PART 2 – CONFIDENTIAL FACTS AND ADVICE

MD2476
Title: Crystal Early Lease Surrender

This information is not for publication until the stated date, because:

The information in the accompanying tables contains confidential commercial information relating to investment to commercially sensitive projects. Disclosure of this information could potentially result in significant material harm to the long-term commercial future of a GLAP asset.

The paper also contains sensitive information regarding Siemens PLC (SPLC); the specifics of which would be harmful to the reputation and long-term plans of the other party.

Date at which Part 2 will cease to be confidential or when confidentiality should be reviewed: to be reviewed once the relevant appointments, commercial and funding agreements have been negotiated and signed and the future of the asset secured– unless brought forward, to review 1st January 2022.

Legal recommendation on the grounds of keeping the information confidential:

The contents of Part 2 include sensitive information which relate to the GLAP's commercial interests, the disclosure of which could prejudice those interests. For those reasons it is considered that the information contained in this report and appendices is exempt from publication in reliance upon the exclusions contained in section 43 (2) (Commercial Interests) of the FOI Act 2000 and because the public interest in withholding the information outweighs the public interest in releasing it.

Legal Adviser -

Name: **Date:**

Confidential decision and/or advice:

Decision required – supporting report

1. **Key Considerations – The Business Case**

1.1 The GLA has carried out substantial due diligence to assess the SPLC deal and ensure there is a robust business case to support the early surrender of the lease. In summary the business case has been developed around the following three key considerations:

- Fulfilment of Mayoral objectives
- Protection from organisational risk

- Commercial benefit

Fulfilment of Mayoral objectives/Delivering Regeneration Benefit

1.2 Referenced in Part 1.

Organisational Risk

1.3 The Royal Docks Team commissioned WorkWild (a workspace and sustainable communities consultancy) to assist officers in scrutinising the organisational risks associated with the GLA taking control of and running the Crystal following the early lease surrender. Workwild supported the GLA led negotiations with SPLC, obtaining detailed operational costs and advising on likely Facilities Management budget allowance (more in Appendix 4). WorkWild additionally assisted in mapping timescales for a Transition Period (as referred to in Part 1).

Commercial Benefit

1.4 JLL (Jones Lang LeSalle) carried out a series of commercial valuations, financially modelling the deal during negotiations (see Appendix 1 and Appendix 6). This provided the GLA with the confidence that the deal could be agreed at both low commercial risk and with potential for commercial benefit. This is elaborated in Section 3 under Commercial Benefit and the Finance Comments.

2. The Early Surrender Deal

2.1 Based on the GLA's key priorities as set out in Part 1, the GLA negotiated an early surrender deal with SPLC. This is comprised of a lump sum premium of £12,345,618.31 inclusive of dilapidations for SPLC to surrender their lease with GLAP. The agreement additionally obliges SPLC to strip out the Sustainable Cities exhibition creating a multi-purpose space which will allow the Royal Docks Team to host an exhibition explaining the future regeneration of the area, community focussed regeneration activities and a revenue generating event space as part of the novated Sodexo arrangement.

2.2 SPLC will additionally pay GLAP legal and dilapidations survey costs to the value of £38,400 in addition to the lump sum figure provided the deal completes.

2.3 The agreement aims for GLAP to take vacant possession of the building by 1st July 2019, subject to legal and contractual agreements being in place by this time.

2.4 The deal is time sensitive. SPLC have clearly expressed that delay to the timetable will cause the surrender to be less attractive as the remaining time on the lease reduces.

3. Business Case Options

3.1 The GLA has tested the business case of accepting the SPLC deal against the 'do nothing' option. This was considered against the considerations set out in Part 1.

Option 1: Do Nothing
Delivering Regeneration Benefit

3.2 In this scenario, SPLC will retain the lease on the building until 2023. SPLC do not intend to invest in or update the 'Sustainable Cities' exhibition; which is out of date and will only degrade further. The impact of running down the Crystal building is that visitor numbers will continue to reduce, and the building will not be used to its full potential. This is an important and prominent gateway site in the

Royal Docks Enterprise Zones adjacent to the Emirates Air Line Cable Car station. Poor use and maintenance of the building could impact negatively on the regeneration of the area.

Organisational Risk

3.3 The Crystal is also a unique and bespoke building with specialist sustainable mechanical and engineering servicing. Without operating or controlling the building, the GLA will lack intelligence on how the building can be efficiently run. This may have adverse impacts on the long term planning for the building which poses long term organisational risk.

