

CABINET

13 November 2018

Title: London-east UK Ltd – Proposed Asset Purchase	
Report of the Cabinet Members for Finance, Performance and Core Services and Regeneration and Social Housing	
Open Report with Exempt Appendix 2 (relevant legislation: paragraph 3 of Part I of Schedule 12A of the Local Government Act 1972 as amended)	For Decision
Wards Affected: Eastbrook	Key Decision: Yes
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Accountable Strategic Leadership Director: Claire Symonds, Chief Operating Officer	
Summary <p>The former Sanofi site at Dagenham East is identified within the Council’s Growth Strategy 2013 – 2023 as a ‘key opportunity site’. By Minute 74 (15 November 2016), Minute 85 (23 January 2018) and Minute 13 (19 June 2018), the Cabinet approved the purchase of various plots of land on the site in order to facilitate the delivery of world-class film studios and a hotel as part of a significant mixed-use development.</p> <p>The latest decision in June 2018 related specifically to the freehold purchase (rather than leasing) of The Cube site, owned by London-east UK Ltd (LEUK), alongside other land owned by LEUK. During the course of the discussions to finalise that deal, an opportunity has arisen for the Council to acquire 100% share capital in LEUK from SOG Limited together with the land and its business interests on the site.</p> <p>LEUK currently owns, operates and maintains land and assets primarily through directly employed staff on a site covering 15.5 acres. The company operates primarily in the field of Facilities Management and looks after all of the buildings on the former Sanofi site as well as other premises.</p> <p>Initial discussions with the Managing Director and Chairman of the Barking & Dagenham Trading Partnership (BDTP) have indicated an interest in BDTP acquiring the LEUK business as a going concern. Further due diligence and assessments of the business case for the acquisition, further viability assessment and valuations and legal/accounting due diligence need to be undertaken before contractually committing to the acquisition. This option could be progressed by way of a loan on commercial terms from the Council to BDTP, who would acquire the share capital in LEUK and, with it, the land and business interests.</p> <p>Should that option not proceed, it is expected that it would still be in the Council’s interests to seek to acquire the entire LEUK land interests at the site. An independent valuation of the LEUK land interests, advice on the state aid treatment of any loans given by the Council and legal due diligence on the corporate acquisition and real estate assets</p>	

will form part of the final due diligence before the Council or BDTP commit to the acquisition, but the provisional sums discussed between the Council and LEUK would not exceed market value.

Recommendation(s)

The Cabinet is recommended to:

- (i) Agree that the Council should seek to acquire London-east UK Limited's land and business interests at the former Sanofi site, in accordance with the strategy set out in the report and subject to all appropriate due diligence, viability / value for money assessments;
- (ii) Delegate authority to the Chief Operating Officer, following consideration by the Investment Panel and in consultation with the Director of Law and Governance, the Cabinet Member for Finance, Growth and Investment and the Cabinet Member for Economic and Social Development, to determine the preferred method of purchase and final terms including, if appropriate, a working capital loan to Barking and Dagenham Trading Partnership subject to:
 - a. a detailed business case;
 - b. appropriate due diligence and assessments, including viability / value for money / financial / tax related implications;
 - c. compliance with state aid law and principles in advancing a loan or other assistance on commercial market facing terms;
 - d. legal due diligence and advice from external advisers on the corporate acquisition;
- (iii) Authorise the Chief Operating Officer, in consultation with the Director of Law and Governance, the Cabinet Member for Finance, Growth and Investment and the Cabinet Member for Economic and Social Development, to enter into all necessary agreements to give effect to the proposals, subject to a recommendation from Investment Panel to approve the financial soundness and viability of the purchase.

Reason(s)

The proposal will contribute significantly to the Council Priority of 'Growing the Borough', in a number of ways: facilitating the Council to gain a controlling land interest in a strategically important site, enabling a short to mid-term income from investment in a going concern which supports the business case for BDTP and mid to long term, could enable the Council to bring forward industrial and creative mixed-use development.

