Finance and Policy Committee

Date: **18 July 2013**

Item 9: **Earls Court – Proposed Re-Development**

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1 Summary

1.1 On 27 March 2013, the Board delegated to the Finance and Policy Committee authority to approve any project or transaction over £100m, from 4 July until 24 September 2013.

1.2 The purpose of this paper is to update the Committee on the proposed development that involves London Underground's (LU's) interest in the Earls Court and West Kensington Opportunity Area and to seek approval from the Committee, under the authority delegated by the Board on 27 March 2013 to enter into non binding heads of terms for a joint venture with Capital and Counties Properties PLC with regard to the development of the current exhibition centres known as Earls Court 1 and 2 and to enter into a Section 106 Agreement both as described in the paper and the supplemental paper on part 2 of the agenda.

2 Recommendations

2.1 **The Committee is asked to:**

(a) note this paper and the supplemental paper on part 2 of the agenda;

(b) in accordance with the authority delegated from the Board, authorise:

(i) Transport for London and/or London Underground Limited or any other of the Subsidiaries (as defined in paragraph 2.2 below) to enter into non binding Heads of Terms to pursue a joint venture with Capital and Counties Properties PLC or a wholly owned subsidiary of Capital and Counties Properties PLC with regard to the development of Earls Court 1 and 2 which includes proposals for the grant of a long leasehold interest in Earls Court 1 and 2 as described in this paper and the supplemental paper on part 2 of the agenda;

(ii) London Underground Limited to enter into a Section 106 Agreement as described in this paper;

(c) delegate to the Subsidiaries and TfL Officers (as described in 2.2 below) to approve and finalise:

(i) the non binding Head of Terms to pursue a joint venture with Capital and Counties Properties PLC or a wholly owned subsidiary of Capital and Counties Properties PLC and

authorise the agreement and execution (whether by deed or otherwise on behalf of TfL or any Subsidiary, as appropriate) of such Heads of Terms;

(ii) the Section 106 Agreement and authorise its execution by deed; and

(d) note that further authority will be sought from the Board prior to entering into any joint venture arrangements contemplated under the Heads of Terms.

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

(a) TfL Officers: the Commissioner, Managing Director Finance, Managing Director Rail and Underground, General Counsel and Director of Commercial Development.

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

3 Background

General

3.1 LUL has a freehold interest in approximately 14 hectares (35 acres) (shown edged red on the plan in Appendix 1) of an overall gross development area of approximately 27 hectares (66 acres) at Earls Court (the Site). The London Borough of Hammersmith and Fulham (LBHF) owns 8.6 hectares of the Site (shown shaded orange on the plan) and Capital and Counties Properties PLC (Capco) through its wholly owned subsidiary Earls Court Properties Limited has a number of freehold interests in the Site and is LUL's tenant of the two exhibition centres at Earls Court known as Earls Court 1 and 2 (EC1&2).

3.2 Capco commenced discussions with TfL and LBHF over the possibility of redeveloping the Site in 2008 and unilaterally took forward a planning application for a masterplan scheme in June 2011 for the Site (the Masterplan). TfL, Capco and LBHF as landowners entered into a collaboration agreement in October 2009 to facilitate discussions regarding the potential development of the Site. Although this has expired discussions have continued. Capco and LBHF entered into a land agreement with regard to the LBHF land in January 2013.

3.3 The Site is served by three stations: West Kensington, Earl's Court and West Brompton and is bounded to the north by the A4, the east by Warwick Avenue, the west by North End Road and the south by Lillie Bridge Road. On the attached plan the Earls Court exhibition centres known as Earls Court 1 and 2 (EC1&2) are shown hatched blue and green respectively.

