

DECISION-MAKER:	COUNCIL		
SUBJECT	TOYS R US (SITE REGENERATION)		
DATE OF DECISION	18 SEPTEMBER 2019		
REPORT OF	LEADER OF THE COUNCIL		
<u>CONTACT DETAILS</u>			
AUTHOR:	Name:	David Childs	Tel: 023 80834389
	E-mail:	david.childs@southampton.gov.uk	
Director	Name:	Denise Edghill	Tel: 023 80834095
	E-mail:	denise.edghill@southampton.gov.uk	

STATEMENT OF CONFIDENTIALITY	
<p>The Confidential appendices contain information deemed to be exempt from general publication based on Category 3 of paragraph 10.4 of the Council's Access to Information Procedure Rules.</p> <p>Those appendices include details of a proposed transaction which, if disclosed prior to contract, could put the Council or other parties at commercial disadvantage.</p>	
BRIEF SUMMARY	
<p>The purpose of this report is to approve a framework for the City Council entering into a contractual Agreement with the head-lessee and its development partners, which will include the conditional grant of new lease(s) as development takes place in phases and thereby facilitate re-generation of the Toys R Us site on Western Esplanade.</p> <p>In addition authority to enter into a separate agreement, with the same parties, by which the Council will invest in a new office building to be constructed as part of Phase 1 and thereby deliver on a number of strategic planning and economic objectives for the city centre.</p>	
RECOMMENDATIONS:	
(i)	That the principles of the Commercial Terms set out in Confidential Appendix 4 be endorsed.
(ii)	That following consultation with the Leader of the Council, the Director of Finance and Commercialisation and subject to receipt of a satisfactory S123 report, the Director of Growth be given delegated authority to finalise contractual terms as referred to in (i) above for the proposed transaction, together with any other legal agreements relating thereto so as to enable the development to proceed.
(iii)	That the Director of Legal and Governance be given delegated authority to enter into all legal documentation necessary to facilitate regeneration of the Toys R Us site (including funding arrangements and new head-leases) pursuant to terms of the Agreement referred to at (ii) above being met.
(iv)	To approve the addition of £27M to the Leader's portfolio in the Capital programme and the expenditure of £27M delivering the office

	element of the proposed scheme, as detailed in appendices to this report. This is to be funded by external borrowing.
REASONS FOR REPORT RECOMMENDATIONS	
1.	As freehold landowner, the Council wishes to see the strategically important Toys R Us site (identified on the Plan at Appendix 1) opposite Central rail station, regenerated for a mix of uses consistent with the vision for the city's central business district and wider Mayflower Quarter.
2.	Bringing about the desired outcomes will necessitate changes to existing tenure arrangements, including re-gearing of the current ground lease, to enable funding of the proposed scheme. In order to achieve the full economic benefits of the proposed scheme, the Council will also need to actively support its delivery, as outlined in this report and appendices.
ALTERNATIVE OPTIONS CONSIDERED AND REJECTED	
3.	Do Nothing – without the Council's active involvement the site will not be re-generated in the foreseeable future and opportunities to achieve significant economic and other substantial benefits would be lost.
4.	Sell the Council's interest – that would sub-optimize financial returns, deny the Council any substantive influence over redevelopment of a key city centre site and risk a scheme coming forward which failed to deliver key objectives.
5.	Council buy out the head-lessee and develop site itself – apart from the lessee's reluctance to sell this would involve significant up front (unbudgeted) capital expenditure, an inflated land price and substantial project resources which the Council does not currently have. It is considered better to work with a willing partner, using the Council's influence as landowner and planning authority to bring forward an exemplar scheme which meets key objectives.
DETAIL (Including consultation carried out)	
6.	The former Toys R Us store, which dates from the mid-1980s was built by the retailer for its own occupation, under a 125 year ground-lease from the City Council and for which the lessee paid a capital premium at the time. The single-storey building with large surface car park was typical of its era but is less suited to current retailer needs and, importantly for the city, adds little value to the urban realm, landscape character or local economy in this important and strategic city centre location.
7.	The Toys R Us business collapsed in early 2018 and shortly afterwards the property company (Toys R Us Properties Ltd) which by then held the lease interest in the site, was placed in receivership by its bond-holder creditors. While the receivers could have re-modelled the existing building for re-letting to other retailers, discussions at the time identified opportunities to redevelop the site for a range of commercial and residential uses which are more compatible with the Council's vision for the city centre. Since that time negotiations have been ongoing to achieve the parties' shared objectives and reach agreement on appropriate commercial arrangements. The agreed approach and financial arrangements are outlined in more detail in Appendix 4 to this report.
8.	The Toys R Us site is recognised as being of importance for both the City and wider area's economic prosperity and productivity of the Region. The site is

