Local Authority Land Sale

Discussion Document – 2nd June 2016

Jeff Morton MRICS

Jeff Morton - MRICS - Executive Career & Credentials - Investment Management

Transactional – Investment Management Experience

- 28 years industry experience having transacted in excess of £2.50bn sales and acquisitions over last 10 years.

Employment

Henley Investments 2012 – June 2016 – Then Consultant - Pure Global Capital

- Chief Operating Officer, Equity Partner and Investor for private real estate vehicle of $1.20bn GAV investing UK, Germany & Holland.

BlackRock 2006 - 2012

- Managing Director and Head of Investment - Transactions & Asset Management for £3.00bn BlackRock UK Property Fund.

Merrill Lynch Investment Managers 2004 - 2006

- Director: Head of Asset Management and Transactions for £2.00bn MLIM UK Property Fund.

Central London Securities CLS Holdings plc 2002 - 2003

- Director: Head of UK Property. Listed company valued at circa £725m.

Hemingway Properties plc 1999 - 2001

- Director: Head of Asset Management for property company circa £300m AUM.

Haslemere Estates plc 1988 - 1999

- Transactions and Asset Manager for property company circa £1.00bn AUM.

Past Executive Directorships

- Premier Marinas Holdings. Eight UK marinas comprising 5,500 berths south coast.

(1) Existing Asset Management Considerations (Three Main Scenarios)

a) **Hold** – Potential cost implications but revenue is retained

b) **Sell** – Capital receipt received

c) **Joint Venture** – Several types to consider

(2) Timing

a) Need to confirm that the asset is not required for operational or investment purposes

b) Understand why are the LA are selling and is timing of sale "Business Critical"

c) Are previous policy decisions determining current action and is this still the best course of action

d) Is the market operating as it should be or are there potentially negative factors influencing value and currently a good example is Brexit

e) Is the market likely to change over next 12 months positively or negatively?

f) If negative i.e. values are falling, is it compelling to sell now or justifiable to "wait and see"

(3) Legal

a) What restraints if any are the LA under in terms of selling

b) Is the only real alternative an open market sale so as to ensure best price/value is achieved

c) What constitutes best value - is it highest price or other factors

(4) Reputational

a) If deciding a JV is a suitable alternative choosing the wrong partner and many other factors could lead to both reputational and financial risks

b) Need to be careful to avoid conflicts of interest

c) Withdrawing from any deal or process should be considered responsibly

(5) Summary Outcomes

a) **Hold** – Self-manage existing asset but LA unlikely to maximize potential value due to non-development expertise within in-house skill set

b) **Sell - Open Market - Auction / Private Treaty** – Object is to get best price and delivery of scheme that is appropriate for site and community – Likely to sell with firm guidelines as to what planning uses are acceptable to include size, constraints, heights, massing etc.

c) Include a 'non embarrassment' clause to avoid purchaser 'flipping' asset at a profit – or potentially include overage provisions – however overage reduces price

d) Widest exposure definitely satisfies questions around whether best price is achieved – planning outstanding - gives further element of control – but not full control

e) Dependent on timing constraints, could sell on a subject to planning basis = longer wait for receipts but potentially achieves a higher price

f) Private Sector "generally" seeks to maximize returns and is less interested in niceties such as aesthetics, quality of materials but fully focused on profitability

g) **Joint Ventures** – Provides an alternative mechanism for capturing longer term value as the LA will hold an equity stake in the JV

h) Possible to obtain a non-monetary gain if that is a potential objective (e.g. JV partner to develop new council/neighbourhood premises at their cost)

(6) Typical Buyers

a) The current market is very difficult for developers and obtaining development finance is particularly tough and an expensive cost for investment appraisals

b) This site I would speculate should attract interest from major developers and REITS but is likely to be sought after by UK Funds who have the lowest cost of capital and would be seeking higher returns through developments often with third party partners

c) Typically Funds such as Hermes, BlackRock, Aviva, Standard Life, Threadneedle, Prudential, Rockspring, AEW, L&G etc would consider such exposure albeit Brexit may have had an effect on value.

d) Is it possible for the LA to JV with Funds or REITS and others that have the necessary development expertise.

e) Limited demand for speculative development or land-banking at current time.

(7) Sale Types

a) Freehold Sale V Long Leasehold Geared Interest.

Freehold

b) Say the site is worth £20m then this is the gross proceeds less costs. 'Day 1' receipt typically.

