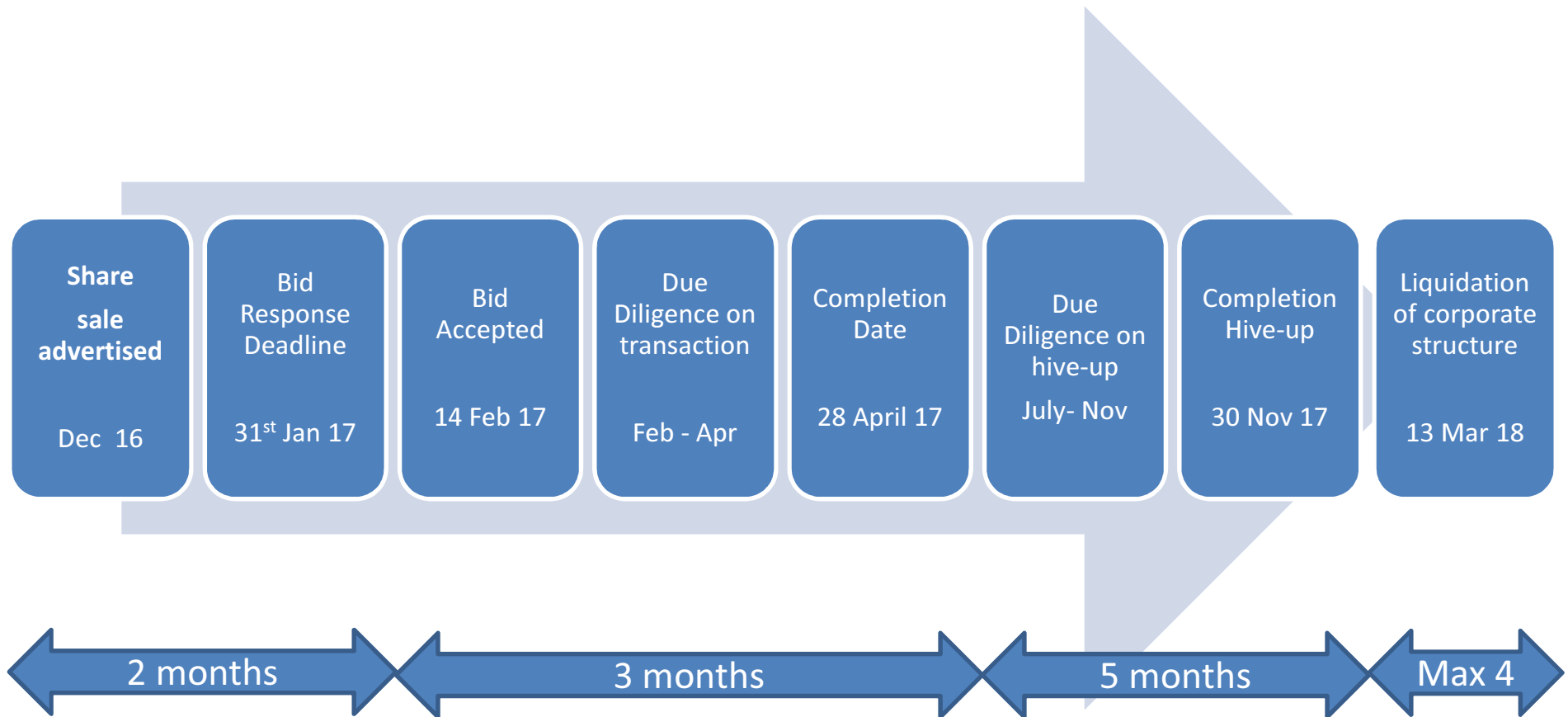
Treasury Management Strategy

- Proposed borrowing was contained within the prudential indicators of the Council's Affordable Borrowing Limit
- Indicators of "capital expenditure" and "capital financing requirement" – updated to reflect the purchase price

Capital Strategy March 17

- Local Authorities are able to borrow to invest in capital works and assets provided that the cost of borrowing is affordable/repayable (in line with CIPFA guidance)
- Sets out the investment priorities (approach to use of capital expenditure and resources)
- *"to enable wider physical regeneration....inclusive of strategic acquisitions and /or developments for re-purposing and/or to meet with town centre priorities, where specific interventions are required and where there is a sound commercial and financial reason to do so"*

Timeline of Commercial Events



Critical Decision-making Factors

Critical Decision-making Factor	Supporting Measure/Due Diligence
Powers to Act	Legal Review QC Opinion
Price (Net Asset Value)	Valuation Bid Strategy Financial Due Diligence Negotiation of the Sales Purchase Agreement
Asset Condition	Building Surveys Concrete Investigation Vendors (warranted) survey
Commercial Performance	Property due diligence Financial due diligence Legal Real Estate due diligence
Tax efficient structure	Tax due diligence Corporate due diligence

Critical Decision-making Factors

Critical Decision-making Factors	Supporting Measure/Due Diligence
Remedies and mitigation to risk	All due diligence Risk Register Sales Purchase Agreement
Long term Investment Yield	Commercial due diligence Valuation (market factors)
Capital for Investment	Budget and Policy Framework Capital Strategy Treasury Management Strategy
Business Continuity	Domicillary Agreement (LuxCo. Management) Asset Manager Property Services Manager Lettings Agent Rent Review Agent Legal representation

Procurement of Advisors

Expertise	Pre-Acquisition	Post- Acquisition
Property	Lambert Smith Hampton	Lambert Smith Hampton
Legal	Addleshaw Goddard	Addleshaw Goddard
Finance	PWC	PWC
Valuation	GVA	GVA
Legal Counsel	Edward Bartley QC	N/A
Lux Legal	N/A	Ogiers

Acquisition £'000	Post Acquisition /Hive Up Stage £'000	Total £'000	% purchase price
678	21	699	2.1%

How was the Diligence Applied?

