Finance and Policy Committee

Date: **21 January 2016**

Item: **Property Partnerships – Developing TfL's Assets**

This paper will be considered in public

1 Summary

1.1 This paper describes the proposal to maximise the value of TfL's property assets by establishing a framework of property developers with experience and expertise in the London development market with a view to entering into joint ventures (JVs) for specific development opportunities to assist with the delivery of £3.4bn of non-fares income over the TfL Business Plan. This paper proposes that TfL should:

(a) establish a framework of property developer suppliers to maximise the value of TfL's property assets; and

(b) establish a series of wholly owned subsidiaries for the purposes of developing or disposing of TfL's land, including (but not limited to) by way of the JVs established under the framework described in (a) above.

1.2 A paper is included on part 2 of the agenda, which contains exempt supplementary information. The information is exempt by virtue of paragraph 3 of Schedule 12A of the Local Government Act 1972 in that it contains information relating to the business affairs of TfL. Any discussion of that exempt information must take place after the press and public have been excluded from the meeting.

2 Recommendations

2.1 **The Committee is asked to note this paper and the supplemental paper on Part 2 of the agenda and to recommend that the Board:**

(a) **approves the awarding of a framework (the Framework) of property development suppliers (Framework Suppliers) as described in this paper with the objective of entering into corporate joint ventures (JVs) with individual members of the Framework on a site by site basis following further competition between Framework Suppliers (a mini competition) as a means of TfL developing its property assets;**

(b) **delegates to TfL Officers and any of its Subsidiaries (as described in paragraph 2.2 below) authority to enter into all such contracts necessary to deliver each development opportunity under the Framework and undertake, all ancillary matters, including (without limitation) the approval and giving of guarantees and indemnities,**

the approval of investment decisions, the transfer of assets including land or shares in any of the TfL subsidiaries formed for the purposes of disposing or developing TfL's land provided that:

(i) **the value of land being disposed of under a mini competition does not exceed the relevant TfL Officer's land authority under TfL Standing Orders (and in the event it does approval of the Board will be sought);**

(ii) **the Mayor's Opinion has been granted in accordance with paragraph 12 (1) to Schedule 11 to the Greater London Authority Act 1999;**

(iii) **if required, the consent of the Secretary of State has been obtained in accordance with Section 163 of the Greater London Authority Act; and**

(iv) **in accordance with TfL Standing Orders, the appropriate consulatation has taken place with the Director of Commercial Development;**

(c) **agrees that, where the disposal of land is proposed to take place by means of a disposal of all or any part of the company in which it is held, such disposal shall be treated as a disposal of land for the purposes TfL Standing Orders and Land Authority and Disposal Authority will be deemed to have been given;**

(d) **notes that approval for any TfL investment and guarantees required for the delivery of any development opportunity following a mini competetion under the Framework shall be sought separately in accordance with the levels of authority under TfL Standing Orders;**

(e) **authorises the TfL Officers and any of its Subsidiaries (as described in paragraph 2.2 below) to:**

(i) **form companies as wholly owned subsidiaries of TfL or any of the Subsidiaries (as appropriate) necessary for the delivery of the JVs formed as part of the Framework referred to in paragraph 2.1(a) above ;**

(ii) **approve the adoption of the memorandum and articles of the new subsidiaries;**

(iii) **approve the individuals to comprise the board of directors and the Company Secretary of each of the new subsidiaries;**

(iv) **approve the names of each of the new subsidiaries;**

(v) **wind up or dissolve any of the new subsidiaries at any time when any of them is no longer required; and**

(vi) **provided that the approvals given under paragraphs 2.1(e) (ii) – (iv) above and paragraph 2.1(f) below shall lapse in respect of any new subsidiary formed in accordance with paragraph 2.1(e) (i) above when such company ceases to be a "subsidiary" of Transport for London, as such term is defined in Section 1159 of the Companies Act 2006;**

(f) **authorises the TfL Officers and the Subsidiaries (as described in paragraph 2.2 below) to negotiate, approve, authorise, agree and execute (whether by deed or otherwise on behalf of TfL or any Subsidiary (as appropriate)) any documentation:**

(i) **to be entered into in connection with the incorporation of any of the new subsidiaries; and**

(ii) **required in relation to the creation, operation, introduction and management of any of the new Subsidiaries' regulatory compliance requirements including, without limitation, letters of financial support, all agreements, deeds, guarantees, indemnities, announcements, notices, contracts, certificates, letters and other documents;**

