Land and Property Committee – Chair's Action

Commercial Office Investment Portfolio Joint Venture

Issued 9 March 2023
Approved 14 March 2023

Land and Property Committee: Chair's

Action Date Issued: 9 March 2023

Item: Commercial Office Investment Portfolio Joint Venture

This paper will be published once the decision has been made.

1 Summary

1.1 This paper seeks approval for TTL Properties Limited (TTLP) to invest in a joint venture to create a growing long-term income stream from a portfolio of high-quality, commercial office assets with best-in-class environmental and wellbeing credentials located near central London transport interchanges. This joint venture is a core element of TTLPs Investment Strategy. As well as long-term income and financial returns that can be reinvested across the portfolio, it will provide investment diversification and will enhance TTLPs environmental sustainability performance and credentials.

1.2 The opportunity comprises the Bank Over Station Development (OSD), Paddington Triangle OSD and Southwark OSD development sites (the 'Seed Sites'). If approved, the selected partner will form a joint venture with TTLP to develop the Seed Sites. It is anticipated that the partner and TTLP will continue to hold the developed assets in joint venture post practical completion and leasing to benefit from the rental income. Additional office-led development sites may be acquired by the joint venture at a later stage.

1.3 This paper includes an appendix which contains supplementary information that is exempt from publication by virtue of paragraph 3 of Schedule 12A of the Local Government Act 1972 in that it contains information relating to the business affairs of TfL.

1.4 Members of the Committee considered this item on 16 January 2023. The Committee agreed to defer its decision to enable matters discussed in Part 2 of that meeting to be addressed, and further agreed that authority would be sought through a Chair's Action as a decision was required before the next scheduled meeting of the Committee on 23 March 2023.

1.5 The members of the Committee are asked to consider the proposal and provide Prof Greg Clark CBE, as Chair, with their views on or before 10am on Tuesday 14 March 2023. The contents of this paper and the exercise of Chair's Action will be reported to the next meeting of the Committee.

2 Recommendations

2.1 The Chair of the Committee (in consultation with available members) is asked to note the paper and the exempt supplementary information provided in the exempt appendix and approve:

(a) unbudgeted Financial Authority, and Land Authority, in the sums set out in the exempt appendix for the transaction as described in this paper (the Transaction); and

(b) the formation of a wholly owned subsidiary company or the use of an existing, unused subsidiary company for the purposes of entering into the contractual agreements relating to the Transaction.

3 Background

Market Characteristics

3.1 The central London office market is an established investment market with a total investment volume of some £13.3bn and total leasing take-up of 8.5m square feet in 2021.

3.2 Total investment returns in the London office market are cyclical. The chart below shows cycles in total return, income return and capital growth for London offices over the last 20 years.

Chart 1: Income return, capital growth and total return associated with holding central London offices over last 20 years [Source: Jones Lang LaSalle (JLL)]

3.3 The chart shows that, although the returns associated with holding central London offices are volatile, that volatility is driven largely by changes in capital value. Income return over the last 20 years has been relatively stable, with a quarterly average of 1.1 per cent.

Market Stratification and Environmental Social and Governance (ESG)

3.4 The buildings will be constructed to achieve Net Zero Carbon and the joint venture will collaborate with tenants to target the highest global standards for sustainability and well-being.

3.5 This proposed joint venture is a core element of TTLP's Investment Strategy. As well as long-term income, it will provide investment diversification and will enhance TTLP's environmental sustainability performance and credentials.

3.6 The strategic rationale for this joint venture is founded on the growing demand among London occupiers and investors for the best commercial workplaces. JLL, TTLP's appointed commercial agents, forecasts that demand for the most sustainable BREEEAM Outstanding and Net Zero Carbon buildings in London will significantly exceed supply over the next decade. The independent research firm Property Market Analysis LLP (PMA) forecasts annual rental growth for prime central London offices to average between 1.6 per cent and 2.1 per cent until 2026.

3.7 Indeed, since the 2020 coronavirus pandemic (the pandemic), investment performance has become increasingly stratified between 1) office assets with the highest occupier wellness and ESG credentials, and 2) the remainder of the market.