- Red/amber/green issues identified

HIGH IMPACT – this means we believe the issue to be one which is fundamental to the Council in its evaluation of whether to proceed with the Acquisition;

MEDIUM IMPACT – risks which we believe are material for the purposes of the Acquisition and which may affect the contractual protections the Council seeks under the SPA. This may include remote risks which, if applicable, would have a material impact on the Acquisition or the Council's ownership of the Company and Property; and

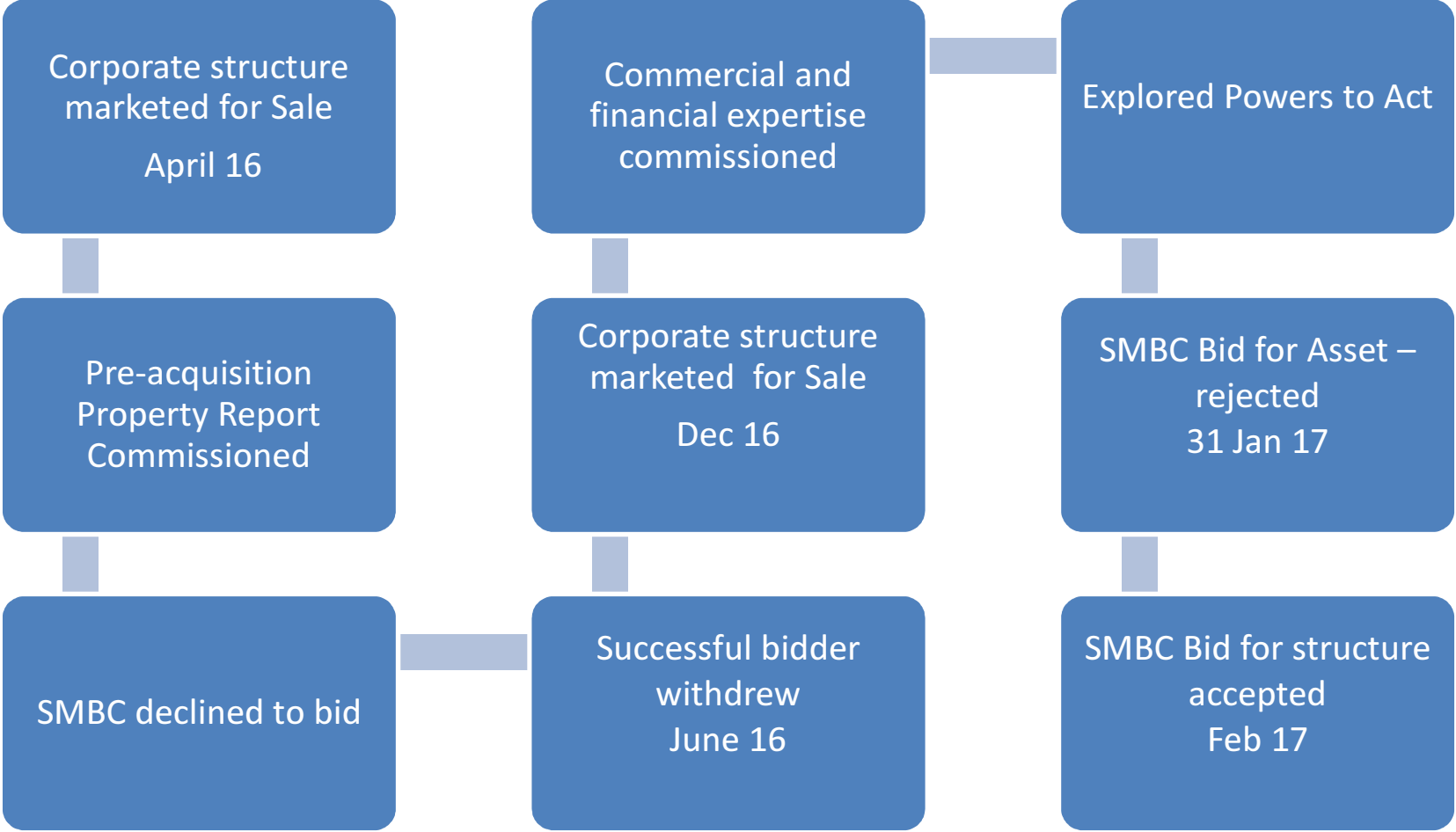
LOW IMPACT – risks which are less material to the Acquisition but which: (a) nevertheless require us to seek contractual protections for the Council; or (b) which will require the Council or the counterparty / counterparties under the transaction documents to carry out certain actions post-Completion.

- Issues – financial costs – potential remedies
- Sales Purchase Agreement – contracts the negotiation, ongoing
- Tax Deed and Disclosure letter
- Warranties, indemnities and insurance

Pre-bid Diligence

- Appointed legal, financial and property advisors
- Vendor's sales pack
- Vendor's building survey
- Vendor's measured survey
- Assumed that the data was reasonable and accurate
- Not enough time to complete a valuation
- Yield within an acceptable range £34m/6.37%
- Subject to caveats and net working capital and net debt adjustments
- Bid strategy – completion by end March 17
- Vendor seeking price and deliverability and share deal

Timeline of events Pre-bid



Property Key Documentation Pre-bid

Property	Produced by	
Vendor Pack	Savills – Property Sales Agent Pack of sales information – Development and Regulation, Scheme overview, property and statutory aspects, income analysis, asset management opportunities and sales information Purpose: Market the target for sale	Jan 17
Tenancy Schedule	Savills – Property Sales Agent Tenancy details Purpose: Informs the post-bid due diligence on financial modelling	Jan 17
Pre-acquisition report (commissioned by SMBC)	Lambert Smith Hampton Gross rent and sensitivity analysis, competition and investment comparables, SWOT, suggested pricing structure Purpose: Inform strategy approach	2016
Paragon Survey	Paragon on behalf of Savills Building Survey Report April 2016 Purpose: Set a baseline against which to bid and determine post-bid dd property survey work required	Apr 2016

