18th November 2014

Brent Cross South: Commercial principles - Contract Ref: 700606

1.1 The London Borough of Barnet (the "Council") is running a four stage negotiated procurement process to select a preferred development partner at Brent Cross South. Following the successful completion of the first stage of procurement (PQQ), the Council has invited four parties to respond to the second stage (ITN) questions.

1.2 In order to inform bidders' responses to the ITN (and in particular questions 3a, 3b and 3c), this paper describes the Council's proposed financial structure, through which the "JVCo" will deliver the regeneration of Brent Cross South.

1.3 This paper is to be read in conjunction with the documents provided in the Appraisals section of the on-line data room www.brentcrosssouth.com and also in conjunction with all other information provided as part of the Brent Cross South procurement process.

1.4 The purpose of this document is to provide an explanation of how bidders are to approach the assessment of, and make proposals relating to, financial returns from the delivery of Brent Cross South and how these are to be distributed to the respective parties.

1.5 This note constitutes guidance which is supplementary to the 'Brent Cross Evaluation Criteria and Methodology'.

Context

1.6 As noted in the ITN document, the Council accepts that its potential development partners may take different approaches to assessing development risk and with it, the required financial return. The ITN questions and evaluation criteria set out requirements for completion of an excel spreadsheet (ref BXS31) which will allow the comparison of developer return on a like for like basis. In accordance with the guidance to ITN question 3(b), bidders are required to stipulate their target profit on cost and this will be the primary method used to compare bidders' proposals.

1.7 We are conscious though that there are other measures of financial success. If an alternative measure is proposed we would ask bidders to provide details as part of their response (Return on Capital, profit on revenue etc) and state the basis on which they would be prepared to contractually commit in such a way that generates an equivalent quantum of profit to that proposed by the bidder's target profit on cost. If the proposed alternative approach does not generate an equivalent quantum of profit (and this is the basis on which the bidder has offered to commit) then this will be treated as an unacceptable response.

1.8 By way of clarification, where an alternative approach to the assessment of profit is accepted then, following selection of a preferred bidder, the financial model will be updated to reflect that bidder's approach to assessing profit and hurdle rates of return.

1.9 We set out below three approaches to the development of Brent Cross South that may have an implication on the way in which financial returns are delivered:

(a) Development management and the disposal of serviced sites to an SPV/third party;

(b) Delivery of phased development in anticipation of short term capital receipts;

(c) Delivery of phased development in anticipation of a long term return.

1.10 It is recognised that the eventual Business Plan may deploy a variety of methods for meeting the Partners' objectives. However, the Council has a strong preference for delivery that results in the creation of a long term revenue income for itself, as opposed to shorter term capital receipts.

1.11 In light of the comments made above, bidders are given the opportunity in responding to the ITN to expand upon their anticipated approach to the funding and delivery of:

(a) Infrastructure

(b) Development plots

1.12 The Council expects bidders to comment on how they propose to finance the delivery of this scheme including an assumption on the proportion of debt and equity for differing elements, how this will impact on the cost of finance to the project and what the risks and rewards are perceived to be in each scenario. Finance cost assumptions can be inputted at E160 on the Plot Costs tab and J186 on the Master Developer Cost tab .

1.13 It is anticipated that the Council's development partner will take the lead in developing the business plan, design and phasing solutions and ultimate delivery of each phase. The Council will identify those key phases where we would expect greater control to be retained by the JVCo (for example, development of the southern landing of the Living Bridge) and those areas which might be suitable for disposal to third parties as serviced plots, albeit where a necessary degree of control is retained over successful delivery.

2 Bidder guidance

2.1 Bidders are invited to consider the contents of the various documents provided in the Appraisals section of the on-line data room. The documents seek to

2.1.1 Confirm the floorspace content of the consented scheme (ref BXS28)

2.1.2 Describe a potential phasing strategy, (ref BXS29 rev1)

2.1.3 Identify the area of land to be contributed by the London Borough of Barnet and to be acquired from third parties (ref BXS34)

2.1.4 Provide an indicative residual appraisal of the scheme and in doing so provide an overview of the expected delivery programme for the scheme, the order of costs and the sensitivity to residential values (ref BXS31). This document also is the basis for bidders to describe how returns might be taken under the scenarios 1.9 a-c above. Green boxes are those variables that the Council believes can be 'fixed' through the Negotiated Procedure, with Yellow boxes accepted as variables unless the bidder believes it can be fixed to provide certainty to the Council. For example, where our partner intends to build out a phase, we would expect that cells B37-43 of the 'Assumptions Summary' tab are fixed and would be treated as 'green'.

2.1.4.1 As a minimum, it is expected that the variables to be fixed through the Negotiated Procedure include Bidders' Development Management fee, Priority Return on Costs incurred and the Partners' share of surplus for distribution.

2.2 Bidders will be provided with an opportunity to meet with representatives from Capita and the Council to review the figures and appraisal structure provided.

2.3 Note that the appraisals and assumptions are solely provided to assist bidders to understand the scale of the opportunity and to consider how the delivery of such a scheme might be approached and returns might be calculated. The figures are not a formal opinion of cost or value and must not be relied upon as such. Neither the Council nor any of its advisers can accept any liability for the accuracy of any of the figures provided or for the integrity of the financial model.

3 Appraisal Principles

3.1 The key Excel file (ref BXS31) for consideration is essentially a residual appraisal that calculates the potential value of a clean, consented and serviced development plot and then deducts the Master Developer (JV) costs of delivering that plot for development. This "Master Developer Residual" or surplus figure is then distributed between the Council and the Private Sector Partner to recognise their respective contributions; land and wider support from the Council, finance and expertise from the Partner.