(g) **authorises the TfL Officers and Subsidiaries (as described in paragraph 2.2 below) to do all such other things as they consider necessary or desirable to facilitate (i) the regulatory compliance of the new companies; and/or (ii) the operation and implementation of the Framework and the JVs formed under the Framework.**

2.2 **The following Officers and Subsidiaries shall have delegated authority:**

(a) **TfL Officers: the Commissioner, Managing Director Finance, General Counsel and Director of Commercial Development; and**

(b) **Subsidiaries: Subsidiaries of TfL including Transport Trading Limited (TTL), TTL Properties Limited and any other subsidiary (whether existing presently or to be formed) of TTL, and the directors of such authorised company shall be authorised to act for and on behalf of that company.**

3 Background

3.1 To date TfL has followed a traditional disposal route for its assets, minimising risk, but also restricting the potential long term receipts from the development of its surplus property assets. In February 2014, the Board approved the formation of a corporate JV with Capital and Counties Properties PLC for the development of TfL's freehold ownership of the former Exhibition Centres known as Earls Court 1 and 2.

3.2 Following the establishment of the Earls Court corporate JV, the TfL Business Plan has been updated to reflect the potential receipts that could be received if TfL were to follow the JV route established at Earls Court and undertake a series of corporate JVs for a number of the development opportunities it controls.

3.3 A portfolio of 75 development opportunities were identified as having the potential for commencing development within the ten year Business Plan. Within these, 49 have been identified as having the potential to be taken forward through a JV within the property partnership framework. A list of these development opportunities is included in the paper on Part 2 of the agenda.

3.4 The TfL ten year Business Plan assumes that Commercial Development will make a gross contribution of £4.2bn, net £3.4bn of which £1.1bn net is from property development activity. The property development business plan targets assume receipts from land sales together with a share of profit from undertaking developments within JVs.

4 Property Partnerships Framework

4.1 After receiving advice from TfL's commercial advisors, Deloitte, it was decided that the best way to maximise TfL's returns was to establish a framework (the Framework) of property developers who have experience in the London development market (the Framework Suppliers). All those Framework Suppliers who are appointed to the Framework will enter into a framework agreement setting out the terms necessary to be a member of the Framework (the Framework Agreement). .

4.2 With each development opportunity brought forward, a further competition will be run with the Framework Suppliers (mini competition). The successful Framework Supplier and TfL will then enter into a series of agreements called off from the Framework Agreement (described in detail in paragraph 5 below) which, if all conditions are met will lead to the establishment of the JV for that development opportunity. TfL will dispose of its land at market value to the JV, for which it will receive an initial return. It will also have the opportunity to invest in the JV. The successful Framework Supplier will provide their expertise by acting as the business and development manager and will provide investment in their capacity as a partner. Returns will be divided in accordance with each partner's shareholding.

4.3 Deloitte advised that a framework of development partners would provide the diverse skills and capacity necessary to effectively deliver the large scale development programme TfL is proposing. As the JV's will involve the delivery of services and occasionally works, in order to establish the Framework, it was necessary to undertake a public procurement exercise in compliance with EU procurement rules, the details of which are set out in paragraph 4.6 below. A number of other options for the procurement of development partners were considered including:

(a) undertaking a full procurement exercise for each site – TfL was advised by Deloitte that individual marketing of sites by undertaking individual procurement processes would be time consuming and expensive for both TfL and the Framework Suppliers; and

(b) selecting a single development partner – in light of the volume and diversity of development opportunities analysis of the market by Deloitte confirmed that there is no single supplier/partner with either the capacity or skill set to deliver all of these developments.

4.4 Once the Framework has been established TfL will continue to retain full flexibility with regard to how it disposes of its surplus property assets. TfL is not committed to offer any of the development opportunities to the Framework and will only do so if the use of the Framework offers best value and is state aid compliant. TfL, on advice from its property advisors, will assess each development opportunity to establish the optimum solution to ensure that it achieves best value. This could be through the Framework but might include a traditional sale route, the formation of a separate JV with a third party (typically a special purchaser), or even a standalone procurement to allow the wider market the opportunity to bid.

4.5 The public procurement process commenced on 6 February 2015 with the issuing of an OJEU notice. A summary of the procurement process and evaluation is set out in the paper on Part 2 of the agenda.

5 Outline of Framework and Commercial Terms

5.1 To align with the TfL Business Plan, the Framework has been designed to last for ten years. In order to ensure compliance with the procurement regulations and to ensure the Framework covers the diverse variety of development opportunities within the portfolio over the ten year period. The majority of detailed requirements will be set when each development opportunity comes forward and the Framework Suppliers bid via a mini competition. Each bidder will have the opportunity of bidding at each mini competition.