Ownership details

3.4 LUL owns the freehold of EC1&2 which comprises approximately 7.7 hectares and is subject to two leases to Earls Court Properties Limited, a wholly owned subsidiary of Capco. The first Lease for EC1 was granted in 1959 and has 28 years remaining. The lease for EC2 was granted in 1991 and has 102 years remaining. Both leases restrict the use for which the property can be used to exhibition use. LU occupies part of the void beneath EC2 for storage and train sidings.

Capco Due Diligence

3.5 Capco is one of the largest investment and development property companies that specialises in central London real estate and is listed on the London Stock Exchange, being a constituent of the FTSE-250 Index. Capco holds 2.8m square feet of assets valued at £1.7bn (as at 31 December 2012) in two landmark London estates: Covent Garden, which has assets valued at £952m, including the historic Market Building and Earls Court & Olympia Group amounting to aggregate property assets of £721m.

3.6 TfL is conscious that it needs to conduct appropriate due diligence with any party that it intends to contract with, particularly in a project with a predicted long timescale such as this. TfL has undertaken initial due diligence into Capco's parent company and its subsidiary currently considered to be most likely to be used by Capco for this transaction. This is an ongoing exercise and will continue during the course of the negotiations. To date, the due diligence exercise has included review of published financial statements, financial robustness checks, creditworthiness checks and published literature reviews. The parent company is considered to be financially robust with a minimal risk of failure. It has a tangible net worth of close to £1.5bn with an annual turnover of over £97m (reported year ending 2012). The published literature review has not identified any significant issues to date. Full and detailed due diligence will be undertaken when details of the vehicle have been agreed.

TfL Separation of Roles

3.7 TfL has dual roles in relation to the Site in assessing: (a) the transport impacts arising from the potential development in planning terms; and (b) TfL's position as landowner and the duty to obtain best consideration by securing the most commercially advantageous development. These workstreams are separate and distinct functions and are treated as such within TfL.

3.8 This paper focuses on TfL/LUL's position as landowner and the potential opportunities to realise value from LU's assets at EC1&2. LU, as landowner, is acutely aware of the need to ensure that LU's operations are fully protected at all times.

Planning Section 106 Agreement

3.9 The redevelopment proposals for the Site are captured in the Earls Court and West Kensington Opportunity Area Planning Framework and supported by London Plan policy. Capco submitted planning applications in June 2011 to both the LBHF and the Royal Borough of Kensington and Chelsea (RBKC) as the Site straddles both boroughs. Both LBHF and RBKC have resolved to grant consent for the respective applications subject to the completion of a section 106 planning agreement, which is currently being negotiated with LBHF, RBKC and Capco and TfL in its capacity as a transport regulator.

3.10 Pursuant to his strategic planning role, on 3 July 2013 the Mayor determined that he is content for the two boroughs to determine the planning applications. The borough's resolutions in relation to the planning applications approve 10.1m sqft of above ground development with approximately 2m sqft of below ground ancillary space. A breakdown of the approximate areas for EC1&2 is as follows:

Use	Approximate Area (million sq ft)
Residential	2.7
Business	0.25
Education / culture / health	0.1
Retail	0.1
Hotel	0.08
Total	**3.23**

3.11 The planning process, negotiations and application have been fully funded by Capco without any contribution from TfL to date and TfL will not contribute to the historic planning costs.

3.12 LU will be required, as a landowner, to be a party to the section 106 planning agreement. LU has agreed with the boroughs and other landowners that it will enter into a confirmatory deed in due course whereby the obligations that will be directly imposed on LU's land holdings will not be effective unless LU has agreed to take forward development. The confirmatory deed for EC1&2 will only be completed after TfL and Capco have entered into a JV and following approval from the Board. TfL will seek an indemnity from Capco on any costs/fees to be incurred by TfL upon signing the section 106 agreement.