	<p>strategically located within 'Mayflower Quarter' (land between Mayflower Theatre and Mayflower Park), an area of some 100 acres representing one of the biggest opportunities for City Centre redevelopment in the country. Ideally placed opposite the station with easy access to London and Southampton airport, within close proximity to a growing and vibrant retail, hospitality and cultural offer and in a City with particular strengths in innovation, marine, environmental, digital, creative and health sectors.</p> <p>This site therefore provides a unique opportunity to attract inward investment, promote urban living and working opportunities in quality employment, help grow businesses and raise aspiration and opportunity, thus reaffirming and growing Southampton's position regionally, nationally and globally.</p>
9.	<p>Southampton's City Centre Masterplan, launched in 2012, has already brought forward £3Bn investment through a range of projects such as the West Quay Watermark development, Studio 144 and the cultural quarter, investment in Higher Education at Solent University, residential provision including the Back of the Walls (Bow Square) and health including the Centre for Cancer Immunology.</p> <p>However, during that time, there has been a loss of office floor-space and minimal new office build, leading to a number of businesses leaving the City, particularly for out of town offices along the M27 corridor. This arrangement has not optimised the access of those businesses to talent (a major factor in investment and location decisions) particularly to Southampton residents and graduates from the two universities and businesses have indicated a wish to return to the City Centre. The lack of development has also led to the market for speculative office development not being tested in the City.</p> <p>Moreover, the City's economy has moved more towards lower skill and part time employment due to the nature of the jobs which have been created. The Toys R Us site can bring back higher skilled and paid jobs for progression of residents and attraction of others, thus underpinning quality of life.</p> <p>The appendices of this report give further economic, social and financial detail on the needs assessment for Council intervention in the Toys R Us development.</p>
10.	<p>Globally, there is a move towards increased urbanisation, with 50% of the world's population soon to be living in cities. The Toys R Us site represents a major opportunity for Southampton to showcase mixed City Centre living and working, where people can walk to work, be less reliant on the car, work flexibly and enjoy their leisure time. It can also demonstrate the latest thinking in design and environmental excellence.</p>
11.	<p>In summary the proposed scheme comprises:</p> <ul style="list-style-type: none"> ◦ Phase 1 iconic office building of approx. 70,000 sq.ft. lettable space. ◦ Phase 1 residential comprising 275 apartments in 3 linked blocks. ◦ Phase 1 commercial including cafés, restaurants, convenience retail and possible gym uses or other leisure (circa 25,000 sq.ft. total). ◦ Phase 2 comprising further residential, office and commercial uses, with final quantum and mix being determined by market demand and availability of additional immediately neighbouring land. ◦ Phase 3 commercial development which may be an office or hotel. <p>The Council will work pro-actively with the developer to ensure that its Green City Charter is reflected in the new development, including use of the latest</p>

	<p>building standards and technologies, as well as significant 'greening' of the public realm. The Phase 1 office building will also be designed to meet a BREEAM 'Excellent' rating, employ low carbon technologies wherever practicable, encourage multi-modal travel to work and achieve the latest staff 'wellness' criteria in the working environment.</p>
12.	<p>The scheme will be undertaken in two or three main phases, starting with the new office building and three residential buildings located around the podium. Phase 1 will also include significantly improved public realm, centred on a new 'maritime promenade' that will link Central rail station to the northern edge of West Quay.</p> <p>This element is of great importance to the setting of the proposed scheme and a significant enhancement of this strategic walking and cycling route (currently a tarmac footpath through a retail car park) that also forms many visitors' first impression of Southampton as they arrive by train.</p>
13.	<p>The proposed scheme has been the subject of extensive consultation within the Council over the past 6-12 months, including briefings to members and other key stakeholders.</p> <p>The planning pre-application process has also commenced (albeit informally at this stage) with the Council's planning and highways teams having been involved in the scheme evolution.</p>
14.	<p>Much of the legal work and background advice required for the purposes of implementing these proposals has already been undertaken and it is proposed that, following Council approval, contract documents are finalised as soon as possible so that the developer can immediately commence the formal pre planning application (PPA) process, in preparation for an early planning application.</p> <p>Counsel's opinion has also been obtained on the legal position in relation to OJEU procurement rules and the proposed transaction structure is considered to be sound in this context.</p>
15.	<p>A commercial terms and financial report is attached at Appendix 4 and financial terms of the development Agreement will be subject to a formal S123 'best consideration' review process and sign-off before exchange of the legal agreement.</p> <p>Specialist external advice has been taken from a national firm of accountants on the proposed office funding structure, including alternative finance models and the results of that exercise are contained in a report at Appendix 7. Recommendations contained in this proposal reflect the accountants' advice.</p>
RESOURCE IMPLICATIONS	
<u>Capital/Revenue</u>	
16.	<p>The proposed Development Agreement will generate capital receipts through land premium and a profit share in the development returns. The projected receipts are outlined at Table 4 in Appendix 4.</p> <p>As well as providing funding for the office development, the Council will also be spending management time and resources involved in managing the Council's interest in the scheme.</p>
17.	<p>It is proposed that the Council invests £27M in the office development as part of Phase 1 of the scheme, to be funded by borrowing. This report provides for</p>

