Finance Committee

Date: 26 January 2017

Item: Strategy for the Broadway Complex

This paper will be considered in public

1 Summary

1.1 This paper describes the proposal for TfL to grant a long leasehold interest in 55 Broadway, 100 Petty France and Wing Over Station ('the Complex') and for TfL to then take a leaseback of the Complex ('the Transaction'). It is proposed that TfL goes to the open market to offer a long leasehold interest on the Complex.

1.2 A paper is included on Part 2 of the agenda, which contains exempt supplemental information and documentation. 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 financial affairs of TfL. Any discussion of that exempt information must take place after the press and public have been excluded from the meeting.

2 Recommendation

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

(a) grant Land Authority for:

- **(i) a long leasehold interest in 55 Broadway, 100 Petty France and Wing Over Station (the Complex) for the minimum value set out in the paper on part 2 of the agenda;**

- **(ii) the leaseback of the Complex to be taken by TfL or any Subsidiary Company for a maximum term as set out in the paper on part 2 of the agenda; and**

- **(iii) the separation works and any other costs relating to the future transaction as set out in the paper on part 2 of the agenda; and**

(b) note:

- **(i) that in accordance with TfL Standing Orders the Delegated Officers and any relevant Subsidiary Company have authority to approve the terms of all documentation required to facilitate**

and implement the matters set out in paragraph 2.1 (a), including selecting the purchaser of the long leasehold interest of the Complex; and

(ii) that an update of the final terms of the transaction will be provided to the Committee in due course.

3 Background Information

3.1 The Complex is situated directly above St James's Park underground station. That part of the Complex known as 55 Broadway was built in 1929 as the headquarters of London Transport and has a Grade 1 listing. Those parts of the Complex known as 100 Petty France and Wing Over Station were built in 1970 and 1930 respectively, and are not listed. All the buildings comprising the Complex are in the freehold ownership of TfL. An aerial photograph and site plan of the Complex are included in Appendix 1 (the Plan).

3.2 Due to operational railway interfaces within the Complex, any disposal considered would be leasehold, meaning that TfL would retain control through freehold ownership of the Complex and grant a long lease. The delivery of the Transaction would not materially impact upon London Underground (LU) operations and the long term day to day function of St James's Park Station is unaffected.

3.3 In 2010 TfL considered selling the Broadway Complex, the historic headquarters of London Underground. The decision was part of a strategy to move to modern accommodation in a series of new hubs in peripheral locations in order to deliver operational cost savings.

3.4 Subsequently, the planned sale of the Complex by way of a 999 year lease as a residential scheme (with planning permission) and vacant possession was discounted as an option. This was due to the significant cost of removing operational equipment and separating the retained operational assets that would be required to allow an early sale. In addition, analysis undertaken suggested that net accommodation savings could be instead optimised by retaining 55 Broadway at a discounted market rent whilst disposing of more expensive leasehold interests and commercially letting a number of freehold assets. For this reason outright sale is not considered further in this paper.

3.5 As part of our Transformation programme we have carried out a detailed review of our office portfolio to ensure we are delivering the best possible value for money from our office accommodation. The Complex is one of the lowest cost buildings within the TfL office portfolio, while at the same time it has a significant capital value. The TfL Business Plan assumes a significant capital receipt from a transaction.

3.6 In order to realise this receipt, keep our office costs down and respond to the changing central London residential property market, TfL is now proposing to change the strategy for the Complex. This paper proposes the alternative approach to attaining the capital receipt which forms part of the Commercial

Development Business Plan and has been reviewed and approved by TfL's independent Commercial Development Advisory Group (CDAG).

3.7 The retention of the freehold of the Complex and the grant of a leaseback arrangement to TfL following the grant of a long lease to a third party is a pre-requisite to meet capacity and capital requirements of the business whilst delivering operational expenditure savings elsewhere on the TfL estate. The forecast rent for the underlease and the forecast net capital receipt are in the TfL Business Plan. The Transaction will ensure TfL can meet Business Plan targets as planned while also keeping office occupancy costs down.

4 Options Analysis

4.1 As set out in paragraph 3.4, given the sale with vacant possession for residential use is not a viable option, three options were considered.

4.2 **Do Nothing/Temporary Retention.** Retain the Complex in its current configuration and maintain ownership of the freehold. This option has been discounted as it does not meet the objective to assist in the delivery of £3.4bn of non-fare income over the TfL Business Plan period by raising a budgeted capital receipt whilst minimising operating costs and targeting savings. This option is therefore NOT RECOMMENDED.