This proposal could help deliver the 'No-one left behind' objective of the Growth Commission and the vision of the Borough Manifesto by through investment in the borough and enabling the development of a cohesive long-term strategy which would encourage more employment opportunities and raise aspirations of local residents.

1. Introduction and Background

- 1.1 The former Sanofi site at Dagenham East is identified within the Council's Growth Strategy 2013 – 2023 as a 'key opportunity site'. By Minute 74 (15 November

2016), Minute 85 (23 January 2018) and Minute 13 (19 June 2018), the Cabinet approved the purchase of various plots of land on the site in order to facilitate the delivery of world-class film studios and a hotel as part of a significant mixed-use development.

2 Proposal and Issues

- 2.1 The opportunity has arisen for the Council to acquire either the assets of, or 100% of the share capital of London East UK Ltd. The initial view is to proceed with the latter, the acquisition of the LEUK company (100% of shares), either by acquiring itself or by advancing a loan to BDTP to acquire the company. The company owns, operates and maintains land and assets primarily through directly employed staff.
- 2.2 London East UK Ltd owns 15.5 acres of land with seven existing industrial buildings with a combined floor area of 442,776 GIA sqft on land that was formerly part of the Sanofi site. The Company currently employs three permanent staff, a number of temporary staff as well as external sub contracted staff in order to maintain the existing tenancies at the assets.
- 2.3 The 15.5 acres of land has been externally valued by Savills in 2012 and BE Group 2013. An independent external valuation has now been commissioned to be undertaken by CBRE to verify this appraisal which is due to be received shortly. This will be analysed as part of the detailed due diligence required prior to any delegations related to this paper being exercised, i.e. before commitment to the acquisition.
- 2.4 There are 38 existing tenants on site with licence agreements ranging from 1 - 25 years in duration, although approximately 40% of the current licences are for a duration of less than 3 years. Additional income is generated by LEUK by utilising the site as a location for filming, corporate events and other activities
- 2.5 Cabinet has already approved the terms of the freehold purchase of The Cube and an adjacent strip of land [19 June 2018, Minute 13 refers] as part of the Land Assembly required to deliver the optimal Film Studio deal. There is an outline strategy to provide £6.5m of capital funding for improvement / extension works to The Cube to enhance its longer-term viability, which is expected to generate up to an additional £1m rental income pa.
- 2.6 The site, adjacent to the proposed Made in Dagenham film studio is an important strategic location and one which is expected to generate considerable interest for additional film studio space and creative industry space. Rental income forecasts in this area which have been evaluated by Lambert Smith Hampton suggest rental interest in Romford and Dagenham at between £12 and £18psf with some interest at £23 psf. However, the Council's preferred supplier for the delivery of the Film Studio has provided evidence from the US that suggests that office rents related to a film studio are double standard office rents which suggest there is opportunity to generate greater rental income and returns on this site over the longer term.
- 2.7 The Barking and Dagenham Trading Partnership (BDTP) commenced trading in April 2018 and has a long-term objective of growing its trading activity through securing new business. The London East UK Ltd company includes a repairs and maintenance function which delivers services to the company's tenants utilising

three permanent employees but also a variety of sub-contracted services which could be delivered in-house by BDTP if LEUK become another subsidiary within BDTP group structure

- 2.8 One of the Council's Investment and Acquisition Strategy objectives is to unlock regeneration and economic growth opportunities and generate income through lending which this proposal combined with the delivery of the Film Studio and the associated employment could facilitate.
- 2.9 Further details of the financial issues associated with the options are provided in Appendix 2, which is in the exempt section of the agenda as it contains the commercially confidential financial information (relevant legislation - paragraph 3 of Part 1 of Schedule 12A of the Local Government Act 1972 (as amended)) and the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

