

Executive

Tuesday July 21 2009
7.00 pm

Supplemental Agenda No. 2

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Date: July 21 2009

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|------------------------------------|--------------------------------|---------------------------------------------------------------------------------------|-----------------------------------|
| Item No. | Classification: Open | Date: July 21 2009 | Meeting Name: Executive |
| Report title: | | Elephant and Castle Development Agreement - Update on negotiations with Lend Lease | |
| Ward(s) or groups affected: | | Cathedrals, Chaucer, East Walworth and Newington | |
| From: | | Chief Executive | |

RECOMMENDATIONS

1. That Executive agrees to enter into a new exclusivity agreement with Lend Lease Europe Ltd on the basis set out in this report.

BACKGROUND INFORMATION

Report Summary

2. This report contains a summary of the background and current situation with the Elephant and Castle Master Development Partner, including a proposal for completion of negotiations to sign binding Heads of Terms and contract. The report concludes with a recommendation to pursue a detailed timetable of actions to achieve that aim. The recommendation to enter into a new exclusivity agreement enables the Council and Lend Lease to conduct commercial negotiations with confidence that no other developer is being considered by the Council.

Background

3. Following the adoption of the Elephant and Castle development framework in the form of Supplementary Planning Guidance [SPG] in February 2004 the council has pursued the implementation of the regeneration of the Elephant and Castle area through a number of strands of activity. A central objective from the outset was the development of the core area of the Shopping Centre [owned by Key Property Investments a Joint Venture between St Modwens PLC and Salhia] and the Council owned Heygate Estate. This was always recognised as the most challenging aspect as it is occupied by residents and businesses and contains key infrastructure.
4. The implementation of the SPG proposals therefore required a commercial partner to prepare a planning application, fund site assembly and secure agreement on public transport and infrastructure issues. The Executive agreed in 2005 to pursue this objective by means of a European Union Procurement process comprising three stages. This exercise culminated in July 2007 when the Executive agreed to select Lend Lease Europe Ltd as its preferred Master

Development Partner. The decision was taken on the basis of the Best and Final Offer (BAFO) submitted by Lend Lease and the Executive instructed officers to proceed with detailed negotiations to conclude full contractual documentation in order to give affect to the proposed joint working arrangements.

5. Following the Executive decision officers commenced negotiations on a detailed contract. However, these negotiations were hampered by the subsequent severe downturn in the economy and the continuing uncertainty as to the cost of Transport for London's mitigation requirements. The position taken by TfL was not one that officers were able to agree.
6. In early May 2008 Lend Lease requested an exclusivity agreement. The purpose of this agreement was to provide Lend Lease with exclusive partner status and this in turn provided their board with sufficient confidence to commit resources to the master planning process while the extent of the decline in the market was evaluated. The agreement stopped the Council from engaging with alternative developers on this regeneration project. Given the market uncertainty and its impact on the UK development industry, granting an exclusivity agreement was considered desirable to retain the active engagement of Lend Lease. The agreement was completed under officers delegated powers on 24th July 2008.
7. Continued market uncertainty resulted in the agreement being further extended until 1st July 2009 with a clear understanding from officers that further extension under delegated authority was unlikely.
8. Progress on achieving a full contractual agreement has been limited until now. The key reasons for this have been:
 - i. Material falls in residential and commercial property values and on-going uncertainty about the recovery of those values. At the time of BAFO, residential property at the Elephant was achieving an average in excess of £600 per square foot. Current values are in the region of £400-450 per sq.ft. Costs of construction have also fallen but not by the same amount. The ability for developers to raise finance to fund investment has been difficult as margins have been squeezed.
 - ii. TfL have taken a significant time to establish the investment costs they believe are needed to be spent to ensure the transport infrastructure is upgraded to support regeneration. The TfL current investment profile extends to 2017 and does not include any allocation for Elephant and Castle.
 The original timetable for the completion of this work was December 2008 and in July 2009 the costs submitted by TfL were over £200 million on a high contingency ratio (65%).
 This created uncertainty as detailed negotiations with TfL are required to get agreement on the development timetable and their future investment proposals because, clearly, the regeneration of the transport infrastructure cannot be met from the development.
9. On the 13th July Lend Lease wrote to the Council setting out a revised proposal including a new timetable for completing revised Heads of Terms. In order for the

Council and Lend Lease to jointly commit to this, Lend Lease have requested a further extension of the exclusivity agreement. The Executive are now being asked to consider whether a new exclusivity agreement is acceptable.

