

<b>DECISION-MAKER:</b>	CABINET
<b>SUBJECT:</b>	PROGRESSING THE NEW ARTS COMPLEX PROJECT
<b>DATE OF DECISION:</b>	29 JANUARY 2013
<b>REPORT OF:</b>	LEADER OF THE COUNCIL
<b>STATEMENT OF CONFIDENTIALITY</b>	
Not applicable.	

### **BRIEF SUMMARY**

The project to deliver the New Arts Complex is progressing. Grosvenor, the developer of the overall scheme, are procuring a contractor, having started investigative ground works in October 2012, and an opening of the Arts Complex in Summer 2015 is anticipated. Further work to establish the organisational arrangements for managing the complex are underway.

### **RECOMMENDATIONS:**

- (i) To delegate authority to the Director of Environment and Economy, subject to consultation with the Leader of the Council and the Director of Corporate Services, the Head of Finance and Head of Legal, HR and Democratic Services
  - a. To establish the Holding Company and Operating Company as detailed in this report,
  - b. To appoint Council Representatives to the Company Boards
  - c. To take any other action necessary to progress the project.

### **REASONS FOR REPORT RECOMMENDATIONS**

- 1. To ensure the project can progress and meet the necessary deadlines agreed with external funders and maximise the benefits of the investment in the Cultural Quarter

### **ALTERNATIVE OPTIONS CONSIDERED AND REJECTED**

- 2. Not to progress the scheme. This would leave the Council exposed to claims from funders and partners for funds invested in the scheme to date and would leave the site undeveloped for some time, until alternative plans were bought forward. This subsequently would delay the benefit of such a substantial investment in the City Centre and not bring about employment opportunities and visitor spend for the City

### **DETAIL (Including consultation carried out)**

- 3. The Arts Complex is the next critical component of the Cultural Quarter. Guildhall Square and SeaCity Museum have made a major contribution to the regeneration of the area, through major events and the tens of thousands of visitors attracted to the quarter. Other businesses have been attracted to the area and are performing well. Grosvenor is concluding leases on many of the commercial units within the broader development of the Arts Complex.

4. The Governance structure has been subject to intensive development, given the need to carefully manage the potential impact on the Council's VAT liability. Appendix 1 shows in pictorial form the planned approach. The structure has two new entities; a Holding Company and an Operating Company.
5. This report analyses the risks to the City Council of forming the Holding Company ("the HC") within the governance structure for the new Arts Complex, and its relationship with the Operating Company ("the OC") and other tenants (City Eye and the John Hansard Gallery).
6. It is proposed that the HC will have a legal form which provides its owners limited liability. Professional advice is that this should also be a Community Interest Company. The HC will look after the building as a landlord. It will have no role in undertaking the management or determining policy for the Arts Complex. It is proposed therefore that the HC is set up as a joint initiative/venture between Southampton City Council and the University of Southampton. Both are bodies with a substantial vested interest in the Arts Complex and both have structures able to provide the identified professional and administrative support to the HC to help keep its costs to a minimum. It is proposed to identify a third party to be a minor shareholder of the HC and take the role of chair.
7. If City Eye or the Operating Company were to vacate its premises in the Arts Complex and cease to pay its rent and service charges, this could threaten the HC's financial position and ultimately its existence as it will have no other substantial income other than from its tenants. The HC's primary creditor would be the City Council itself. (although other creditors may include maintenance contractors for example).
8. In commercial leases there is usually an obligation on the landlord to contribute an amount equal to the service charge in respect of any lettable parts of the building which are not producing any service charge. This is crucial to the financial stability and peace of mind of all tenants. The point being that it is not usual for tenants to bear the risk of any empty units particularly in this situation where none are profit making.
9. Because the continuing existence of the HC is crucial to both the success of the Arts complex and to the City Council in managing its VAT liabilities, it is therefore proposed that, subject to the necessary Cabinet authority, the City Council gives an undertaking in the sub-lease to the HC to waive the rent and service charge element due for the Operating Company and City Eye's units if they were to become vacant. It is proposed that a similar commitment is given in the sub-lease from the HC to the OC. This would be a temporary commitment until the vacant units were re-occupied by organisations in a financial position to take on the liabilities. As the number of other providers able to undertake the function of the operating company is limited, the identification of a replacement organisation may take a little while.
10. Furthermore, as the John Hansard Gallery is not a legal entity, the University of Southampton will be responsible for any rent or service charge that would be due for the unit to be occupied by the John Hansard Gallery. The University is to be requested to take a 40 year lease with no breaks. Whilst