Financial Key Documentation – Pre-bid

Financial	Produced by	Date
Bidding Approach & Negotiations	PWC Purpose: to inform bidding approach and negotiations, structuring options, high level commercial and financial assessment, risk assessment	Jan 17
Structure Options	PWC Purpose: to consider differing structural approaches to the bid	Jan 17
Commercial & Financial Assessment	PWC Purpose: to consider high level cash flow modelling, project viability analysis and key sensitivities to a base case scenario to understand the risk to the cash flow and possible level of additional borrowing	Jan 17
Risk Assessment	PWC Purpose: to identify key risks to be considered as part of the Council's decision-making process	Jan 17

Legal Key Documentation Pre-bid

Legal	Produced by	Date
Legal Powers	SMBC Monitoring Officer Purpose: To determine if Council has powers to invest in the target in context of statutory guidance, CIPFA code & Treasury Management	Jan 17
Legal Advice Note	Addleshaw Goddards Purpose: To confirm internal view that Council had powers to act to purchase either the asset directly or corporate structure	Jan 17

Corporate Key Documentation Pre-bid

Corporate	Produced by	Date
High Level Briefing Paper	Executive Director Purpose: Provides decision-making context, deal structure, commercial & financial analysis, risk assessment used to support decision to bid and agree bid strategy	25 Jan 17
Bid – Letter of Offer	Lambert Smith Hampton Purpose: To confirm the Terms of the Offer of the Council	31 Jan 17

Conclusions of Pre-bid diligence (1)

Bid Report

- Put forward a conditional first round bid, thereby committing to further diligence to confirm the price, with ability to withdraw at any time
- Initial bid is prepared and analysed on the basis that the Council buys the asset only and the asset is held on the Council's balance sheet

Property Report

- The Strand is well let , occupancy standing at 88%, scheme is well anchored with B&M Bargains, TJ Hughes and Home Bargains.
- The current WAULT to expiry is 8.62 years and 7.04 years to break which is good for a shopping centre = good income cover whilst working through the asset management opportunities.
- Returns over a 10 year period are healthy but will depend on asset management plan: risks are relatively low
- Asset management Company has achieved its strategies

Conclusions of Pre-bid diligence (2)

Vendor Pack

- Based on information provided, the asset is performing well, with low void rates and plans for the current anchor tenant to extend its floorplate

Structures Report

- An asset deal = base deal
- Examined alternative options of a share deal and including hive-up to the Council or a UK Ltd Co or a UK LLP

Commercial & Financial Analysis

- Risks with greatest impact = those within control of Council – will form a key part of due diligence going forward (specifically price paid, key works of refurbishment

Conclusions of Pre-bid Diligence (3)

Key Risks

- Acquisition, income and expenditure, economic impact, future retail considerations and regeneration . Key Risk Mitigation Strategy = further due diligence and ongoing bid negotiation