Commercial Benefit

3.4 This option however, would secure guaranteed rent of £1.75m per annum to GLAP through this period. JLL valued this interest at £21.35m assuming the GLA refurbish and re-let the building by 2025 (please see JLL report in Appendix 6 and Finance comments for further detail).

3.5 The primary benefit of this scenario is that there is no commercial risk to the GLA until 2023. The rental income is guaranteed and the GLA will not be exposed to any operational costs associated with operating the building.

3.6 Do Nothing timetable:

SPLC Lease Expiry	May 2023
Close building, refurbish and market as office	May 2023 – early 2025
Full market rent in place	Early 2026

Option 2: SPLC Early Surrender

3.7 In this scenario GLAP will gain vacant possession of the building in July 2019 as set out in Part 1. Following vacant possession, the GLA will seek to keep the building open and operational for no more than three years and four months (the Transition Period). The aspiration will be for the Transition Period to last two years in order to progress securing a long term sustainable use for the building, maximising the commercial benefit of the deal. The Transition Period will include continuing the private conference facilities (which have bookings in place beyond July 2019) and the café, both run by Sodexo. The Royal Docks Team will be able to maximise the building use with community activities in the exhibition space and full use of the 2nd floor office space. During this period a long term plan will be established for the asset.

3.8 The Transition Period establishes a timeframe for keeping the building open whilst making a decision regarding the long term use of the building. Following the Transition Period, a further 2.5 years allows the GLA to develop and deliver the strategy before market rent is back in place.

Delivering Regeneration Benefit

3.9 The primary benefit of this option is that the GLA have an opportunity to maximise regeneration impact in the Royal Victoria Dock area. The Crystal has the potential to become a key hub for communicating what is happening at the Royal Docks as well as offering space for development partners, the Royal Docks Team and the local community to meet and attend events.

3.10 Through the deal the GLA will have the opportunity to benefit from fully controlling the building. In this scenario, the GLA will be able to test uses, consult with the local community and run regeneration activities from the Crystal. All of this will help inform the long term planning of the building whilst acting as a regeneration hub for the Royal Docks Delivery Plan programme. The GLA will also have the opportunity to understand more regarding the operation of the building (facilities management) with a view to improving its efficiency.

Organisational Risk

3.11 There is an organisational risk regarding the potential mismanagement of the building. The building is located in a prominent location with public facilities; if it is not transitioned smoothly from SPLC to the GLA, there is a risk of adverse publicity. The GLAP Estates team will have full responsibility for the facilities management of the building. The work will be undertaken by Avison Young, GLAP's existing commissioned FM provider. They are one of the leading firms providing FM support and have already started to plan for the transition of responsibility of the building from SPLC to GLAP. In this decision the GLA have also set aside a budget for consultancy support to provide additional capacity to the Royal Docks Team who will work with the GLAP Estates team on the management and stewardship of the building from an organisational perspective.

Commercial Benefit

3.12 Base Case Option: 2 Year Transition Period (4.5 years to achieve market rent)

The commercial benefit was tested by JLL to value the deal based on the timeline in paragraph 3.13; this establishes a Transition Period of two years and makes allowance for major capital investment to re-let the building (JLL guidance note in Appendix 6). In this scenario the GLA would secure the lump sum from SPLC; paying off the rent owed by SPLC until 2023 and a portion of the money required to operate and renovate the building (see Section 5 and impact on GLAP Estates budget). The Transition Period costs and owed SPLC rent would exceed the value of the SPLC lump sum by £3.4m, creating a shortfall. However, that would be paid off and an additional £3.25m of income generated once re-let compared to the 'do nothing option', making this option commercially beneficial. The value of the deal using this timeline is £3.25m including major capital investment. If the future use determined by the long term plan does not require such investment, there is possibility of further commercial benefit.

3.13 SPLC Deal timetable (two year Transition Period)

SPLC Early Lease Surrender	July 2019
Transition Period (building stays open)	July 2019 – July 2021
Refurbish and re-let the building	July 2021 – early 2023
Market rent back in place	Early 2024

3.14 Extended Option: 40 Month Transition Period (five years, ten months to achieve market rent)

If the GLA take longer to re-let the building or decide to keep the building operational for longer (Transition Period), the commercial benefit will reduce as more money is spent on operational costs. JLL have advised the GLA that the Transition Period can last up to three years and four months (40 months), at which point the value of the deal diminishes to zero (and therefore is of no commercial benefit). To fully understand this, a second timetable showing extended timelines for each period has been calculated. If the GLA exceeds these timescales, the SPLC deal becomes commercially unfavourable. Again, this timetable assumes major capital investment to refurbish the building.