	<p>delegated authority to the Director of Growth, following consultation with the Leader of the Council, the Director of Finance and Commercialisation and subject to receipt of a satisfactory S123 report, to finalise contractual terms for the scheme.</p> <p>The new office building will create revenue income for the authority from leasing the building to commercial tenants. A financial appraisal has been undertaken on the proposal in consultation with specialist advisors. Details of the analysis are included in Appendix 4.</p> <p>A number of scenarios have been modelled by the accountancy firm advising on the finances of this arrangement, which address different potential approaches and options that the Council has for its participation. Prudent assumptions have been made and in some instances, depending on the specific assumptions, the total capital financing costs incurred by the Council exceed the income yield. However, as highlighted by the accountants, after taking the significant residual value of the asset acquired into account, this would be expected to more than outweigh potential revenue costs. Additionally, the modelling is sensitive to assumed inflation levels and if a 2% growth in rental income is assumed from year 10 onwards (rather than a cautious 0% p.a.) the proposal makes a modest surplus. Tables 1 to 3 in Appendix 4 contain details of the assessment, including the various assumptions made and the accountants' full report is at Appendix 7.</p> <p>There are also 'lumps' in the profile of the cash flow over the 35 year life of the project, which means a deficit is forecast to be incurred in some years. This can at least be partly offset by 'smoothing' expected surpluses in good years to mitigate any deficits in other years.</p> <p>In addition to the cost of construction the project includes £0.30M of fees for professional and legal services in relation to the project.</p>
<u>Property/Other</u>	
18.	<p>The Council owns the freehold reversion in this site but currently receives no regular income from the asset and the principal value of its interest lies in the influence which the lease provides over future uses of the land.</p> <p>The transaction described in Appendix 4 will deliver early elements of the Council's long-term objectives for both this site and wider Mayflower Quarter.</p> <p>Because of the other contracting parties' long leasehold interests in the site and exclusive rights over the property, they are effectively the only parties with which the Council can deal in this connection if the substantial benefits that will flow from the proposed re-generation are to be realised within a reasonable time-frame.</p> <p>The structured Development Agreement will also generate substantial capital receipts to the Council (which would otherwise not be realised) as outlined in the appended financial reports, by leveraging its property interests.</p>
LEGAL IMPLICATIONS	
<u>Statutory power to undertake proposals in the report:</u>	
19.	<p>The Council powers to promote this development are Section 123 Local Government Act 1972 and Section 1 Localism Act 2011.</p>
<u>Other Legal Implications:</u>	

20.	Legal advice, including counsel's opinion, has been taken on procurement and related matters. Based on that advice it has been decided that the Council may proceed as outlined in the detailed appendices to this report.
RISK MANAGEMENT IMPLICATIONS	
21.	The Council's participation and any risk management implications, are detailed in Appendix 4 to this report. Appendix 4 also outlines the steps that will be taken to manage risk throughout various stages of the development.
POLICY FRAMEWORK IMPLICATIONS	
22.	The statutory Local Plan currently identifies the subject site as being located in a primarily office and commercial area. Local plan policies also promote new housing in the central area and recognise the role of mixed uses in providing variety and supporting a vibrant city centre economy.
23.	This scheme supports many of the Council's strategic objectives around housing, environment, sustainability, Green City and economic development. Bringing this under-utilised site back into viable long-term use will therefore contribute significantly to the Council's vision for the city in the future.

KEY DECISION?	No
WARDS/COMMUNITIES AFFECTED:	Bargate
<u>SUPPORTING DOCUMENTATION</u>	
Appendices	
1.	Site Location Plan
2.	Site Layout Plan (exempt)
3.	Indicative Plans and Images of the proposed scheme (exempt)
4.	Report on Commercial Terms & Funding (exempt)
5.	Economic Impact Report (exempt)
6.	Office Market Report (exempt)
7.	Financial Structure & Options Report (exempt)
8.	Responses to Accountancy Advisors Report (exempt)

Documents In Members' Rooms

	None
Equality Impact Assessment	
Do the implications/subject of the report require an Equality and Safety Impact Assessment (ESIA) to be carried out?	No
Data Protection Impact Assessment	

Do the implications/subject of the report require a Data Protection Impact Assessment (DPIA) to be carried out?		No
Other Background Documents: None		
Other Background documents available for inspection at: N/A		
Title of Background Paper(s)	Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)	
	Appendices 2, 3, 4, 5, 6, 7 & 8	Para 3