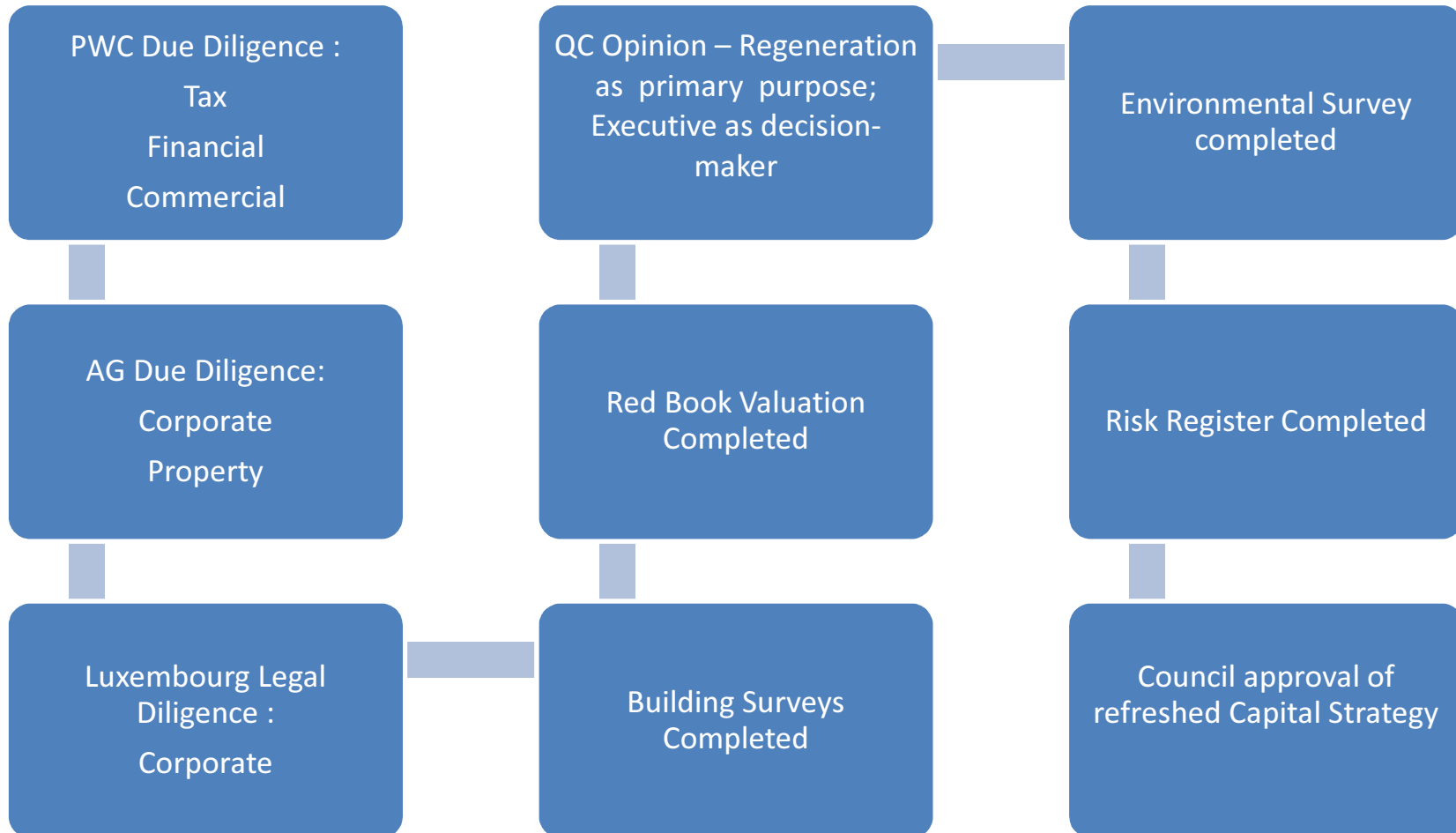
Legal Report

- Council has the Powers to Act

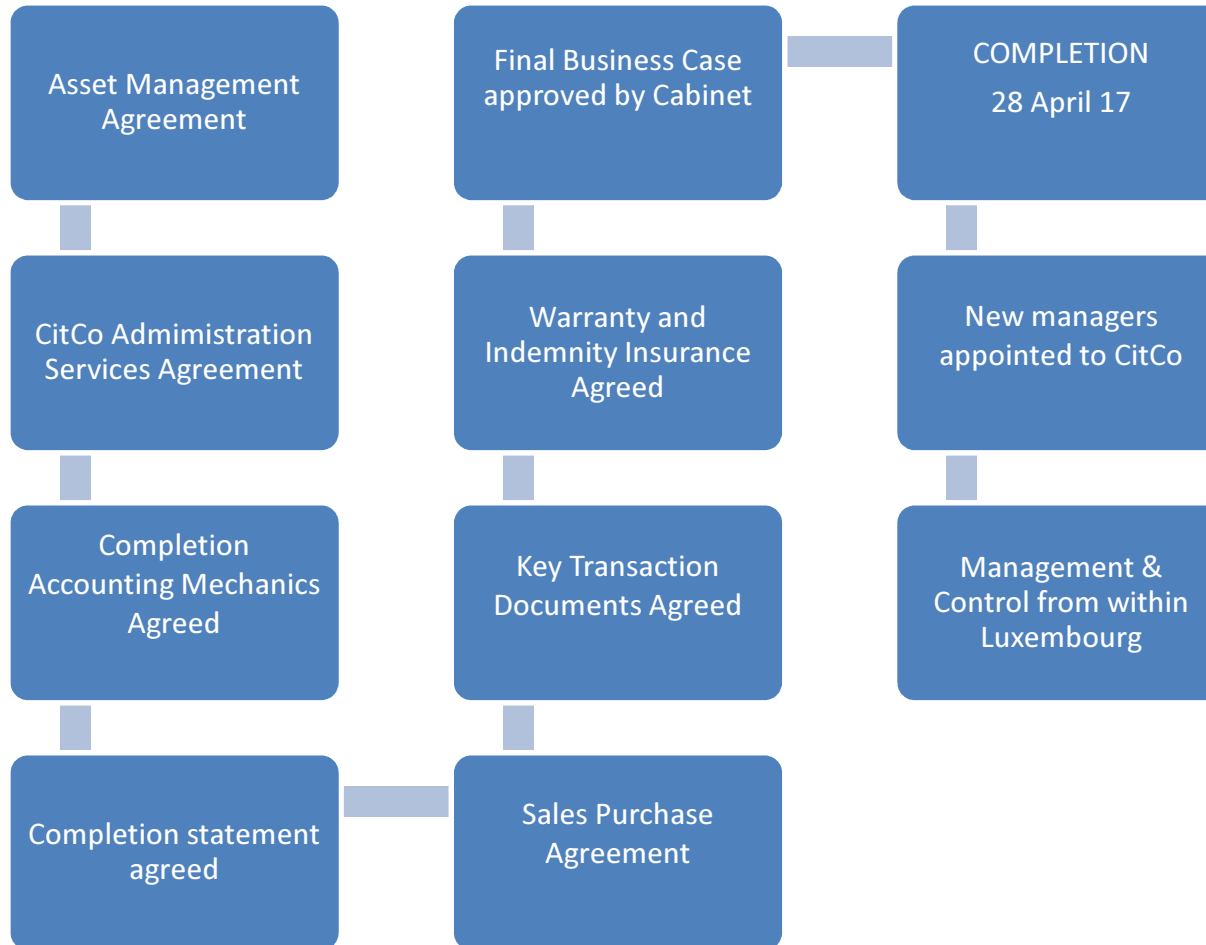
Counterfactual: No bid

- Opportunist bidder looking to drive returns in a short-timeframe
- Shorter hold period = less time for strategic investment aligned to Town Centre plans
- Other bidders intent to sell off M & S lease = limited options for Town Centre plans
- Other bidders to sell off elements of site = multi-ownership, limiting ability for cohesive future plans for the shopping and town centres

Process Post-bid – commercial confidentiality from here-in, now binds the Council by legal contract



Process Post-Bid (2)



Financial Key Documentation – Post bid

FINANCIAL	Produced by	Date
Business Risk Assessment	PWC Purpose: To identify Risks of Finance (Performance and Accounting); Operational and Management; Property; Future Retail Consideration; Governance (Acquisition & Ownership); other (tax, company structure, regeneration and acquisition)	Mar 17
Structures Options Report Report	PWC Purpose: a high level report of possible acquisition and holding structures	Feb 17
Financial DD Report	PWC Purpose: To determine the Completion Statement and mechanics for resolutions as defined in the SPA; Analysis of financial performance yr end 2015 and 2016 of the Company	April 17