3.15 SPLC Deal – extended timetable (three year, four month Transition Period)

SPLC Early Lease Surrender	July 2019
Transition Period (building open)	July 2019 – November 2022
Refurbish and re-let the building	November 2022 – May 2024
Market rent back in place	May 2025

3.16 The GLA have carried out due diligence such as scrutinising the operational costs of the building provided by SPLC to evaluate the risk. There is commercial risk associated with the possibility that operational costs exceed the assumptions made by the GLA.

3.17 A full risk register is attached at Appendix 5.

Comparison and conclusions

3.18 Based on the assessment of both options, a decision to take the SPLC deal shows key benefits:

- Maximisation of regeneration impact at an important time with the Royal Docks Team in place and Delivery Plan approved.
- Gaining intelligence from controlling the asset which will also support the GLA in finding a long term sustainable use for the building.
- A longer period of time to establish a long term use. In the 'do nothing' scenario JLL have established a 2.5 year period between lease expiry and full market rent being back in place. With the deal the GLA will have 4.5 years between vacant possession and full market rent being place, whilst still commercially benefiting by £3.25m (see paragraph 3.12).
- Calculated low commercial risk derived from assessing SPLC operational costs, retaining income streams such as Sodexo and establishing a longer period of time to find a long term sustainable use for the asset.

3.19 The costs and risks are as follows:

Option	Value	Cost Risk	Mitigation	Cost Risk	Mitigation
Do Nothing	£21.35m	Re-letting the building	None identified		
SPLC Deal	£24.6m	Re-letting the building	SPLC deal provides more time to resolve this	Operational costs exceeding assumptions	£3.25m SPLC buffer in value difference, GLA due diligence assessing SPLC operational costs

This shows the SPLC deal offers mitigation options for cost risk alongside the regeneration benefit.

3.20 It is recommended that the GLA accept the deal with SPLC. The lump sum value of £12,354,618.31 has been carefully negotiated to alleviate commercial risk until 2025 as set out in the extended timetable (paragraph 3.14). This will provide commercial security and enable the Royal Docks Team and GLAP to maximise use of the building via the Royal Docks Delivery Plan.

4. Long Term Use Strategy

4.1 The GLA have defined some key options for the Crystal. More options may be identified during the Transition Period.

i. Events Venue: the Transition Period will test this use alongside community uses and identify if this is a long term sustainable use. This may mean that the GLA can re-let the building without significant capital investment (£3m, as set out in the JLL report).