Risks and Issues

- 2.10 The primary risks in this proposal relate to lost revenue from low occupation of the buildings or higher than expected maintenance or landlord liabilities. Mitigations would need to ensure that the immediate opportunities to maximise income are in place and that the medium-term strategy is sufficiently flexible to enable the decant and demolition of buildings to reduce revenue costs in the event that income could not be maximised.
- 2.11 It is recognised that Dagenham does not have an established office market and Barking and Romford have limited supply and this is expected to inform the medium-term strategy however the primary focus for longer term demand is predicted to be from firms related to the development of the film studios. There is strong evidence of production companies wanting to have short term lettable space as well as a wide range of associated industries wanting to locate close to film stages. As part of the expressions of interest stage in the Film Studio tender there were numerous companies offering film/TV related services wishing to locate. It is believed many will want some form of presence near the studios.
- 2.12 There is also potential to be some long and medium term demand relating to the proposed datacentre, however none of this is guaranteed and the Council would need to fund the purchase through borrowing which would need to be an additional net annual cost to the Council's revenue budget in the event rental income and/or development profits did not cover these costs.
- 2.13 The ground at the entire Sanofi site has contamination and raises environmental considerations. Remedial work has been undertaken by LEUK and warranties would be provided to the Council against those remediations, however, these remain a key risk in terms of costs for the longer-term development. Insurance can be bought to protect the Council against these risks which would cost approximately £350k for 10 years cover. This would need to be included in the costs of the project whichever option is pursued.

3. Options Appraisal

3.1 Option 1 – Do Nothing.

The Council has the option to do nothing and to not acquire a controlling interest in this wider site and to proceed with purchasing The Cube and the strip of land needed for the optimal Film Studio delivery as previously approved. This option would provide no further benefit to the Council and would incur no additional risks than those otherwise already considered in relation to The Cube. In this scenario, it is likely that the Companies that own the share capital of LEUK could jointly decide to market LEUK or the land interest separately to a third party. In this scenario the development of the site for uses which support the industrial and creative industry spaces that are likely to be required or complimentary to the film studios when delivered would be left to the market to deliver.

3.2 Option 2 – Acquire the land interest only.

An opportunity exists for the Council to purchase the land within LEUK as a straight land transaction. Through this approach, the Council could still benefit from the opportunity to acquire a controlling land interest but at an increased purchase price.

The Council would still need to develop a medium and long term strategy for the site as well as put resources towards immediately maximising income opportunities and reducing the revenue impact from the carry costs related to the purchase. One option the Council could exercise in due course, subject to due diligence, is to sell the vacant units although it is not yet clear if this would be feasible or desirable given a medium and longer term strategy has not yet been developed.

As with the option above, there are potential opportunities that could be exploited in the short to mid-term and then developed in the medium and longer term. Overall this remains the most expensive option for the Council

Option 3 – Purchase the Share Capital

3.3 This offers the most economically efficient way to acquire the site. In addition to the same risks and opportunities present in option 2 this option includes the purchase of an ongoing commercial concern through which the on-site staff are employed. This company was incorporated in August 2014 and has three years of audited financial accounts and an existing revenue income which could be maintained as is and then over the short term maximised. Purchase of the Share Capital provides the most economically efficient way of acquiring the land.

3.4 Further information on the potential costs associated with these options is set out in Appendix 2 in the exempt section of the agenda.

4. Consultation

4.1 Initial consultation has taken place with relevant Cabinet Members, the Managing Director and Chairman of BDTP and officers (including external advisers). Subject to Cabinet's approval to progress the proposals, the detailed arrangements will be subject to full assessment by the Council's Investment Panel.

5. Financial Implications

Implications completed by: Chris Randall, Interim Finance Accountant for Transformation

- 5.1 The Council is undertaking in depth financial due diligence on the proposed additional purchase option identified in the report. This includes the use of expert external financial and property advisors to ensure the acquisition represents best value to the Council and is structured in the most tax efficient way, and also that all current and future risks and opportunities are considered prior to any potential purchase. Initial costings associated with the options are set out in Appendix 2 in the exempt section of the agenda.
- 5.2 Whatever option, the Council will need to fund the purchase through borrowing which will be an additional annual cost to the Council's revenue budget. This will be offset by expected rental income and/or development profits from the site. However, in the short term during the development phase the borrowing costs will be an additional net cost to the Council's revenue budget and this will form part of the final option appraisal and will be included in the Council's medium term financial plan if appropriate.