Recommended Approach

3.13 TfL has the option to undertake a market disposal of EC1&2 by the grant of a long leasehold interest (which would be necessary to ensure the protection of LU's operational assets). However, TfL's commercial property advisers, Cushman and Wakefield (C&W) have advised that unless this was to Capco any disposal would be subject to the existing leases to EC Properties Limited (a subsidiary of Capco) and would not maximise the value for LU. C&W also state that LU will maximise its value by agreeing terms with its tenant Capco to release the long term marriage value generated by combining their respective freehold and leasehold interests. C&W further confirm that the best way to achieve this and capture the maximum value in light of the size, complexity and length of the development programme is through a joint venture as opposed to a development agreement.

3.14 LU owns the freehold and occupies the 6.47 hectare site at Lillie Bridge Depot (LBD). Until a decision is known on the viability and feasibility of relocating the operational assets and future business needs, which is currently being investigated by the business, it is premature to decide whether a market sale or development either in conjunction with one of the adjoining landowners or with a third party partner is either operationally feasible or will represent best value for money. C&W recommends that LU does not commit to a disposal route until it has finalised an operational solution. LBD is therefore not included in the proposed arrangements for the proposed joint venture with Capco.

4 Proposed EC1/2 Commercial Terms

4.1 TfL, supported by C&W, has developed non binding Heads of Terms with Capco for a Joint Venture arrangement (JV) whereby a development vehicle will take forward the development of EC1&2 over the estimated ten-year development programme. A separate JV vehicle is preferred as it offers flexibility and gives LU the opportunity to fully participate in the development.

4.2 The corporate JV vehicle (Devco) would be established and initially owned by LU (or a wholly owned subsidiary of LU or TfL) as a minority shareholder and Capco (or a wholly owned subsidiary of Capco) as the majority shareholder. The proposed shareholdings, reported in Part 2 of this paper, have been calculated by reference to the relative value of LU and Capco's pre-existing interests in EC1&2. Devco would be granted development rights via the surrender of Capco's existing leases and the simultaneous grant by LU of new 999-year leases (the length of term TfL has been advised is required by the market) and would appoint Capco as development manager to take forward the development on behalf of Devco. Further details are in the supplemental paper on part 2 of the agenda. TfL, through LU, would retain its freehold interest, subject to these new leases. It is proposed that LU would hold its shareholding in Devco via a separate Special Purpose Vehicle (SPV). This is discussed further in the supplementary paper on part 2 of the agenda.

4.3 It is proposed that the JV would be established with provision for sharing the financial contributions and costs of key infrastructure elements such as community, energy and educational facilities as set out within the proposed Section 106 planning agreement.

4.4 PricewaterhouseCoopers is currently reviewing the proposed structure and will advise on tax and accounting strategies together with the Heads of Terms before they are finalised.

4.5 Following execution of the Heads of Terms the parties will negotiate the necessary documentation relating to the JV arrangements. Approval from the Board will be sought before any commitment is made to enter into the proposed JV arrangements.

Operational Implications

4.6 LU needs to relocate its operational assets including storage and train stabling from beneath the current EC2 while a new deck structure is built, as the existing deck is not capable of taking the loads of the proposed development. The development of EC2 cannot commence until this has taken place.

4.7 LU can re-provide the stabling currently beneath EC2 within LBD. This necessitates the relocation of maintenance and storage facilities off site to Ruislip Depot. The initial feasibility of this work has been proven and the next stage will be to undertake full design.

4.8 Once the new deck is constructed, the proposed arrangements with Devco provide for a lease to be granted back to LU of space beneath the new EC2 deck in order that stabling can be relocated (if required) in due course to facilitate any future LBD development as envisaged in the masterplan for the Earls Court and West Kensington Opportunity Area. It is not envisaged that this space will be required unless a wider development of LBD is implemented, but retaining this area allows maximum flexibility for TfL in the future.

Financial Implications

4.9 The proposed commercial and financial terms for entering into an agreement with Capco are described in the supplemental paper on Part 2 of the agenda.

List of Appendices attached to this report:

Appendix 1 – Site Plan

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

List of Background Papers

None

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Appendix 1 – Site Plan