

AKH/LM

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Dear Sirs

**COUNTY OF HEREFORDSHIRE DISTRICT COUNCIL ("the Council")
HEREFORD FUTURES LIMITED ("Futures")
STANHOPE PLC ("Stanhope")
DEVELOPMENT AGREEMENT RELATING TO THE RETAIL QUARTER SITE, EDGAR STREET, HEREFORD
("Retail Quarter")**

Introduction

1. The Council have instructed Montagu Evans LLP ("Montagu Evans") to provide a review of the issues relating to the development of the Retail Quarter and that the Agreements entered into with Stanhope previously, still achieve the best obtainable outcome for the public interest with regard to the price and other conditions achieved.
2. The objectives of the Retail Quarter are to complete a development to meet demand from national multiples for modern floorplates not currently available within the city centre and provide an open-air retail led mixed-use scheme which is led by comparison shopping offer. In addition, the Retail Quarter will provide significant family leisure opportunities including a multi screen cinema and a number of family dining restaurants which will extend the trading hours of the area as a whole, creating a vibrant environment that will attract maximum repeat visits.

Selection of Stanhope

3. Montagu Evans were appointed at the initial masterplanning stage in 2006/7 and to then work alongside Futures and the Council to select a developer of appropriate standing to deliver a development that would secure the support of the Council as landowner and planning authority; stakeholders and potential funders and occupiers.
4. It was decided that to ensure an appropriate level of strategic control, by the Council over this important piece of land and surrounding ownerships, that an OJEU compliant process to procure a developer was adopted. This methodology was adopted as best practice by many other Local Authorities and continues to be so.
5. A comprehensive fully OJEU compliant procurement and marketing process was therefore initiated in early 2007 that resulted in some 18 national developers completing detailed Pre Qualification Questionnaires. 3 of the UK's leading retail led town centre developers demonstrated the appropriate experience and appetite to progress analysis and scheme development of the vision. A competitive process evolved where these 3 shortlisted bidders produced design, legal and financial proposals. After a stringent analysis, Stanhope was selected by the Council as the preferred developer.

6. A Development Agreement for the Retail Quarter was entered into by the Council and Futures with Stanhope on 4 November 2009. By way of a Supplemental Agreement dated 25 March 2011, the Development Agreement was varied to document the proposed phased development of the Site.

Update on Best Obtainable Price

7. This paper is a brief review on matters as they sit as at 26 March 2012, as it has been indicated by Stanhope that they are nearing a position where the Development Agreement can go unconditional as they are close to securing the necessary pre lets, funding, planning and other conditions of the Development Agreement.
8. The Council have always made clear to Montagu Evans that their statutory duties to secure Best Consideration are taken very seriously. This has resulted in a number of steps being taken within the Development Agreement to protect the Council from market factors.
9. Local Authorities are given powers under the 1972 Act to dispose of land in any manner they wish, including sale of their freehold interest, granting a lease or assigning any unexpired term on a lease, and the granting of easements. The only constraint is that a disposal must be for the best consideration reasonably obtainable, unless the Secretary of State consents to the disposal.
10. Since selecting Stanhope as the preferred development partner of the Council, there has been a significant deterioration to the global economic situation. This has had a material impact upon the conditions for commercial property in the UK with five of the key impacts upon the Retail Quarter development being:
 - 10.1 The lack of availability of bank debt and other funding options for development projects;
 - 10.2 Declining rental values;
 - 10.3 Declining commercial values;
 - 10.4 A lower level of demand from certain retail and leisure operators;
 - 10.5 Developers and investors seeking to take less risk but to secure greater returns.
11. To address these concerns a phasing agreement was entered into by the parties in March 2011 that allowed greater certainty to the Council and allowed the development to progress in a manner that would have the strongest likelihood of delivery and at the time reflected *"An increase in overall scheme value and net financial position to the Council but reduction in capital payment from Stanhope"*.
12. The financial agreements that the Council entered into March 2011 remain consistent with the structure of the deal currently being progressed and although the Council are bound to the commercial terms, it is prudent to evaluate the position as it stands at today's date.
13. In relation to financial aspects of the Development Agreement, the protections that the Council have with Stanhope include:
 - 13.1 **An upward only revaluation mechanism:** At the point that Stanhope are in a position to confirm that the pre-conditions of the Development Agreement can be met, the land value is assessed to consider the Net Residual Site Value in the context of the Development Agreement. We can confirm that we have undertaken the necessary work to consider the Net Residual Site Value under the mechanism in the Development Agreement. Montagu Evans LLP consider the terms negotiated by the Council within the prevailing market conditions, could not readily be replicated and even in attempting to do so would expose the Council to considerable timescale risk.
 - 13.2 **Overage:** where Stanhope must pay to the Council a one third share of any profit generated above the developers preferential profit of 15%. Based on the open book analysis, Montagu Evans do not believe that it is likely that Stanhope will reach its preferential profit level. Nevertheless, the Development Agreement provides a mechanism to allow the Council to share in profit, if the developer potential profit levels are exceeded.

14. Together with these protections, it is the view of Montagu Evans that by undertaking the development, Stanhope are taking considerable development risk. Their likely returns, against the level of development risks surrounding letting, construction and other developer factors that they are responsible for, appear low. It is possible that ongoing development issues will both reduce the value of the completed development and increase the cost to reach completion.
15. If Stanhope were not to meet their Development Agreement pre-conditions and the Council chose to progress an alternative route for the disposal of the site, at the point that the Development Agreement ceased to have effect, being up to November 2015, then it is likely that it would take a number of years to realise an alternative development that would be capable of securing a planning permission.
16. The risk associated with seeking an alternative development route for the site, added to the site holding costs, professional and management resources is significant and there is a high probability that it would not be possible to improve on the terms of the Stanhope deal based upon current and foreseeable market conditions, planning policy and qualitative need of the Council.

Conclusion

17. It is therefore the view of Montagu Evans that:
 - 17.1 the Council have undertaken a marketing and procurement process that aligns with best practice for other similar projects involving local authority land. This has been comprehensively negotiated and involved significant competition from a financial and qualitative perspective;
 - 17.2 the Council have introduced a phasing agreement that was reported on in March 2011, that demonstrated the reduced risk and greater certainty and financial benefits to the Council;
 - 17.3 the Council have entered into an agreement with revaluation and overage provisions to protect potential enhanced returns by Stanhope;
 - 17.4 the Council are achieving a development that meets their wider economic and regeneration objectives.
 - 17.5 the Council are securing a developer who are committing to proceed to undertake the development at a reduced profit level whilst taking considerable development risk.
18. If Stanhope do not succeed in converting the conditional Development Agreement to an unconditional Development Agreement and thus do not start on site, the Council are going to be exposed to an unquantifiable level of time delay and it is likely, from the information that has been provided to us, that any new development proposals would require a developer to see a higher level of developer profit certainty which would have a direct impact on either the quality of the development and/or the receipt available to the Council.
19. **Montagu Evans LLP considers that the proposed transaction is the best obtainable outcome for the public interest at this time with regard to the price and other conditions achieved.**

Yours faithfully

Montagu Evans LLP

MONTAGU EVANS LLP