6. Legal Implications

Implications completed by: Suzan Yildiz, Deputy Head of Legal Services (Commercial)

- 6.1 The report proposes the acquisition of LEUK Limited by the Council or an entity owned by the Council, together with its land and business interests. This is a corporate acquisition of a target company (with its assets and any liabilities). To enable the transaction the report delegates authority to the Chief Operating Officer, in consultation with others, to consider the most appropriate mechanism to facilitate the transaction which may involve acquisition through an entity owned by the Council subject to further due diligence on financial, legal and accounting matters before final terms are settled. If the acquisition proceeds through another company entity owned by the Council, such as BDTP, the Council would also advance a loan for the acquisition to that entity.

Relevant legislative powers

- 6.2 The Council has a number of relevant powers concerning borrowing, investment and other dealings. Section 1 of the Localism Act 2011, the general power of competence ("GPC") empowers local authorities to do anything that an individual can lawfully do provided that the activity is not expressly prohibited by other legislation. Activities authorised by the GPC can include investment, trading or charging decisions which may be undertaken through commercial vehicles with the aim of benefiting the authority, its financial management, its area or its local communities. The power is wide and provided that the specific activity is not expressly restricted or proscribed by other legislative provisions, it will be within the parameters of the GPC power. Section 4 of the Localism Act 2011 requires local authorities to carry out any activity which may be deemed for a commercial purpose through a company and to ensure that the proposal and the mechanisms to effect it are within the GPC power. As LEUK Ltd is already a company, acquiring LEUK will

be compliant with this requirement. The report states that the acquisition is to enable the Council's investment and regeneration priorities, as such the purpose of the acquisition is not necessarily for a primary commercial purpose, it is also intended in the mid to long term to facilitate the wellbeing of the area through regeneration of the land held in LEUK Ltd. A more detailed business case for the acquisition would clarify the purposes for which the company is to be acquired.

- 6.3 To the extent that borrowing and subsequent loans to an acquiring entity, such as BDTP are required, Sections 1 and 12 of the Local Government Act 2003 (as well as the GPC under s.1 of the Localism Act 2011) enable a local authority to borrow and invest for any purpose relevant to its functions, or for the purposes of the prudent management of its financial affairs. Speculative borrowing to invest purely for profit will not be deemed directly relevant to the authority's functions and will not, therefore, be authorised under this power.
- 6.4 Section 15 of the Local Government Act 2003 requires local authorities to have regard to the Statutory Guidance on Local Government Investments (3rd edition effective from 1 April 2018) ("the Statutory Guidance") in exercising borrowing and investment powers, which the Council may do to facilitate this transaction. The definition of an investment includes 'all of the financial assets of a local authority as well as other non-financial assets that the organisation holds primarily or partially to generate a profit' and for the avoidance of doubt it includes 'loans made by a local authority to one of its wholly-owned companies or associates' The CIPFA Code contains detailed recommendations in the context of prudent borrowing practice, such as prioritising security, liquidity and yield (in that order) and should be considered as individual investment decisions are made.
- 6.5 In exercising their powers to make decisions about the acquisition of LEUK, any associated borrowing and lending, the decision makers must have regard to:
- i) Compliance with the Statutory Guidance on Local Government Investments;
 - ii) Fulfilling its fiduciary duty to tax payers;
 - iii) Ensuring best value, effective risk and credit management, i.e. that the acquisition represents best value and an open market price (depending on the methods of valuation) and effective arrangements are in place to manage risk;
 - iv) Compliance with state aid requirements (see below).
- 6.6 The Council has a fiduciary duty to the tax payers of the Borough in respect of public funds. This means the Council is a trustee and holds, spends and manages money for the tax payer but does not own those public funds. Therefore, any investment powers must be exercised for a proper purpose and reasonably in all the circumstances. The decision maker/s need to be satisfied that the justifications, due diligence and risk management for the acquisition and providing funding/loan are in place and are consistent with what prudent investors would do in the market place.