Financial Key Documentation – Post bid

FINANCIAL	Produced by	Date
Financial Commercial Analysis	PWC Purpose: To understand viability and risks; returns and VFM; impact on cash, balance sheet and I & E position; surplus cash to support additional borrowing	Apr 17
Tax Due Diligence Report	PWC Purpose: to report on the tax due diligence review, identification of risk and mechanisms for Council to bear these risks	April 17

Sensitivity modelling

Base case – share capital purchase @£34m

- Price sensitivities
- Trading Sensitivities
 - Void risks 15% after years 5 and 10
 - Major named tenants not renewing
 - Rental increase by 5% year 5
 - Car park and mall income reduced by 50%
- Macro-economic sensitivities
 - PWLB rate + 0.5%
 - Cost inflation at 3%

Property Key Documentation – Post Bid

PROPERTY	Produced by	Date
Tenancy Schedule	Savills Purpose: Confirms tenants, respective lease term and area of occupation, rental income	Nov 16
Measured Survey	Savills Purpose: to confirm that measurements of property are accurate	Feb 17
Concrete Report	Paragon Purpose: Testing for chlorine and carbonation	Feb 17
Environmental Survey	SMBC Purpose: Desk top study of the local environmental issues	Mar 17
Building Survey Report	Lambert Smith Hampton Purpose: To understand the full building condition and landlord liabilities not covered by tenant service charge	Mar 17
Red Book Valuation	GVA Purpose: Third-party valuation to internationally agreed standard	Mar 17

Legal and Corporate - Key Documentation

Legal and Corporate	Produced by	Date
QC Legal View of Capital Strategy & Council Report	Edward Bartley Jones QC Purpose: To confirm that acquisition for the primary purpose of regeneration is legally substantiated through the Localism Act 2011 and Local Government Act 2003	Mar 17
Heads of Terms Agreement	Savills Purpose: Agree the headline terms of the deal and confirm exclusivity	Feb 17
Memorandum –	Ogier (Luxembourg Counsel) Purpose: To provide an overview of the duties and liabilities of managers of a S.a.r.l.	Mar 17
Sale Purchase Agreement	Addleshaws Purpose: To make legally binding the transaction including the purchase price	April 17

Legal & Corporate - Key Documentation

Legal and Corporate	Produced by	Date
Corporate Legal Due Diligence Report	Addleshaws & Ogiers Purpose: to set out the legal issues to matters under English law and under Luxembourg Law	April 17
Asset Management Agreement	Ellandi Purpose: The legal obligation of the asset manager to provide asset management services	Apr 17
Property Management Agreement	Savills Purpose: To provide day to day management of the property; to collect rent, service charges; maintain property records; maintain repairs, redecoration, mechanical services; administer domestic services; tenant liaison; recommendations to assure statutory compliance	Apr 17
Agreement for Domiciliary Services	CitCo Purpose: To provide domiciliary services to the Company	Mar 17

Building Survey Report Conclusions

Suitability for Purchase

“Subject to your acceptance of the issues raised within our report, the anticipated future liability to you as leaseholder and the outcome of your solicitor’s enquiries, we see no reason from a Chartered Building Surveyor’s perspective, why you should not proceed with your proposed acquisition”

Building Survey Report - conclusions

- Focuses on any material issues which may impact on investment value
- Issues highlighted relate to general repair and maintenance of the roofs & refurbishment/replacements of lifts
- 10 year budget cost of repairs - £4.7m
- Recommend to undertake concrete test reports/letter of reliance or warranty on previous tests
- Building well managed and subject to a regular planned maintenance regimen
- Mechanical and electrical services well considered and remain focused on matters relating to fire safety and general welfare of public and staff

Red Book Valuation

- Assessed the market value of the long leasehold interest in the property, the Strand as £34,250,000
- 66 page report assesses:

Location	Tenure	Site Areas	Floor Areas
Situation	Tenancy Information	SWOT analysis	Condition of Building
Services	Economic Overview	Capital Allowances	Statutory Enquiries
Valuation Considerations	Market Commentary	Local Market Commentary	Investment Markets
Basis of Valuation	Deleterious Materials	Energy Performance Certificate	Environmental Issues

Financial DD - Conclusions

Options on possible structures

- Share Deal (the bid deal) – increases the Net Present Value on cashflow;
- Hive-up to the Council – no income tax is due; NPV of net cashflow would fall if held in a UK Company
- Council enters into a JV, and transfers the asset, there will be an SDLT charge

Corporate Residency

- Company is resident in Luxembourg, therefore management and control must take place in Luxembourg (control exercised by Directors of the Company)
- Properly constituted Board holds genuine Board meetings in Lux and makes real decisions that are documented
- The Company is not UK tax resident: UK Lux double tax treaty means there is a form of international uniformity regarding tax residency
- Problem areas identified
- Case law set out for comparator purposes

Financial DD - Conclusions (2)

Tax Due Diligence

- No **high impact** risks identified: **medium impact** (3) and **low impact** (8) risks identified

Commercial

- A share deal that sees the asset hived-up to the Council's balance sheet returns the asset to local ownership and is the tax efficient compared to other structures
- Due diligence indicates a significant adjustment on Year 1 NOI to that indicated in sales brochure
- Risk register compiled and key risks need ongoing monitoring, including market risk over the long term

Financial

- Completion Statement prepared
- SPA prepared including mechanics for "true-ing up" the final purchase price