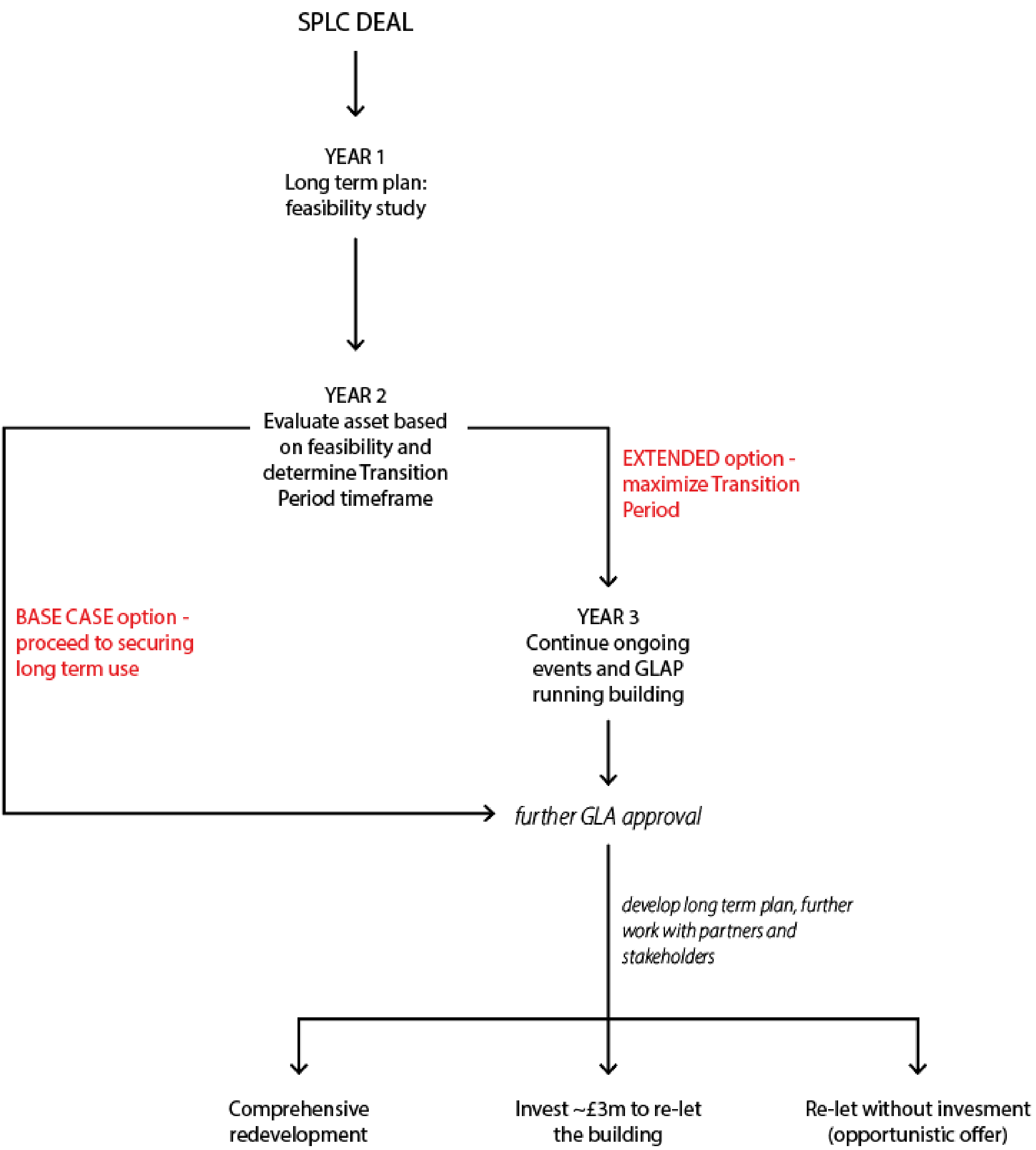
ii. Office: the JLL report identifies this use as financially viable and makes allowance for investment to refurbish and market the building (£3m).

iii. Comprehensive Redevelopment (mixed use): the acquisition MD (MD2035) established that the site may deliver in the region of 785 homes. This will require further consultation and approvals. It should also be noted that the site has a number of policy constraints, including restrictions on height. The Crystal Gardens is additionally designated Open Space in the Newham Local Plan.

4.2 The GLA are reliant on the JLL valuation studies regarding assumptions on budget and funds. It is the view of JLL that with continued development across the Royal Docks and the opening of

Crossrail, that there is room for an enhanced commercial position at the Crystal compared to previous years.

4.3 This decision therefore considers the following basic outcomes:



5. Transition Period: Contracts

5.1 The current maintenance contracts will either be novated or renegotiated on more advantageous terms. Avison Young, as the GLA's facilities management contractor, will review current arrangements, renegotiate current contracts in order to maintain continuity and take over responsibility for the building once the surrender is completed. Avison Young held a supplier's day on 24th May 2019. All suppliers indicated that they were amenable to transferring their services to Avison Young contracts subject to closer review. This provides the GLA greater certainty that facilities management services will be transitioned smoothly.

5.2 The Royal Docks Team previously consulted with the GLA internal Facilities Management team regarding taking on the Crystal building in either the short or long term. The majority of the building is used for events and public exhibition, whilst a small area is used for GLA employees. For this reason, the building is not a feasible project for GLA Facilities Management.

5.3 The GLA has sought legal advice regarding novating Sodexo's contract with SPLC. This would be under a concession arrangement up to a procurement threshold of £4.55 million. The novation will be wholesale without amendments to secure Sodexo's continuity in the short-term. This will have Sodexo in place until at the latest, May 2023. Sodexo currently generate circa £600,000 per annum via a turnover arrangement for SPLC. The GLA would benefit from this income following novation.