State Aid Implications

- 6.7 As a public body (and an emanation of the state) the Council is required to comply with (and ensure its entities and companies comply with) the state aid rules. Article 107 (1) of the Treaty on the Functioning of the European Union (Treaty)('The Rules') declares that state aid, in whatever form, which could distort competition

and affect trade by selectively favouring certain undertakings, is incompatible with the common market, unless the Treaty and in practice the European Commission (through regulations and decisions) allows otherwise.

- 6.8 In respect of any loan arrangements, to mitigate the risk of giving illegal state aid, any commercial transactions or loans must be made on 'market terms' in order to satisfy the "Market Economy Investor Principle" (the MEIP). The MEIP means that when a public authority invests in an enterprise on terms and on conditions which would be acceptable to a private investor operating under normal market economy conditions, the investment will not be state aid. Therefore, if a loan is to be advanced by the Council to one of its companies to enable the acquisition of LEUK Ltd, such funding must be on commercial market facing terms which would be acceptable to a prudent private investor. In addition, considering the CIPFA Prudential Code and Statutory Guidance, which require Council's to ensure sufficient security, before liquidity and yield, senior security documents over both the shares of the borrower entity and the assets should be put in place to mitigate the risks of default.

Governance Implications

- 6.9 Section 9D(2) of the Local Government Act 2000 as amended establishes the functions of Executive Cabinets. This enables a Cabinet to carry out decisions on any function unless reserved by order of the Secretary of State. Investment decisions of an authority are not a reserved function. Under part 3 Chapter 1 paragraph 1.2 of the Council's Constitution, the Cabinet can in turn delegate its functions to an officer or authorise the officer to take investment decisions subject to established parameters, such as the need to consult prior to deciding. In the case of investments there can be a need to move quickly when opportunities arise. Hence, the Chief Operating Officer (as S.151 Local Government Act 1972 Chief Financial Officer) can be authorised to make investment decisions and in this case delegations are requested to finalise the transaction.
- 6.10 In addition to the above consideration and before contractual commitment to the acquisition of LEUK Ltd and any associated loan arrangements, decision makers are advised to: -
- i) Carry out valuations of the company and the real estate assets using appropriate methodology relative to the Council's business case for the acquisition. For example, the valuation methodology of a company versus real estate assets acquired for development purposes will differ. It is noted financial due diligence has been carried out by PWC (which is private and exempt as it contains commercially sensitive material);
 - ii) Further financial and legal due diligence to mitigate the risks associates with a corporate acquisition (i.e. the Council or its entity will acquire the company with its assets and liabilities);
 - iii) Ensure that borrowing complies with the relevant regimes and state aid requirements;
 - iv) Any loans and security documents (over shares and / or real estate assets) are robust and on commercial terms market facing terms and obtain an opinion that the arrangements are state aid compliant.

7. Other Implications

- 7.1 **Risk Management** – The risk assessment is detailed in the body of the report.
- 7.2 **Contractual Issues** – Any contractual issues will need to be resolved subject to approval of the method of purchase and will be subject to satisfactory due diligence at that point.
- 7.3 **Staffing Issues** – This paper outlines that the Company currently employ a number of permanent and temporary staff however the actual impact on these individuals cannot be identified until the method of purchase has been approved. Any impact would be overseen by LEUK as the employer.
- 7.4 **Corporate Policy and Customer Impact** - No issues relating to the specific recommendations as the existing tenants are unlikely to be impacted by the change in share ownership.
- 7.5 **Safeguarding Children** – The proposals should have no impact on safeguarding children.
- 7.6 **Health Issues** – No issues relating to the specific recommendations.
- 7.7 **Crime and Disorder Issues** – No issues relating to crime and disorder
- 7.8 **Property / Asset Issues** – There are a number of potential property and asset issues but these are currently subject to the due diligence process. Any impact will be covered.

Public Background Papers Used in the Preparation of the Report: None

List of appendices:

Appendix 1: Site Plan

Appendix 2: Financial and Due Diligence Summary (exempt information)