4.3 **Strip Income Deal.** Sometimes referred to as a finance lease this comprises a structured bond sale via the Capital Markets. Whilst a strip income deal would achieve a similar financial outcome to the preferred option, the asset would be retained on TfL's balance sheet and therefore the finance agreement would be treated as borrowing. This option has been discounted as under current accounting standards the income strip approach is highly likely to be treated as a financing transaction rather than a property transaction of the grant of a long lease and leaseback. In accounting terms, the upfront receipt would be recorded as a pure financing transaction. The property would remain recorded on TfL's balance sheet as is currently the case. Rentals paid by TfL under the agreement would be split between a notional repayment of the outstanding lease creditor balance on the balance sheet and payment of the notional interest charge on the lease liability. Given under the accounting regulations finance lease creditors count towards TfL's authorised debt limits this option is therefore NOT RECOMMENDED.

4.4 **Grant a Long Lease and Leaseback.** TfL grant a long leasehold interest in the Complex and leaseback in the current commercial use, as offices to TfL or one of its subsidiary companies. It has been determined that this is the optimum solution to achieve the cost effective office space required by TfL, reduced operational expenditure (rent) and attain the forecast capital receipt and is therefore RECOMMENDED.

4.5 Should the Committee approve this option, TfL's appointed agent and advisor Knight Frank will then present the Complex to the open market on the basis of granting a long leasehold interest. This Transaction has the potential to raise capital in 2017/18 without the need for TfL to vacate the building and undertake some of the more complex decoupling activities before completion of the Transaction. The works can then be completed within the duration of the occupational leaseback period through a mixture of required work and natural obsolescence.

4.6 TfL has a statutory duty to deliver best value when entering into the Transaction. This will be achieved through the open marketing of the property and TfL's property advisors Knight Frank confirming that best value has been achieved. Knight Frank have confirmed that given the occupational needs of TfL and technical restrictions of the Complex that the proposed grant of a long lease and the leaseback offers TfL best value.

5 Commercial Terms

5.1 Detail of the proposed commercial terms of the transaction is set out in the paper on Part 2 of the agenda.

6 Operational Separation Works

6.1 In addition to the commercial considerations to create the optimal criteria for presentation of the Complex to the market, it has been necessary to address a series of property and technical issues. The property issues are outlined below.

Separation

6.2 The basement and parts of the first floor of the Complex currently have heating, power, telecoms and other equipment which serves both LU's retained operational requirements for the station and the offices above. The grant of the long lease and leaseback option will require TfL to undertake the separation of this equipment by the end of the underlease to achieve the ability to provide vacant possession between all the office space in the Complex through the relocation of the equipment.

6.3 As part of the appointed advisory team, TateHindle architects and Mott MacDonald engineers have progressed the design, technical and on-site investigative implications of separation. TateHindle are completing the RIBA Stage 2 design which will be represented in a due diligence report for potential purchasers. This will capture the works required for demise separation and demise plans and identification of space requirements for all equipment.

Building Services

6.4 Invasive surveys have been completed to investigate existing services such as IT, drainage, cable tracing, fire suppression etc. Survey report findings will be included by Mott MacDonald within the due diligence report.

Fire, Planning and Heritage

6.5 The feasibility of achieving the required fire engineering, town planning, listed and building/heritage outcomes to achieve separation has been evaluated during this phase and the scope is included in the cost assessment for the separation works. Mott MacDonald are advising on the fire strategy for the new headlease / underlease arrangement and Portico (Heritage) are advising on the heritage aspects of proposed changes in the basement and at ground floor with CBRE similarly appointed to assess statutory planning implications.

Cost Assessment

6.6 An updated schedule of costs for the separation of building services, means of fire escape and the formation of a new demise have been prepared by cost consultant Currie and Brown as part of the separation works project.

6.7 Further detail on the proposed works is set out in the paper on Part 2 of the agenda.

7 Due Diligence

7.1 Due diligence has been undertaken on all potential sale requirements and they have been assessed to test technical capability, financial standing and whether they can commercially offer best value for TfL when the sale opportunity is offered to the market.

7.2 Knight Frank and TfL have, in addition, undertaken due diligence to determine the technical assurance that the separation of services is achievable for the sale and leaseback of the Complex.

7.3 Prior to marketing the Complex, TfL and its advisors will set the parameters for the due diligence that will be undertaken on the potential purchasers. Full due diligence will be undertaken on any successful bidder (who for the length of the underlease will be TfL's landlord) prior to completion of the Transaction.