5.2 The Framework allows TfL to take between a 10 per cent and 90 per cent stake in any JV. Following the advice of its property and financial advisors TfL will assess what percentage stake it will take before each opportunity is sent to mini competition. A number of factors will inform this decision, including the impact development finance would have on TfL's corporate borrowing. Currently, under government rules, if TfL holds a minority stake in a JV then any borrowings of that JV will not be regarded as a TfL debt and so will not impact on TfL's corporate borrowing. If TfL holds a majority of the shares in the JV then it will be regarded as a debt.

5.3 Prior to each development opportunity being presented at a mini competition TfL will produce a detailed pack of information and specify a number of factors. This will include the required percentage stake in the proposed JV together with requirements for future overage.

5.4 Bids at each mini competition will be judged using the same evaluation criteria used when establishing the Framework.

5.5 The Framework has the flexibility to allow development opportunities to be introduced with or without planning. This will allow TfL to utilise the skills of the

Framework Supplier, without committing to the formation of the JV until planning consent is granted.

5.6 The Framework will be supported by a suite of legal documents. To gain entry onto the Framework, each successful bidder will need to enter into the Framework Agreement. The remaining documents (referred to as the call-off contracts) will be entered into with the successful Framework Supplier following each mini competition and will include a conditional JV agreement, a business and development management agreement, a shareholders' agreement, a works agreement and the site specific property documents. A summary of the key principles of these agreements is described below:

Outline of Key Principles in the Legal Documents

Primary Purpose

(a) TfL's primary objective is to obtain best value from any development opportunities it puts through the Framework so that the revenues received by TfL can be utilised to improve London's transport system.

(b) As with Earls Court, all activities are governed by the "Primary Purpose" which is to maximise the economic value of the development opportunity for TfL and its partner. This applies for the period before the JV is established and thereafter once the JV is established. Once the JV is established, the Primary Purpose is to maximise the economic value of the development opportunity for its shareholders by enabling the development of the site in accordance with the relevant planning consent.

(c) The Primary Purpose provides focus and direction for the partners and makes it clear that the activities are commercial in nature. Once the JV is live it also provides protections for minority shareholders (be it TfL or its partner) in that it provides a check on the majority partner's activities in the JV.

Guarantees

(d) TfL's partner in any JV is to provide guarantees (or other suitable alternative security) in respect of its obligations where required and such guarantees will need to meet a minimum covenant test and then be subject to an on-going net asset value test. TfL likewise may be required to provide guarantees for the financial obligations of its subsidiaries.

Satisfaction of conditions and the conditional period

(e) Each successful Framework Supplier for a development opportunity will enter into a conditional JV agreement. This will govern how TfL and its partner will work collaboratively during the conditional period to seek to satisfy the conditions which need to be satisfied before any JV is formed. Activities will be in accordance with an agreed business plan.

(f) The following conditions will need to be satisfied during the conditional period, following which the JV will be established:

    (i) securing a planning consent for the relevant site;

    (ii) site assembly (if relevant); and

    (iii) the relevant site being valued at market value with the benefit of planning consent (following satisfaction of the other two conditions).

(g) Once the conditions are satisfied TfL and the Framework Supplier will form the JV.

(h) The costs incurred during the conditional period will be shared between TfL and its partner Framwork Supplier. TfL will cover 50 per cent of the costs except where it elects to take more than a 50 per cent equity stake in the JV (its commitment to fund those costs being increased to the relevant equity stake percentage).

(i) During the conditional period, TfL and its partner will establish a project board that will act as the “shadow JV” and oversee the progress of the development. All decisions must be unanimous at this stage.

Management arrangements

(j) TfL initially (and the JV upon satisfaction of the conditions) will appoint the successful Framework Supplier as the Business and Development Manager (BDM) for the relevant development opportunity. The BDM will be responsible for day to day management of the opportunity to achieve satisfaction of the conditions initially and once satisfied, day to day management of the JV to the conclusion of the development under the direction of the JV Board and Executive Committee (if applicable). The BDM will be paid a fixed percentage fee, which will be bid at mini competition stage and will be evaluated as part of the selection process.

(k) The BDM’s authority will be subject to acting at all times in accordance with the agreed business plan and subject to specified financial authority levels.

