

Southwark loan to MV – Commercial Issues Update

DRAFT – 01 March 2016

Following our report dated September 2015 we have been provided with a draft loan agreement and lease documents (provided by e-mail from Neil Kirby on the 24th Feb 2016). Hereafter these documents will be referred to as “Term Facility Agreement”, “Agreement for Lease” and “Lease” or “the documents”.

We have considered the documents in light of the comments previously made to the Council in our draft report dated September 2015 under the engagement letter dated 16/07/2015 and have provided additional commentary on each category below. We have not carried out a full commercial or financial review of the documents, but sought only to consider if the documents would alter any of the comments we made previously to the Council. We would also note that we have not been involved in any of the discussions that have led to the development of the detailed documents.

In considering the documents we make no comment on the suitability or strength of the legal drafting, noting only where we understand an issue raised by us previously appears to have been addressed in the current documents. The Council should ensure they discuss any of our comments with their legal advisors to determine whether the intent of the drafting as we have interpreted it accords with the intent of the drafting from a legal standpoint. As our comments are limited to the context of our previous report the Council should also ensure they carry out their own detailed review of the documents against their own project objectives and identified risks.

In providing this addendum we have seen no other documents other than those noted above and have not sought any further discussion with Mountview or seen any updated business plan that may or may not affect the original analysis we provided.

Interest Rate Negotiations

We note that the version of the Loan Facility Agreement we have seen defines the Fixed Rate as 4.5% interest. This is the higher of the two rates being discussed last year and helps to mitigate the risk that the loan will cost the Council money. We would reiterate our comment that detailed engagement with the Council treasury team should be carried out to determine if there are any risks linked to either accounting policies or treasury management that could mean the Council ends up providing a loan at lower than its own cost of finance.

Loan Drawdown Date

The proposed loan has been split into two facilities (Facility A and Facility B). The availability of Facility A commences on the date of the Term Facilities Agreement which has yet to be signed but is expected to be imminent. This structure would imply the loan is being made available earlier than the original projections we were shown last year (a first drawdown in 2018/19). The Council should satisfy itself that the additional interest burden of early drawdowns is manageable in MV's latest business plan.

Sufficiency of Capital Amount

The Total Facility A Commitments are defined as £500,000.00 and the Total Facility B Commitments are defined at £24,500,000.00.

Our interpretation of the Term Facility Agreement is that the Facility A loan is for the professional fees in the planning and pre-contract stage and that Facility B is to cover the costs and expenses as set out in the Budgeted Costs. We have not seen evidence of the Budgeted Costs, nor have we seen any

record or projections of the professional fees expected to be set against Facility A so can make no comment on the sufficiency of the Commitments.

We understand that the Termination Date of Facility A is the first Utilisation of Facility B, and that the Facility must be repaid in full on this date (Clause 6.1.1). There is a question whether Facility A can be refinanced within Facility B or if there is an expectation that MV can repay the loan from other sources. If it is to be refinanced within Facility B this limits the use against the Budgeted Costs to £24,000,000 (assuming no capitalised interest in the meantime).

We understand that a fixed price contract for the construction has yet to be agreed and therefore there remains a risk that there will be overruns against the Budgeted Costs which will need to be funded to ensure the completion of the project. We note that the Term Facility Agreement includes reference to Subordinated Debt which might be used to fund such overruns.

Cost overruns and the associated costs of any Subordinated Debt continue to represent a risk to repayment of the loan by MV.

Repayment conditions

Repayment terms are set out in Section 4 of the Term Facility Agreement. We would note that Clause 6.1 appears to add some confusion over the size of Facility A and should be reviewed carefully by the Council and its legal advisors before signing the contract. It may be that Clause 6.1.2 should instead refer to Facility B.

We would also note that our interpretation of the intent of clause 6.1 is that it obliges MV to repay sufficient debt within 20 years such that the amount outstanding at that date is no more than £12,500,000; the drafting as it stands implies the loans should be exactly £12,500,000 at this date. If the Council is content that repayment be faster (i.e. £12,500,000 is a maximum) which is implied in Clause 7.5, they should consider re-drafting this section accordingly.

The final Termination Date of Facility B (assuming Facility A has been refinanced within Facility B) is the 30 year anniversary of the date of the Term Facility Agreement meaning there are a further 10 years to repay the outstanding £12,500,000, or resolve a refinancing facility for MV.

Revenue downturn

We have not viewed any updated business plan from MV nor any Budgeted Costs document. For this reason we are not in a position to change the conclusions of our previous report which is that in the case that revenues fall such that MV cannot repay the loan as it falls due, or even worse are unable to meet the interest in any period, the Council will need to understand what security is available to them and ensure the rights to exercise that security are clearly set out in the loan documents.

Security

Discussions between us and Neil Kirby at the Council lead us to believe the Council have negotiated with the intention that they will hold first ranking charge over the property (supported by the inclusion of the defined term Legal Charge) as well as security over MVs finances at certain points of the agreement (supported by the inclusion of the defined terms of Security Document and Account Charge). Whilst the existence of such definitions, including also Security Assets, suggests the Council have put in place such security as may be required in the event of a default, the ability of the Council to access the security on demand under a relevant default is key. We strongly recommend the Council engage with their legal advisors to understand the process for exercising their security and how it would interact with any termination of the Lease.

We note that there are a significant number of restrictions set out in Clause 18 of the Term Facility Agreement that would have the intent of protecting the Council, again we would highlight the need to

engage positively with the legal advisors to ensure the Council fully understand their rights and the method by which they would enforce these rights.

We would also flag that there are a number of wide-ranging undertakings in place and the Council should ensure they do not create any unintended consequences. For example Clause 18.8.2 states that the “Borrower may not have any Subsidiary”. We are not in a position to conclude whether this is appropriate or not, but we would highlight that the business plan viewed last year demonstrated a desire to generate commercial income streams in addition to the MV core business (catering and room hire) and that it may be in the Council’s interests to allow MV to structure such revenues within specific legal entities that may fall in the definition of Subsidiary.

Commercial Income

Noting the elements of commercial income in the business plan we reviewed last year we would highlight to the Council the need to ensure such restrictions that are placed on the Borrower within the Term Facility Agreement do not unintentionally restrict the ability to generate income, but that such income is available to the Council in the event of any default.

Use Restrictions

We have been provided with the draft Agreement for Lease and Lease documents drafted by Pinsent Masons and are aware that there are a number of restrictions of use included (see for example the defined term Permitted Use in the Lease). We assume for the purposes of this addendum that the Council have actively sought these restrictions and are content they have sufficient restrictions to protect them in ensuring their provision of capital remains in line with their stated objectives.

We would also note from a review of the Lease the following comments:

- The defined term Finance Agreement would seem to refer to the Term Facility Agreement. If this is the case it may be sensible to alter the definition to state this explicitly;
- In clause 7.2 of the Lease there appears to be a typographical error referring to Clause 14.3.2 when clause 4.13.2 may be the intention
- In reviewing the RPI rent review we would note that it is not immediately clear how the Land Value Review interacts with the RPI Revised Rent such that Principal Rent is appropriately updated for any RPI Revised Rent.