8 Commercial Development Advisory Group (CDAG)

8.1 TfL's independent CDAG has been engaged throughout the process. Input has been offered from the members of the CDAG to refine TfL's commercial position and its views have been reflected. The evaluation of bids will be subject to CDAG oversight.

List of appendices to this report:

Appendix 1: Aerial photograph and site plan of the Complex

A paper containing supplementary exempt information is included on Part 2 of this agenda.

List of Background Papers:

None

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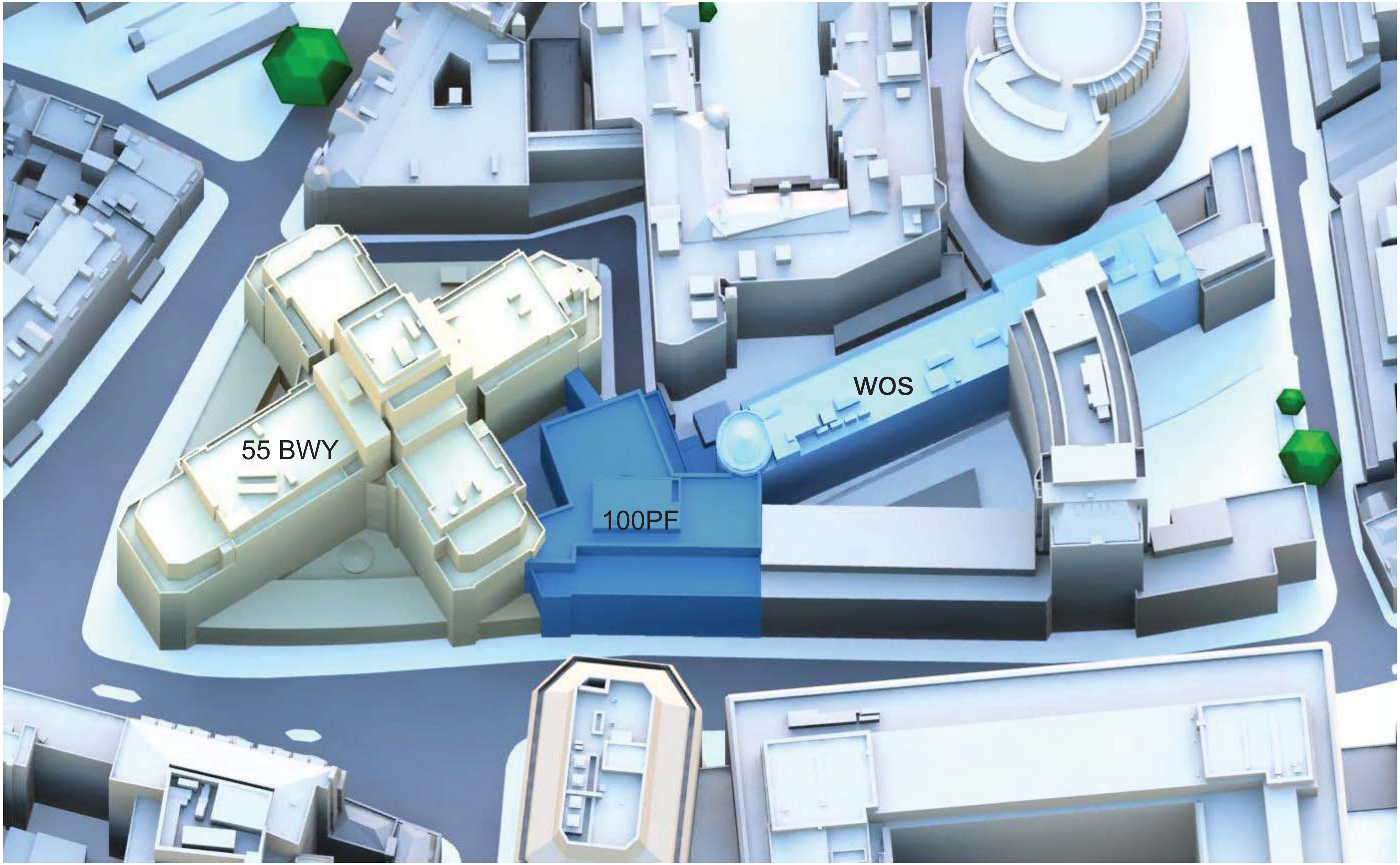
Appendix 1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