Formation of the JV

(l) In certain circumstances it may be more economically efficient for TfL to transfer the land into a new vehicle in advance of the JV being formed (with that coporate vehicle then becoming the JV) and, where appropriate, TfL proposes to do this.

(m) It is intended that ultimately TfL will be able to establish new corporate JV’s constituted as UK Limited Liability Partnerships (LLPs) but this will not happen until TfL secures the necessary statutory powers to enter into an LLP. If the powers are not obtained then the development opportunities will be taken forward as companies limited by shares.

JV governance arrangements

(n) Under the terms of the shareholders agreement, the JV will maintain a JV Board for the duration of the agreement.

(o) The number of directors to be appointed by TfL to the JV Board will be confirmed at the point in time when TfL confirms what shareholding percentage it wishes to take in the JV, save that TfL has reserved the right to require equality of representation should it hold over 40 per cent (but less than 50 per cent) of the shares in the JV. Voting will be by majority at board level but where the board is deadlocked there are deadlock resolution procedures for the parties to follow.

(p) The JV Board will meet regularly, likely to be at least quarterly.

(q) Depending on the scale of the opportunity, an executive committee will be formed which is likely to meet more regularly and oversee the BDM.

(r) Where either TfL or its partner has a conflict of interest, their respective board appointees will be conflicted out at board and, if applicable, executive committee level.

Transparency

(s) TfL will have access to information from the JV (and BDM) to enable it to prepare a status and progress report on the JV that TfL will then publish.

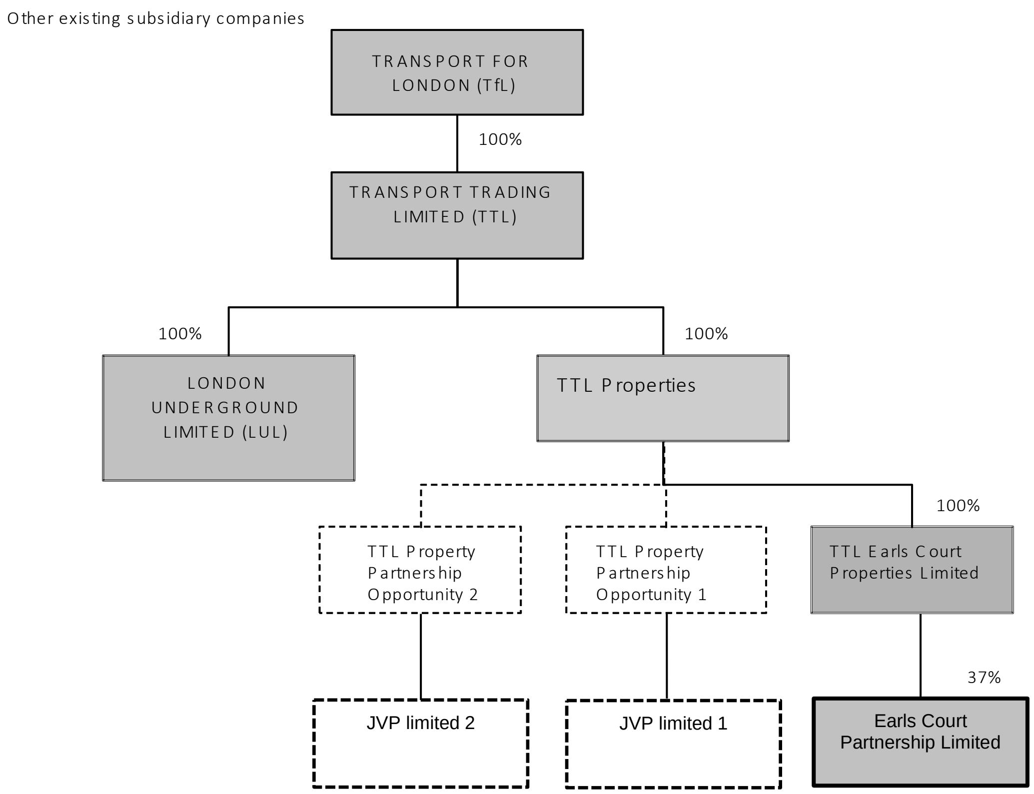
6 New companies and corporate structure

6.1 It is proposed that TfL utilises the company holding structure previously approved by the Board and established for the Earls Court joint venture. It is therefore proposed to establish new companies with the intention that they are delivered under the Framework. Flexibility is required because as analysis of the development opportunities are undertaken it may become apparent that development under the Framework may not offer best value in all instances and at all times, but there could be advantages in establishing corporate vehicles in advance for the reason set out in paragraph 7.2 below.