FACTORS FOR CONSIDERATION

10. The Council and Lend Lease have committed significant resources to this project, for example on the extensive master planning work that has evolved to date. Lend Lease have put forward a proposal that they believe will take us jointly to final negotiations that quantify the impact of the recession, resolve the outstanding issues and finalise an agreement which satisfies the financial and redevelopment requirements of the Council and Lend Lease.
11. Lend Lease have reaffirmed their commitment to ensure that the future process remains compliant with procurement guidelines and the BAFO submitted in 2007.
12. One of the features of the Lend Lease BAFO which made it attractive was the provision of priority payments to the Council prior to any return to the Master plan Development Partner (MDP). Since the BAFO in July 2007 and the significant change in market circumstances officers have sought clarification from Lend Lease as to how they now intend to deliver the early payments set out in the BAFO and in particular confirmation as to their quantum and timing. This clarification is of critical importance because of the implications for the Council's finances. By way of the letter dated 13th July 2009 Lend Lease have clarified their approach to the early payments and to how the process of completing negotiations will be supported by an open book joint financial model.
13. There are a number of outstanding issues which will need to be jointly resolved in order to finalise the financial model and conclude negotiations. These are identified in brief below, together with the suggested timetable.
14. The outstanding issues, as set out in the Lend Lease letter are agreed by officers as representing a comprehensive list of issues on which agreement will be required. These include, amongst other issues:
 1. Revenue assumptions.
External organisations have been commissioned to independently and separately provide residential and retail valuations for joint adoption within the financial model.
 2. Transport for London.
This is a major issue which must be resolved as development and investment from TfL must be aligned. Lend Lease and the Council will work together to ensure there is a clear understanding as to what the quota system will raise, what development can take place prior to TfL investment being available and how we ensure that any lack of investment on their part does not inhibit our development plans.
 3. Shopping Centre.
This remains an integral part of the regeneration scheme. There is a clear preference for a cooperative approach.
 4. Staging
Staging the development provides significant opportunity to improve the

project economics and phasing of infrastructure costs.

5. CPO

There is little doubt that some aspects of the regeneration area will require CPO action to secure vacant possession. We will work together to minimise these requirements and develop a clear strategy where CPO is deemed necessary.

15. The Chief Executive, Deputy Chief Executive and Director of Finance have reviewed the contents of the 13th July letter from Lend lease and are satisfied that the proposal presented represents a pathway and a systematic approach to working together over the coming months to finalise a Regeneration Agreement in line with procurement guidelines and the 2007 BAFO. The Council will have to continue to commit on-going revenue resources to maintain the practical working arrangements of the partnership.

SUPPLEMENTARY ADVICE FROM OTHER OFFICERS

Strategic Director of Communities, Law & Governance

16. The Executive is being asked to approve a new exclusivity agreement with Lend Lease in order to move towards final agreement on the basis of the original procurement. The final agreement will need to conform with procurement guidelines and the BAFO mentioned above and further legal advice will be sought on the final agreement.
17. The proposal to approve a new exclusivity agreement to enable the negotiations to be completed as set out above is in accordance with procurement law and the Executive's powers.

Finance Director

18. Conclusion of pre contract negotiations have always been known to be complex, not least in the context of market conditions and issues surrounding TfL funding. Recent correspondence with Lend Lease confirms their continued commitment to the project and demonstrates their continued compliance with the core principles of the BAFO, not least early cash payments for certain elements of the project.
19. Their proposals for reviewing phasing of development work seem highly appropriate given the state of market conditions and the need to mitigate risks for all parties. Most relevantly, the proposals for management of the Shopping Centre arrangements for the development and the handling of TfL matters are considered appropriate to contain risk and optimise the value of the overall scheme.
20. In particular, the commitment from Lend Lease enables the Council to continue with site clearance work on the Heygate estate with a view to recovering these costs as part of the arrangement to be finalised by November. This will remain under review, together with all other elements of the original BAFO that will be evaluated in the light of market conditions and future commitment from TfL and other partners.

Reason for urgency

21. The Lend Lease proposal requires officers to work intensively with them in a very tight timeframe to resolve outstanding issues and to meet deadlines

Reason for lateness:

22. The letter from lend Lease was received on 13th July 2009 and had to be considered by officers before advice to Executive could be provided

| Background Papers | Held | Contact |
|---------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------|
| Southwark Plan post inquiry modifications and E&C SPG adopted Feb. 2004 Stage 1, 2 and 3 competition invitations and bidder submissions. | Papers held at Elephant & Castle Development Team Coburg House 63-67 Newington Causeway SE1 6LS | Jon Abbott 020-7525-4902 jon.abbott@southwark.gov.uk |

APPENDIX A**Audit Trail**

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|---------------------------------------------------------------------------|-----------------------------------------|--------------------------|
| Lead Officer | Annie Shepperd | |
| Report Author | Eleanor Kelly | |
| Version | Final | |
| Dated | July 21 2009 | |
| Key Decision? | Yes (General Exception issued 09.07.13) | |
| CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / EXECUTIVE MEMBER | | |
| Officer Title | Comments Sought | Comments included |
| Strategic Director of Communities, Law & Governance | YES | YES |
| Finance Director | YES | |
| Executive Member | Yes | |
| Date final report sent to Constitutional Support Services | July 21 2009 | |