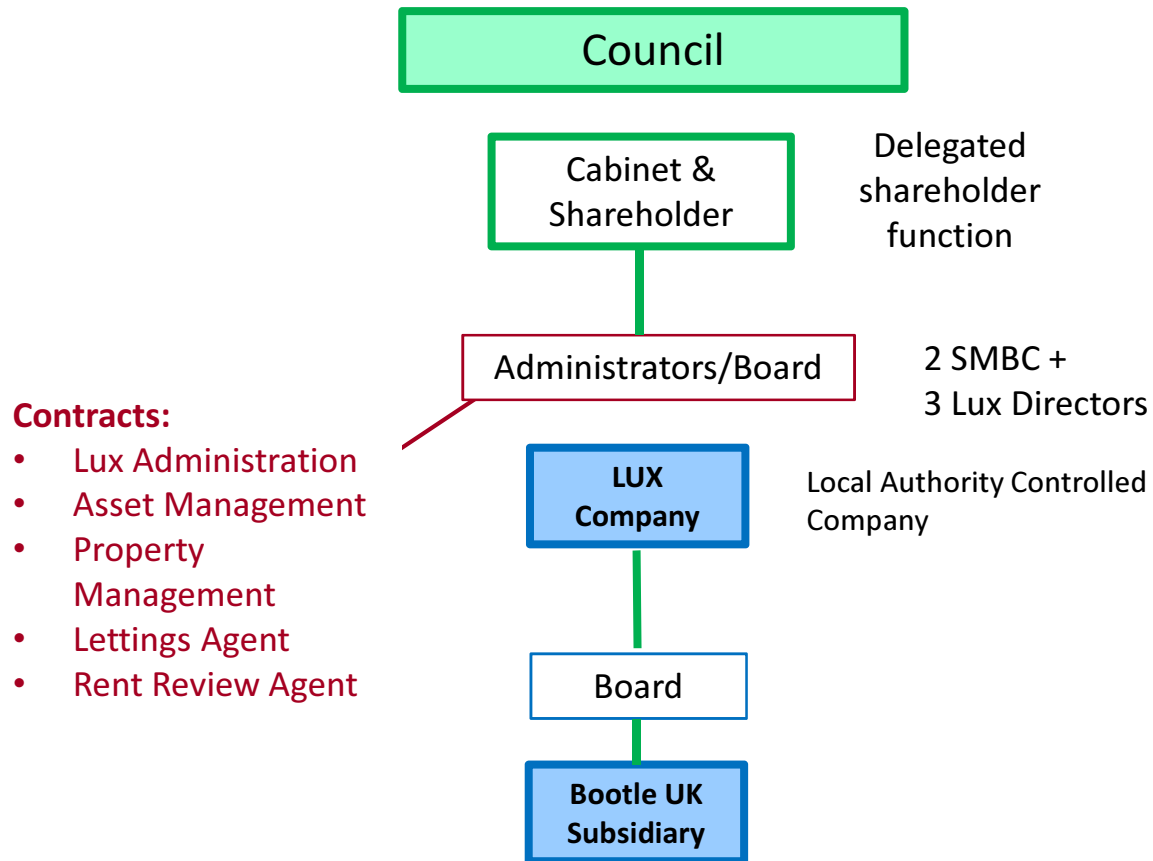
Legal/Corporate DD - Conclusions

- No **High Impact** Issues
- **Medium impact** issues – employment; financing; VAT; Intellectual Property
- **Low impact issues** – Post- completion affairs relating to Lux administration; filing of annual accounts; Luxembourg specific points
- Ownership structure (see slide)
- Savills Sub-contracts (40) e.g. cleaning equipment, ICT, hire equipment, maintenance, CCTV