the lease would be assignable this would be subject to the University entering into an authorised guarantee agreement which would offer the comfort that the University would step in if any subsequent tenant failed to comply with their obligations to pay the rent and service charge. This would be a requirement of the University of Southampton whether or not they form part of the HC and is not a consequence of the University being part of the HC.

11. The above proposals will underpin the HC financially with it being underwritten by the City Council and the University of Southampton (the latter to the extent of the obligations of John Hansard Gallery). It is proposed that two Council officers sit on the Board of the Holding Company alongside representatives from the University of Southampton and an independent chair
12. The Operating Company will provide the overall strategic direction for the Complex and manage the performing arts facilities. Establishing a new organisation to deliver this role is an integral part of the funding agreement with Arts Council England. In order to maximise external fundraising opportunities and to secure other fiscal benefits, the operating company will be an organisation with charitable status. Approval to develop this organisation is part of the Cabinet approval sought.
13. The operating company will be the ultimate beneficiary of the Council's and the Arts Council's revenue funding. It will employ the staff who will operate the building, and in the meantime will employ the staff who will lead the audience development programme. This will start with the appointment of the Artistic Director, starting in February 2013. The City Council will facilitate the recruitment, but it is not intended that the Council will be the employer.
14. Recruitment of the Board of the Operating Company is an urgent task. It is proposed that a Council representative sits on the Board for an interim period as a minimum. It is suggested that initially this should be an Officer in order that the Board can receive appropriate support and advice relating to a wide variety of management and operational issues.

## RESOURCE IMPLICATIONS

### Capital/Revenue

15. It is proposed that the City Council will make an annual ongoing £160,000 grant contribution to the Operating Company. The Arts Council has confirmed that it will also contribute grant funding (from the National Portfolio Organisation funding strand) as shown in the table below:

	<b>2012/13</b>	<b>2013/14</b>	<b>2014/15</b>
SCC Grant	£40,000	£160,000	£160,000
Arts Council Grant	£80,000	£109,000	£160,000
<b>Total Income</b>	<b>£120,000</b>	<b>£269,000</b>	<b>£320,000</b>

16. In addition the City Council currently pays an amount of £27,634 to City Eye from the Voluntary Organisation Grant budget.

17. The Arts Council has been unable to confirm the level of grant they will pay to the Operating Company after 2014/15 as they are awaiting the outcome of the Comprehensive Spending Review before committing to any additional funding. Discussions with the Arts Council have encouraged officers to present a bold application for ongoing funding.
18. Should the grant reduce, the Operating Company would have to downsize its operations accordingly with a view to reducing costs/ increasing income and assess its ongoing long term viability as a whole.