5.4 The GLA has carried out early due diligence regarding TUPE with internal TfL legal advisors. The GLA have identified that there are no TUPE liabilities in the Sodexo, cleaning or waste management contracts. In regard to the facilities management contracts (EMCOR) which will be replaced; this is contingent on the exact services of the new contracts and overall scope. This is currently being worked on by Avison Young and as yet the TUPE implications remain to be established.

5.5 The Royal Docks Team have a sublease with SPLC for a portion of the office space on the second floor of the building. The Royal Docks Team pay rent from the Royal Docks Delivery Plan budget which is LEAP funded. The rent equates to roughly £60 per sqft. The Royal Docks Team plan to take occupation of a larger proportion of office space across the eastern (dock-facing) side of the 2nd Floor. The Royal Docks Team have also received interest from local stakeholders for office space at the Crystal. It is therefore likely that £300,000 per annum of income can be sourced from leasing of office space.

6. GLAP Estates Budget Review

6.1 The GLAP Estates budget currently receives a net benefit of £1.75m per annum, projected until 2023. This budget has been reviewed, with consideration of the income the GLA will receive from Sodexo and the Royal Docks Team who will rent office space on the second floor. This budget accommodates for major refurbishment to repurpose the building in 2021/2022 (as set out in the JLL report) however this will be subject to further review once a long term plan is established.

6.2 The revised GLAP Estates budget will be:

2019/2020	-£2.93m
2020/2021	-£3.77m
2021/2022	-£6.50m
2022/2023	-£2.55m
TOTAL	-£15.75m

This is based on the following assumptions:

- Operation and facilities management costs of £2.3m per annum
- Rates RoDMA service charge of £375,000 per annum
- An estimated income of £900,000 per annum until the end of 20/21
- Early light refurbishment in 2019/2020 (£200,000), long term plan professional fees in 2020/2021 (up to £150,000) and full refurbishment *subject to the long term plan and further GLA approval* in 21/22 of £2.95m at a total cost of £3.3m (£2.57m on JLL advice + £400,000 dilapidations + £300,000 contingency and inflation)
- Building assumed vacated for refurbishment works beginning of 21/22
- Total running costs are reduced to £1.7m per annum during 21/22 (JLL advice)
- Total running costs are reduced to £0.7m per annum during 22/23 (JLL advice)

6.3 The financial benefit of the SPLC lumpsum figure will be received through the Crystal being re-let earlier than otherwise assumed if SPLC stay in place until 2023. As set out in paragraph 3.12, this is estimated to be worth £3.25m.

6.4 Once a long term plan is established, the GLAP Estates budget will be reviewed.

7. Costs

7.1 In the event of the deal not exchanging or completing the GLA have agreed to cover professional costs. The budget for this is £38,400. If the deal completes, SPLC will pay GLAP the professional fees and GLAP will pay the consultants.

Transition and Long Term Planning Costs

7.2 It is advised that the budget for the transition period is as follows:

- £2.3 million per annum Property Management and Facilities Management budget (please see Appendix 4)
- £364,476 per annum in rates
- £11,080 per annum Royal Docks Management Authority service charges
- Other transition period activities will be covered by the Royal Docks Delivery Plan budget and meet core LB Newham and GLA objectives.

7.3 It is advised that a small budget for initial investment is as follows:

- Up to £150,000 professional fees budget for the long term plan to include:
  - Architectural design feasibility
  - Commercial & viability studies
  - Sustainability surveys (regarding the specialist M&E equipment)
  - Early planning advice
  - Fixed term internal resource or consultancy to manage stakeholders day to day and lead on long term planning
- Short term capex works
  - Up to £200,000 for initial works and building refresh (2019/2020)

Further capex investment (£2.95m) subject to further GLA decisions based on long term feasibility study

7.4 Projected **income** over transition period

- Circa £600,000 per annum from Sodexo turnover rental contract
- £300k rental income from 2nd floor, including the Royal Docks Team
- This will generate in total approximately £900,000 per annum

7.5 Cost Summary

- Fixed early investment: £350,000 (revenue)
- Transition Period projected running costs per annum: £2,675,566
- Current SPLC income: circa £900,000 (Sodexo income, office space licences to the Royal Docks Team and Siemens Mobility Team)
- Projected income per annum during Transition Phase: £900,000 (Sodexo turnover contract, Royal Docks expanded team plus income leasing the rear of the Crystal office space)
- Fixed later investment ***subject to long term plan and further approvals*** of up to £2.95m.