6.2 With regard to the JVs formed as part of the Framework, a wholly owned subsidiary of TTL Properties Limited (JVP Limited) will need to be formed if the land is to be transferred in advance of the establishment of any JV under this Framework, with shares in that company being held by another wholly owned subsidiary of TTL Properties Limited (Holdco). Where this occurs, the selected Framework Supplier will purchase shares in JVP Limited. JVP Limited will then become the JV vehicle. Where land has not been transferred in advance of the establishment of the JV, a new JV vehicle would be established by the parties into which TfL’s land interest will transfer. The framework documents provide for various combinations of these arrangements to allow flexibility to reflect the particular circumstances of the development opportunities. Therefore it may be necessary for two companies to be established as TfL subsidiaries for each JV development opportunity.

Diagram 1 shows how the new property partnership JV companies would fit in the existing TfL group structure.

Diagram 1 – company structure.



6.3 It is recognised that the Commercial Development team and the functions that support it such as legal, finance, operational and procurement will need to increase in order to manage the work envisaged by the Framework. This process has commenced with the property development team increasing from five surveyors at the commencement of 2015 to a team of 11 senior development professionals including a new Director of Development. It is envisaged the overall team will number 29 by the end of 2016. Commercial Development is currently working with other departments to ensure their resource is being increased to meet the needs of the new team.

7 Tax

7.1 Transfers of land are subject to Stamp Duty Land Tax (SDLT) at 4 per cent. However, if a TfL company transfers a property to a 100 per cent owned new TfL subsidiary, SDLT Group Relief will be available, meaning that no SDLT liability will arise on the transfer. If the new TfL subsidiary remains in the TfL Group for a minimum of three years from the date of the transfer, no SDLT liability will arise in respect of the earlier property transfer.

7.2 Based on the current TfL Business Plan, a number of sites will not satisfy the three year ownership period requirement. In these cases, if the new TfL subsidiary leaves the TfL Group within three years of the transfer there will be a claw back of the SDLT Group Relief. The SDLT payable will be the SDLT that would have been payable at the date of the intra group transfer i.e. based on the market value at that date. On the assumption that the intra group transfer takes place pre-planning permission and the JV is entered into post-planning permission, this would still represent a tax saving as the SDLT would be chargeable on a lower market value.

7.3 Transfers of shares in companies are subject to stamp duty at 0.5 per cent, payable by the purchaser of the shares.

7.4 Further detail of other relevant tax issues is provided in the paper on Part 2 of the agenda.

8 Strategy for Investment Decisions

8.1 Each development opportunity will be evaluated utilising independent property and financial advisors prior to being taken through the Framework to ensure that best value will be achieved by using the Framework and to ensure compliance with the state aid rules.

8.2 If a development opportunity is to be developed through the Framework, key decisions will be required before a mini competition can be launched. These will include the shareholding in the JV to be retained by TfL and whether value added through the planning process will be shared with TfL's partner as a performance incentive.

8.3 In considering which development opportunities should be the subject of a JV and the details of the JV, TfL will consider:

(a) the value of the development opportunity and scale of potential development;

(b) the growth potential for the development opportunity;

(c) the risk and level of developer profit the market is expected to require on the development opportunity;

(d) the balance of risk and exposures across the TfL's property portfolio; and;

(e) the scale of the capital requirement to develop the development opportunity.

8.4 Disposal and investment decisions will be taken in accordance with the authority levels set out in TfL's Standing Orders, in consultation with the Commercial Development Advisory Group (CDAG).

9 Due Diligence

9.1 Due diligence has been undertaken on all the potential Framework Suppliers and they have been assessed to test technical capability, financial standing and whether they can commercially offer best value for TfL when development opportunities are offered via mini competition to the Framework. Deloitte and

TfL have, in addition, undertaken due diligence on the Framework Suppliers to establish whether any of them or their current directors have been involved in any criminal activity or fraud. All of these will be re-tested at the mini competition stage. A commentary on each of the bidders is included in the paper on Part 2 of the agenda.

10 Commercial Development Advisory Group

10.1 The CDAG has been engaged and updated throughout the process in the procurement of the framework partners. Input has been offered from the members of the CDAG to refine TfL's commercial position and their views have been reflected in the contractual documentation. Future mini competitions and the strategy for each site will be subject to a CDAG oversight.

List of appendices to this report:

Exempt supplemental information is contained in a paper on Part 2 of the agenda.

List of Background Papers:

None

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