19. The forecast operating costs of the Holding Company are shown below:

	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>
Building Service Charges to Grosvenor	£58,700	£61,000	£63,500
Maintenance costs	£106,400	£109,800	£112,300
Rent due to the City Council	£10,000	£10,000	£10,000
<b>Total expenditure</b>	<b>£175,100</b>	<b>£180,800</b>	<b>£185,800</b>
<b>Funded by service charges from:</b>			
Operating Company	£117,500	£121,300	£124,700
John Hansard Gallery	£47,600	£49,200	£50,500
City Eye	£10,000	£10,300	£10,600
<b>Total income</b>	<b>£175,100</b>	<b>£180,800</b>	<b>£185,800</b>

20. It is proposed that the City Council underwrites the value of services charges should either the Operating Company or City Eye vacate the complex. Southampton University have agreed to guarantee the costs for the John Hansard Gallery area of the complex for the full 40 years of their lease.
21. It has been assumed in the Holding Company's business case that the tenants of the Arts Centre will be liable for the Business Rates (NNDR) on the areas that they occupy and would be entitled to charitable organisations discount. Should either City Eye or the Operating Company vacate the building after a period of time the full NNDR liability for their respective parts would fall on the holding company (this is estimated to be a figure of £27,000 for the Operating Companies accommodation and £10,305 for the City Eye accommodation).

22. If both the Operating Company and City Eye were to vacate, the implications to the Council until a replacement tenant was found are detailed below

	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>
Service Charges due to Holding Company	£127,500	£131,600	£135,300
Estimated NNDR liability	£37,305	£37,305	£37,305
Less Council Grant to Operating Company	(£160,000)	(£160,000)	(£160,000)
<b>Cost to the Council</b>	<b>£4,805</b>	<b>£8,905</b>	<b>£12,605</b>

(Figures are a full year effect.)

23. Should City Eye vacate for a reason that might mean none of its City Council funding is required, there is a potential saving of up to £27,634 to the City Council from the Voluntary Organisations Grants budget (based on 12/13 allocation).
24. Ultimately, should the Operating Company close as a result of lack of funding it is possible that the Arts Council could clawback up to £7.3 million of the capital grant awarded to build the complex. This is the worse case scenario should the Council fail to put measures in place to achieve the agreed terms of the grant, in negotiation with the Arts Council. Any VAT implications of this would need to be fully investigated by the Council's VAT advisors.

### **Property/Other**

25. Given the nature of the Arts Complex and the conditions of the Arts Council grant, many of its current or future occupants are likely to be non-profit making. Developments with this type of tenant will always be financially vulnerable to some extent. However it is proposed that the structure of the new company's, the grant funding conditions and the lease terms for the tenants will ensure that there are sufficient safeguards to ensure Council officers are kept fully informed of tenants business plans and their financial position in order that any potential financial problems can be dealt with early on to reduce financial risks for the council so far as possible.

### **LEGAL IMPLICATIONS**

#### **Statutory power to undertake proposals in the report:**

26. Section 1 of the Localism Act 2011 permits a Council to do anything that an individual may do whether or not normally undertaken by a local authority (the general power of competence) subject to anything which is specifically prohibited (not applicable in this case).

### **Other Legal Implications:**

27. The Council is committed, on a conditional basis, to taking a 999 year lease of the Arts Complex and to the Capital Funding Agreement with Arts Council England. There are commercial risks, effectively in perpetuity, in taking from Grosvenor a 999 year fully repairing and insuring lease of the Arts Complex and the assumption of primary liability for the repair of the structure of the Complex, for its internal repair and for Business Rates. Whilst these liabilities are devolved through the proposed structure, the implication to the Council of tenant default within the structure is highlighted elsewhere in this report.
28. The complexity of the structure is fuelled by the requirement, because of VAT advice, to have a holding company interposed between the Council and the Operating Company. It is further complicated because the responsibility for repairing obligations does not fall where one might expect it to, all with the organisation at the top of the structure in terms of the structural elements of the building and at the bottom of the structure in terms of the internal elements of the building. In the model that is proposed most responsibilities fall on HC, which will occupy the middle position.
29. Careful thought has been given to the exposure of the Council to public liability, not just in respect of the building, but also in respect of plant and substantial fittings and items of equipment.
30. Thorough consideration has been given to the manner in which HC will deal with the service charge in respect of the Complex. As a result there is a mechanism for dealing with exceptional expenditure over the 40 year lease term. With a view to securing so far as practicable that the service charge is progressive and cumulative, rather than irregular, and that tenants for the time being bear a proper part of accumulating liabilities which accrue in the future, there is provision to establish both a sinking fund and a reserve fund. Protection is afforded to tenants with the result that monies they pay in advance are to be held by HC in a trust.
31. In an hierarchical structure of this nature, an important issue for the Council as a superior landlord, is to ensure it has the right to enforce lease covenants against undertenants directly. The documentation that has been developed allows for this so that the Council is protected, so far as possible, against intermediate tenant collapse or insolvency. The documentation contains provision that if it is reasonable so to require, any assignee of either the lease to the University or the lease to City Eye must also provide a guarantor and the assignee is further required to provide a guarantee and indemnity to the superior landlord HC.
32. The structure anticipates the Operating Company has charitable status. When such charity is constituted it would be beneficial to ensure there was no obligation requiring it to hold the Arts Complex for the purposes of its charitable objectives – in other words that such land is not a designated asset of the charity. Provisions of the Charities Act 2011 require the taking of certain procedural steps before the charity could enter into leases with the University and City Eye. Whilst there may be no intention of any joint involvement, nevertheless it would also be important to ensure there was