The projected income, projected running costs and fixed one-off costs establish a net deficit of £15.75m until 2023 including inflation and contingency. This creates a £3.4m gap between the SPLC lump sum premium and GLA costs (£12.35m - £15.75m) and includes allowance for later investment of up to £2.95m. The money is then recuperated in later years when the building is re-let to the market value of £1.75m per annum as set out in the Business Case.

7.6 **Assurances**

The GLA believe there are assurances on the above costs for the following reasons:

- Initial reviews of operational costs (Facilities Management) show cost savings can be made. There are plans in place to keep this under review.
- Opportunities have been identified for increasing income over the Transition Period, including growing Sodexo's business.
- The Transition Period time length has been carefully considered to reduce GLA cost risk whilst maximising regeneration benefit and GLA knowledge of the asset. A maximum period of 3 years and four months (40 months) has been established.
- The £3.4m gap will be monitored. The GLA will target to close this gap by 2026 with rental income and profit in the following years.

8. Financial Comments

8.1 This decision requests approval for GLAP to accept a lump sum of £12.3m in exchange for terminating the lease currently held by Siemens on the Crystal Building in Royal Docks on 1 July 2019. The building is leased for an annual rent of £1.75m per annum and the lease runs until 11 May 2023. In addition to the rent, Siemens claim the building costs £2.3m per annum in operational costs. The lump sum includes payment for dilapidations on the building.

8.2 The liability to Siemens of continuing to occupy the building has been assessed by property advisers JLL at £19.35m. JLL have also advised that if Siemens were to mitigate this liability by subletting, it could be reduced to £13.55m.

8.3 JLL have completed a review of the commercial impact of accepting the early termination of the lease and the lump sum against not accepting it and requiring Siemens to remain as tenant to the end of the term. Based on a number of assumptions, JLL concluded that it was commercially advantageous for the GLA to accept the early termination and lump sum.

8.4 In addition to requesting approval to terminate the lease, this decision also seeks approval for an adjustment to the Estates budget in Housing and Land to fund the loss of rental income and increased operational costs for the years 2019-20 to 2022-23. The total additional cost is £15.75m as set out in paragraph 6.2 above, incorporating the refurbishment works (the majority of which are planned to take place in 2021-22) at a cost of £3.3m (including £0.4m of dilapidations). Under the scenario where the lease is not terminated, this work and cost would be planned to take place in 2023-24.

8.5 The budget adjustment of £15.75m assumes an income stream of £900k; £600k from the transfer of the Sodexo rental contract and £300k from occupation by the GLA's Royal Docks team of their current space and additional space not currently occupied and sub-leasing unused parts of office space to third parties. The expansion of the space rented by the Royal Docks team should be subject to a separate decision.

8.6 The £15.75m expenditure will be funded from the £12.35m lump sum payment. The assessment by JLL shows that there will be savings in future years from the investment. The £3.4m shortfall will be funded from GLAP receipts which will be recuperated from reduced Estates spending in later years.

8.7 The GLA may also wish to keep the building open after accepting early termination to consider potential future uses during a transition period. JLL undertook a separate exercise to assess how long the transition period would have to be before the benefits from accepting the early termination eroded the benefits of keeping Siemens as a tenant until the end of the lease. Using a set of assumptions, JLL concluded that this period would be 40 months.

8.8 JLL also assessed the value to the GLA if the transition period was 2 years. The value to the GLA was £3.25m better than the transition period of 40 months/keeping Siemens. The implication is that the cost of the GLA delaying the works would be over £0.2m per month.

8.9 The major risks behind accepting the earlier termination are: -

- If the office use option is selected, not progressing with the planning permission and converting the exhibition space to workspace and office space
- Changes in the assumptions used by JLL in their assessments over rents received, length of marketing time, length of rent-free periods etc.
- Loss of the Sodexo contract, currently paying £600k per annum in income.

Appendices and supporting papers:

Appendix 1 – JLL Valuation Report
Appendix 2 – Avison Young Schedule of Dilapidations
Appendix 3 – GLAP & Siemens PLC Heads of Terms agreement
Appendix 4 – Building Running Costs with WorkWild comments
Appendix 5 – Risk Register
Appendix 6 – JLL Guidance Note