3.8 A 2022 occupier survey, undertaken by JLL, has shown that this trend is, in part, driven by firms looking for high-quality office space to attract staff back to the office following the pandemic. Another important driver is an increasing focus on office ESG credentials on the part of investors and occupiers. For these reasons, the joint venture will collaborate with tenants to target a rating of BREEAM Outstanding and Platinum WELL v2 Core.

3.9 The Building Research Establishment (BRE) established the Building Research Establishment Environmental Assessment Method (BREEAM) standards as the leading global science-based certification systems for the sustainable built environment. The BREEAM "Outstanding" rating represents the highest achievable certification within the BREEAM assessment.

3.10 JLL research indicates that BREEAM Outstanding buildings let at a nine per cent rental premium to comparable buildings with lower ESG ratings. The same research shows that, on average, a BREEAM Outstanding building is 81 per cent let on practical completion compared to 48 per cent for BREEAM Excellent buildings.

3.11 The International WELL Building Institute (IWBI) created the WELL Building Standard to certify spaces that advance human health and well-being with rigorous performance standards, operational protocols and company-wide practices. WELL Core is a distinct pathway for core and shell buildings seeking to implement features to benefit tenants, and WELL Core Platinum is again the highest available global standard.

TTLP's Goals and Objectives

3.12 TTLP has a diverse portfolio that has grown organically. A key principle of the Investment Strategy is to provide strategic direction across the portfolio mix, encouraging investment in sectors and assets with medium to long-term growth while supporting the rationalisation of areas with poor performance and / or management issues. This strategy not only seeks to increase the gross income of the portfolio but also the cost efficiency through a higher operating margin.

3.13 The Commercial Office Portfolio is identified in the TTLP Investment Strategy and Business Plan as key to achieving TTLP's medium-term goals. By developing a portfolio of best-in-class offices that will be retained for income, TTLP will diversify and improve the ESG credentials of its portfolio and associated dividend. It will create a new standard for offices achieving the highest sustainability performance, both leading the market and modelling the working environment that will be required to attract people into city centres in a post-pandemic world.

3.14 TTLP's current asset portfolio includes 100,000 sq ft of offices generating £5m a year. In line with the 'flight to quality' among London office occupiers, the Investment Strategy advocates a focus on market-leading, purpose-built office space located near transport nodes, which makes the most of the stations and their environs and drive London's future growth and transport ridership with new capacity.

3.15 The core elements of the commercial office strategy for TTLP include:

(a) rationalise / exit existing secondary office portfolio with high vacancy rates and significant capex requirement;

(b) invest in joint venture to create a portfolio of core, high-quality central-London assets at transport nodes;

(c) produce a recurring, growing rental income stream to TTLP;

(d) increase and improve TTLP's investments in the London office market to bring it in line with the TTLP Investment Strategy and Business Plan;

(e) significantly improve TTLP's value weighted sustainability performance by developing best in class offices using the Sustainable Development Framework and Mayoral policy (London Plan) on environmental and design standards;

(f) utilise and promote Modern Methods of Construction (MMC) in accordance with TTLP's wider commitments;

(g) maintain and promote exemplar health and safety both in its construction and development phases; and

(h) provide opportunities for skills and apprentices.

3.16 The proposed commercial office portfolio joint venture will create commercial revenue and capital from developments that contain a significant commercial-office component.

3.17 It is important for joint venture longevity that the joint venture has the flexibility to trade its investments and recycle its capital into higher performing assets to retain high-quality returns. This includes investing in new assets for development. This will mitigate potential risks such as falling income growth and asset value as the buildings age in the long-term.

3.18 Future iterations of the TTLP Business Plan, including the paper scheduled for the meeting of the Committee on 23 March 2023, will include recommendations for commercial office investments that will involve our investment in this joint venture.