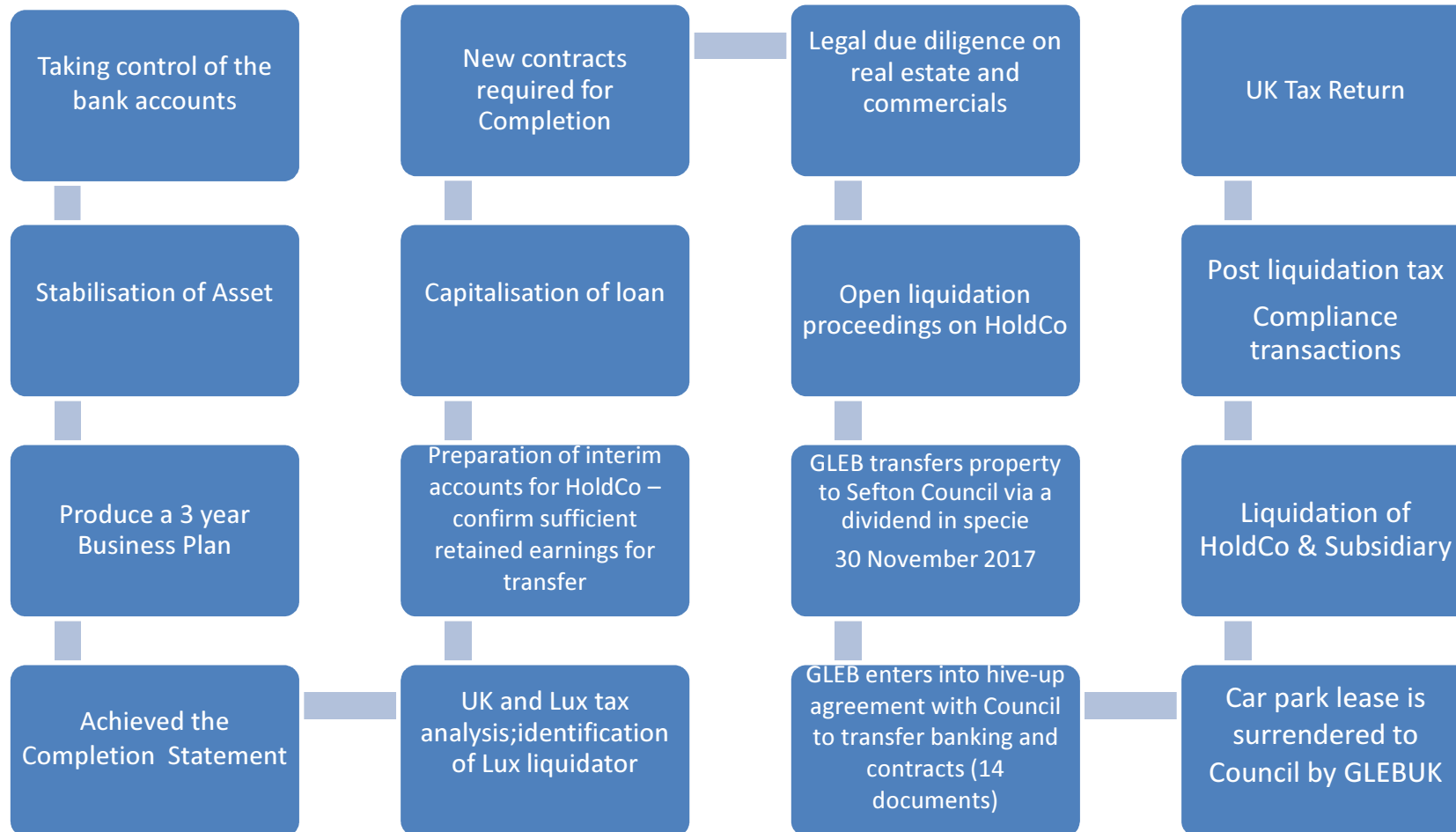
Transactions approved by Cabinet

Transaction	Date
Decision to Purchase: Share Deal + Hive-up and liquidation of corporate structure Release of appropriate info for a future scrutiny review (Regen & Skills)	April 2017
COMPLETION	28 th April 17
Note the terms on which the transaction was concluded	May 2017
Approval of the 2016/17 accounts as Shareholder	June 2017
Confirm Shareholder wishes to hive-up Request Transition Plan to completion of full transaction Approve costs to complete the transaction	June 2017

Corporate Structure on Completion



Process - Post Acquisition to Hive -up

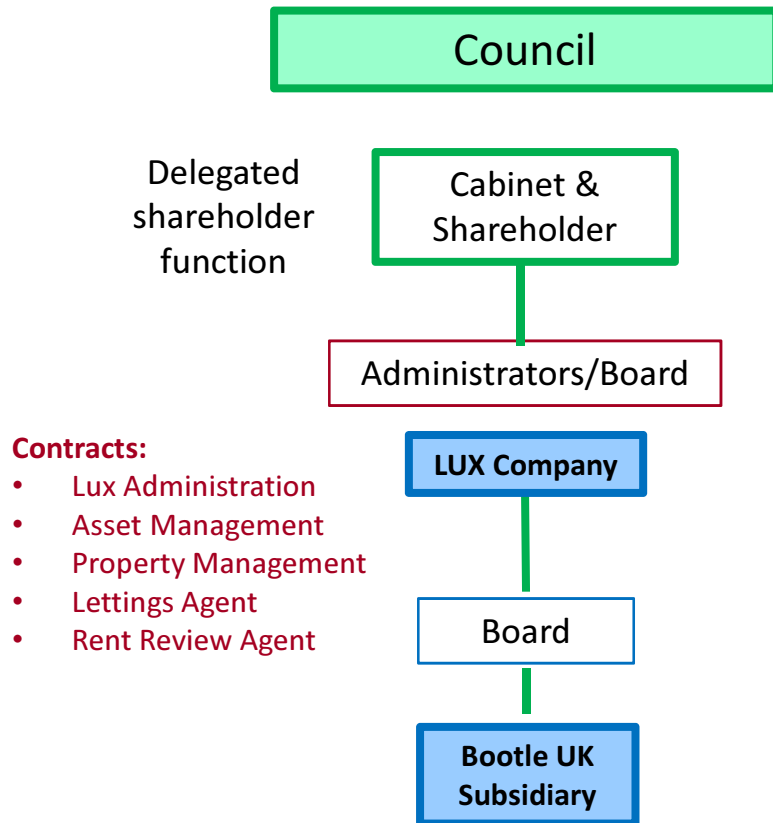


Key Documents – Hive up

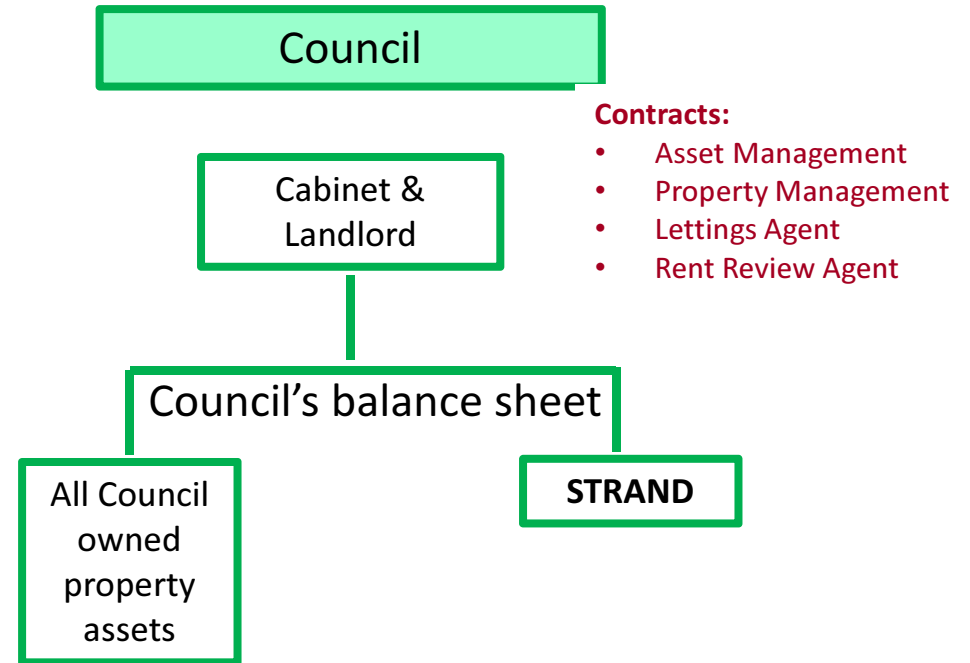
Due Diligence	Produced by	Date
Bootle Hive-up	PWC Purpose: To set out the requirements and issues for transfer of property from GLEB, the Company to Council; produce step plan	Sept 17
Bootle Hive-up Due Diligence Report	Osbourne Clark Purpose: Summary of issue most important to Council	23 Oct 17
Advice Note	Addleshaws Purpose: To assure the Council of its powers to effect the transaction of hive-up	07 Nov 17
Outline legal advice Luxembourg	CitCo Purpose: To advise the Company on the issues relating to the hive-up under Lux law	
Transaction Documents (14)	Osbourne Clark Purpose: to bind in law the transaction	Nov 17