3.2 For the purpose of comparing proposals, the appraisal assumes the following process;

3.2.1 Council land is placed in to the Joint Venture on the basis of the residual land value generated at line 110 on the Residuals tab within the model. This residual land value will be based on the principle that a residual appraisal will be undertaken for a phase and the Council's proportion of that land value being identified. For example, if phase 'x' is comprised entirely of Council land then the Council would receive 100% of the RLV. If the Council contributed 20% of the land in phase 'y' then the Council receives 20% of the RLV.

3.2.2 The Council's RLV is underwritten by the JVCo to be paid as either a future capital receipt, a physical output (eg. PRS units) or a long term revenue stream. Land contributed by the Council is to be transferred at nil initial consideration and not expected to be a 'cost' to be 'borne' by the JVCo at the outset.

3.2.2.1 The valuation of the Council's land will reflect the benefit to the project of the deferral of the receipt and the fact that the land is being transferred at nil initial consideration. As such the following costs will not be shown in the valuation

(a) Agents fees on Council's land value;

(b) Legal fees on Council's land value;

(c) Finance costs on Council's land value; and

(d) Developer's profit on the Council's land value.

3.2.2.2 The transfer of land into the Joint Venture, and the requirement for the commencement of investment by the bidder, is to be subject to a hurdle rate being met. Bidders are invited to describe what these hurdle rates for its return will be.

3.2.2.3 The Business Plan will need to recognise a methodology for addressing particular plots or sub-phases that fail to deliver commercial returns due to infrastructure burdens being borne on behalf of subsequent plots or phases.

3.2.3 Although the Council expects most of its contribution to be reflected in long term revenue receipts it also expects to retain the right to seek a shorter term capital receipt as and when might be required. However, it is recognised that this matter will need to be declared in the Business Planning process for each phase. The land's value at the point of transfer is to reflect the terms on which the Council will expect a return. i.e. capital payment, or completed development/residential units.

3.2.4 Subject to the agreed hurdle rate being met, the Council's Partner will be required to purchase third party land as might be required and also to commit to secure optimum Planning consents for the various plots and phases. The partner will also be required to commit to investing in infrastructure as required to bring the various plots and phases in to a condition capable of being implemented. The Partner will be expected to fund the delivery of all third party land acquisition, infrastructure investment and professional fees but these costs will be an allowable cost within the development appraisal.

3.2.5 On the delivery of serviced plots, the appraisal model assumes that these plots are 'sold' to facilitate delivery. It may be that these plots are sold on the open market or to a company related to the Joint Venture company or the Council's Partner. If the land is sold to a connected entity the transfer must be supported by a valuation. If the site is to be sold to an unconnected third party, this is to be on an open market basis and subject to verification by JVCo's advisers as to the acceptability of the assumptions as regards costs and values. The Council will also need to ensure that at the point the land is committed to be drawdown, it has satisfied statutory requirements as to best consideration and state aid by way of approving inputs into the approved form of model.

3.2.6 For the purpose of exploring the potential of this land, the appraisal assumes an open market transaction and includes land transaction costs such as Stamp Duty Land Tax, Agency fees and Legal fees. These will not be relevant where the developer itself builds out a phase. As drafted, the appraisal shows all 'plot developer' costs and returns (i.e. those that would be incurred/received by the party buying the serviced plot) as Yellow – i.e. not fixed.

3.2.7 It is expected that whichever route to plot delivery is selected, there will always be a 'crystallisation' of respective anticipated returns prior to start on site;

3.2.7.1 In the event that land is being sold and capital receipts are being taken, the Partners' priority returns (the Council's land value and the Partner's return on cost) will be taken *pari passu.* Any surplus (over and above the residual land value and the Partner's priority return) will be distributed between the Council and the Partner. It is expected by the Council that the method and proportion for sharing surplus returns/value will remain consistent throughout the project and the Council will expect to receive a share of any surplus on each phase of the development, whether or not the Council owns any land within that phase. Bidders are invited to commit to a proportion within their submissions. The Council expects the share of surplus offered to the Council to reflect:

3.2.7.1.1 the Council's investment of land into the project; and

3.2.7.1.2 the Council's investment of time and resource into the project as outlined in paragraphs 7.4 – 7.6 of the 'Joint Venture Structure Paper' .

3.2.7.2 The Council also expects bidders to commit to offer an increased share of the surplus to the Council in the event that a phase involving Council land bears a disproportionate share of costs such as costs attributable to infrastructure or affordable housing costs. The level of proportionate cost will be developed through the business planning process.

3.2.7.3 In the event that the Partners are committing their investment in return for revenue income, the Partners' investment will be valued accordingly. The Partners will be expected to identify and agree upon how the revenue is to be received (i.e. through the grant of long lease interests in the completed residential and/or commercial units, through ground rents or a combination thereof). In the event that the delivery of a plot/sub phase outperforms or underperforms – the loss or benefit will again be notionally apportioned between the Council and the JVCo based on the proportion of investment in that plot/sub-phase and taken into account in any future assessment of profit distribution. For the avoidance of doubt, the Council is not able to contribute from its own resources towards any such shortfall.

3.2.8 Bidders are invited to consider how returns might reflect the differing ways in which particular plots or phases are delivered; (as per para 1.9 above)

(a) Development management and the disposal of serviced sites to an SPV/third party;

(b) Delivery of phased development in anticipation of short term capital receipts;

(c) Delivery of phased development in anticipation of a long term return.

3.2.9 As part of their ITN submissions, bidders are invited to consider which of the variables in the attached appraisal models might be suited to ‘caps’ or ‘collars’ in the interest of providing certainty to the Council.