complete separation between the persons controlling the Operating Company and the persons controlling City Eye so as to avoid there being any connection within section 118 of the Charities Act 2011 between those two companies.

**33. Corporate law implications**

The Council will be a corporate member of the “Holding Company” which will be a Community Interest Company (“CIC”). It will be a company limited by shares, and the Council will have a 49% shareholding. It is anticipated that the Council’s shares will have a ‘nominal value’ of £49. Thus the exposure to liability would only be £49 which is only triggered in the event that the company is wound up.

34. It is proposed that two Council officers sit on the Board of the Holding Company, and one on the Board of the Operating Company. Directors have statutory and common law duties to the company they are appointed to. These duties can be summarised as duties to exercise reasonable skill, care and diligence. Further detail on these duties is set out in the Appendix to this section.

35. Directors may have personal liability to creditors in the event that the company goes into insolvent liquidation and the director has not taken appropriate measures in the circumstances. The legal term for this is “wrongful trading”. Both companies will have various legal obligations and liabilities under a range of contractual and financial connections. The Directors must ensure that sufficient funds and proper budgets are in place and that these are adhered to. If there is a material departure from these, or unforeseen circumstances arise effecting the income and outgoings of the company in question, then the directors must take appropriate action.

36. Accordingly the Council’s directors must pay reasonable attention to the financial standing of the companies. If there are any concerns, they should ensure that these are recorded in writing, and they should promptly take advice, and continue to take advice, from an Insolvency Practitioner. This advice should be carefully documented and followed. If the standing of the Operating Company remains stable then the standing of the Holding Company should be secure. However if the Operating Company has financial difficulties or it fails, then there will be consequences for the Holding Company, and financial requirements to cover shortfalls.

37. Under various relevant statutes there are restrictions on disposals and acquisitions, and requirements for proper valuations. Directors must ensure compliance, taking advice as required. In summary, directors should always carefully monitor the standing of a company, take advice as soon as they have any concerns, and follow through diligently on that advice.

**POLICY FRAMEWORK IMPLICATIONS**

38. The project is in line with the Policy Framework.

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**KEY DECISION?** Yes

<b>WARDS/COMMUNITIES AFFECTED:</b>	Potentially all, specifically Bargate
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### **SUPPORTING DOCUMENTATION**

#### **Appendices**

1.	Organogram of Governance Structure
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#### **Documents In Members' Rooms**

1.	None.
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#### **Equality Impact Assessment**

Do the implications/subject of the report require an Equality Impact Assessment (EIA) to be carried out.	Yes/No
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#### **Other Background Documents**

**Equality Impact Assessment and Other Background documents available for inspection at:**

Title of Background Paper(s)	Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)
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1.	None
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