Corporate Structure on Hive-up

Before Hive-up



After Hive-up



Capital Investment Funds

PWLB borrowing:

- 25 year annuity loan
- 2.2% fixed interest rate
- Payment dates (50) 27/10/17 – 27/4/42
- Twice yearly payments of £850k

Tax Implications-Tax Payable on operations

	Rate	Pre Acquisition Avenue Capital 100% share holding	Post Acquisition Sefton MBC 100% Shareholding	Post Hive Up Sefton MBC Property/asset
VAT-UK	20%	Yes	Yes	Yes
VAT- Luxembourg	17%	Yes	Yes	N/A
Income Tax- UK (Car park)	20%	Yes	Yes	No
Income Tax –UK (Asset)	20%	Yes	No	No
SDLT	5%	Yes	No	No

SDLT was paid by the previous owners having purchased the leasehold and transferred the asset into the G.L.Europe S.a.r.l., the Luxembourg registered company

HMRC Taxes

[www.gov.uk/government/publications/stamp duty land tax group relief](http://www.gov.uk/government/publications/stamp-duty-land-tax-group-relief)

- *“A business may choose to acquire a property-owning company as opposed to acquiring the property from that company. The purchaser may, after acquiring the company, transfer the property out of the company acquired and into a different company in the purchasing group. HMRC do not regard that of itself, and subject to the list of transactions mentioned above, as resulting in the avoidance of tax such that FA 2003 paragraph 2(4A)(b) would be in point, even if the acquisition of the property-owning company and the subsequent intra-group transfer of the property formed part of the same arrangements.*
- *The purchaser may, after acquiring the company and transferring the property intra-group, liquidate, wind-up or strike-off the company acquired. HMRC do not regard that of itself as resulting in, or being evidence of, the avoidance of tax such that FA 2003 paragraph 2(4A)(b) would be in point, even if the liquidation, winding-up or striking-off formed part of the same arrangements that also included the acquisition and the intra-group transfer.”*

Management Arrangements

Domiciliary Mngmt (LuxCo Administration) – CitCo (Apr-Nov 17)

- Board of 3 Luxembourg and 2 Council Directors
- No management and control outside of Luxembourg
- Council's role is Shareholder and nominating Board members

Asset Management – Ellandi

- Appointed by the Company
- Report directly to the Board
- No direct contact with the Council

Property Services Management – Savills

- Report through the Asset Manager to the Board

Asset Management

- Financial statements and reporting, annual returns, audit, corporation tax VAT, annual reporting
- Quarterly reporting, performance and management
- Preparation of annual business plans and secure owner approval; implement delivery
- Management of capex, advising the owner
- Tendering & management of contractors
- Letting and rent review services
- Debt service, covenant monitoring, testing and reporting
- Property Insurance services
- Sale of asset & associated promotion and due diligence

Property Services Manager

- Day to Day Centre Management
- Compliance of Instructions of owner and AM and upwards reporting management accounts
- Collection of tenant receipts
- Maintenance, security, cleaning
- Maintenance of property records
- Repairs, decoration and mechanical services<
- Marketing and Promotion
- Outgoings, Invoices, sinking funds, budgeting, cash flow
- Tenants liaison and application for consents
- Property Insurance
- Common areas
- Identifying & supervising of works
- Notices and breaching of covenants

Post acquisition Company decisions

- Approve a new 3 year **Business Plan**, prepared by the Asset Manager, approved by the Board and Shareholder
- Approve **new/variations to tenancy agreements**
- Agreed to respond to Shareholder wishes – hive up the asset to the Council and collapse the corporate structure
- Executed the decisions of **hive-up and liquidation**

Current Status quo

- Strand shopping centre now sits on the Council's balance sheet and the corporate structure is in liquidation
- All contracts that relate to the Strand – AMA, PMA, service contracts and tenancy agreements are directly held by the Council
- All Company bank accounts are closed and balances transferred to SMBC
- Investment Board will act as commercial interface with the Asset Managers; all decisions will be made according to constitutional processes
- The Council does not pay income tax on rental income

Why Part 2 Cabinet Decision?

Report – not for publication by virtue of Paragraphs 3 and 5 of Part 1 of Schedule 12A of the Local Government Act 1972. The Public Interest Test has been applied and favours the information as being treated exempt.

- The Heads of Terms and Sales Purchase Agreement are legal bound by Commercial Confidentiality
- Cabinet agreed conditional permissions, whilst final negotiations were still live until Completion following Cabinet's decisions

The Council as owner is fully exposed to market risk and therefore must protect and enhance the competitive position of this commercial asset