Leasehold Geared Interest

c) What if the site is worth £20m and sold not freehold but subject to a 150-year lease with the LA retaining the Freehold

d) The 150 year lease could be "geared" at say 10% of rent passing (side by side v non side by side – important gearing is not too high

e) Potentially subject to a minimum base rent say of passing rent of 2.5% per annum or fixed base rent it's all negotiable

f) Gearing / ground rent can be set to suit LA depending on whether initial capital receipts or future income is most important

g) If site is worth say £20m residual value the Gross Development Value very high level is £60m. Keeping numbers at this very high level a 5% gross yield provides an income to the developer of £3m per annum

h) The above assumes all commercial in this illustration when in reality the subject site will be mixed use thus including residential and ground rent income

i) The LA could negotiate to keep the Ground Rent income which is very valuable and a liquid investment cap yield 3.50% - 4.00% = 25 x ground rent income

j) Say LA accept minimum base of 2.00% and the market can absorb this "ratchet" that's £60k per annum of revenue

k) Potential to sell the freehold interest at a future date for a capital receipt

l) Maximum of £300k per annum revenue on the above illustrative figures at 10%

m) In addition to the income there is the capital receipt from the sale (although logically this figure is lower than freehold but does depend on competition

(8) Some Factors to Consider

a) What is the **reduction in liquidity** if any by selling Leasehold rather than

Freehold

b) Likely to be dependent on the nature of the planning title and any covenants imposed but all of these are within the LA gift to make these flexible (within reason)

c) What is the **reduction in price if any** by selling Leasehold rather than Freehold

d) The sale of leasehold geared interests is very common for offices as it is for other asset classes. This is best illustrated by the sale of such interests by the large landowners in central London such as The Grosvenor Estate, The City Corporation, The Cadogan Estate, Howard De Walden Estate and the numerous Livery Companies to name but a few.

e) What are the benefits in having the reversion of the land at expiry to the LA

f) What are the accounting implications if any

g) What are the wider benefits to the LA in having additional control

h) The LA has excellent borrowing power and possibly cash surplus thus the cost of borrowing is typically below market levels and could be a profit centre if lending at a higher rate than current cost with the loan secured against the asset.

(9) Simple JV Illustration

a) LA Contributes land with planning audit and detailed advice – Land value based on third party valuation

b) Partner contributes procurement expertise and delivery management etc

c) Profits – Typically apportioned 50% - 50% but can be structured numerous ways but important both sides are motivated to succeed

d) In every deal its essential to determine and show explicitly the relative equity being put into the deal by each party.

e) Value of LA land relatively easy, JV partner share based on build cost for example but is it up front or deferred etc

f) Typically, the party injecting the greater/highest amount of equity gets the greatest rewards or highest profits thus parity is important

g) The LA borrows at low rates and may even have cash reserves thus can lend the project at higher rates for superior returns could be outside of arrangement

h) Existing LA debt may be in place at higher LA market levels and capital receipts pay down liability

i) End profits shared as agreed apportioned typically on sale – not uncommon for JV Partners to have a pre-emption on sale but again liquidity affected.

j) Detailed documentation and expertise required to administer the process

(10) Risk - Reward Scenario Summary - Conclusions & Recommendations

1. **Lowest Risk > Potentially Lowest Price > Highest certainty of sale = Freehold sale of land with negligible planning conditions. Timing & Cost Consideration - Nil delay & no additional costs other than those currently allowed for.**

2. **Lower Middle Risk > Potentially Geared Leasehold Sale = Possibly lower price but retains valuable ground rent income which in turn could be sold in the future > Provides long term annuity income and retains an element of control on design etc. Timing & Cost Consideration - Initial view from independent third party supplier to interrogate & validate this advice 10 - 15 working days and at negligible costs. If sale route**

progressed standard fee at 1% of contract price - no post sale ongoing fees anticipated.

3. **Higher Middle Risk > Joint Venture > Potential trips & traps not least crucial to choose a good partner and prepare first class documentation and detailed brief > increased risk but shares in expected upside profitability as aligned with partner and scheme will inevitably be enhanced in design and value engineered thus GDV higher than currently anticipated. Retains increased control on design etc. = Potentially higher rewards. Timing & Cost Consideration Initial view from independent third party supplier to interrogate & validate this advice 10 - 15 working days and at negligible costs. If JV route progressed standard fee at 1% of contract price - with some post sale ongoing fees required.**

4. **Highest Risk > LA Develop Direct > Potentially greatest profit & definitely greatest risks and thus not a recommended route.**

(10) Third Party Advisory & Recommendation

a) *Option 2 – 3 All need careful third party advisory input which involve initially negligible costs up front and minimal time delay 10- 15 days to validate. Progression of option 3 involves increased time and costs up front but with appraisals undertaken potential profit is higher – ongoing fee costs required.*

b) *For the avoidance of doubt Jeff Morton is not retained by anyone and has no fee proposed or agreed. He has no financial interests in the site or indeed anything within the LA area. This report offers no warranty or liability it is merely the authors opinion who is acting in good faith and as a good corporate citizen for the benefit of others.*

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