4 Joint Venture Proposal

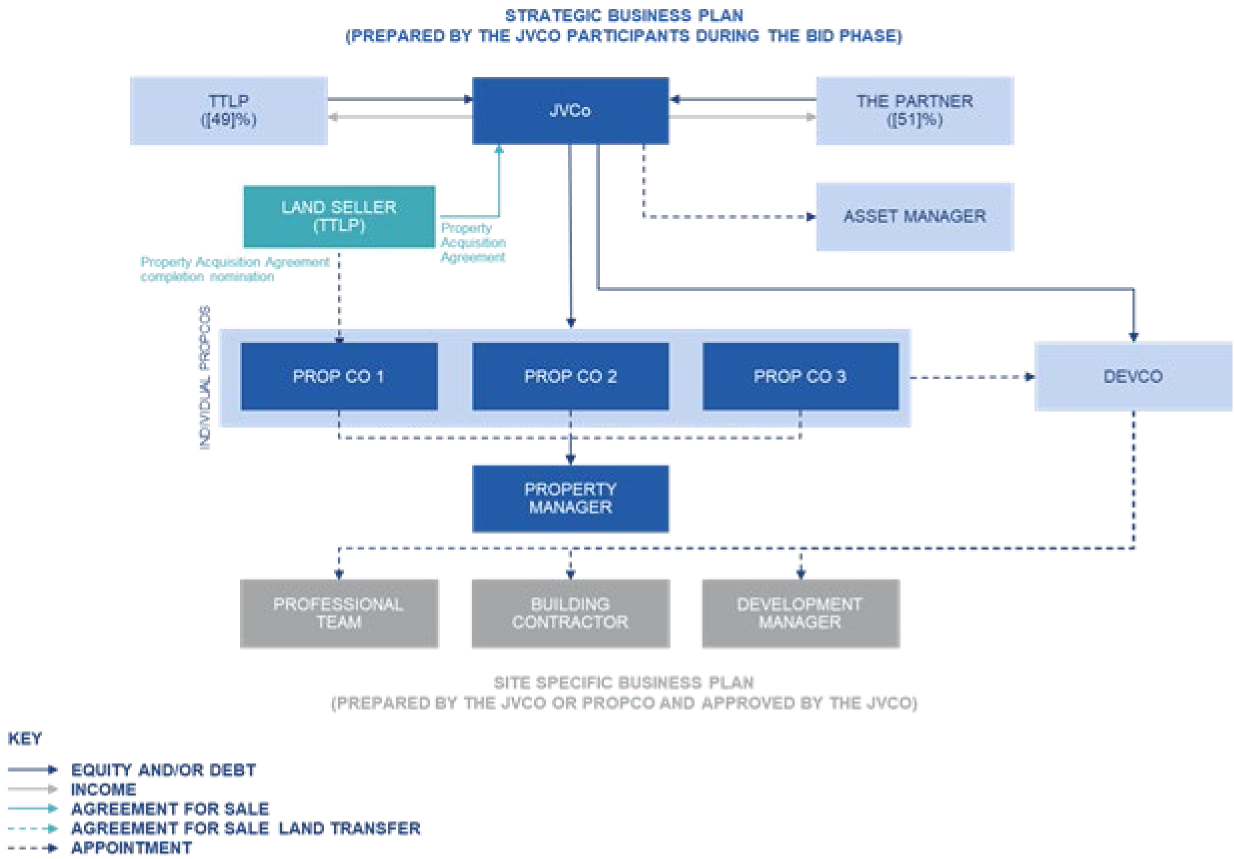
4.1 The proposed joint venture will be formed by a TTLP subsidiary company holding a 49 per cent equity stake and the joint venture partner holding 51 per cent equity stake. The TTLP subsidiary company will either be newly incorporated or an existing unused subsidiary company will be used, such as TTL FCHB Properties Limited which was incorporated for a development joint venture under TfL's Property Partnership Framework that did not proceed.

4.2 Key contractual terms of the joint venture are listed below, with an executive summary of the Heads of Terms included in Appendix 1.

4.3 The joint venture will commit to acquire long-leasehold interests in the Seed Sites on an unconditional basis at a fixed purchase price, and on fixed future dates, prior to the joint venture's planned commencement of major construction works. The joint venture's acquisition of Southwark over station development (OSD) will not occur before TfL confirms that the part of the station that will form part of the site is no longer required to operate the station.

4.4 The structure of the joint venture will be determined based on legal and tax advice. The currently anticipated structure is that each property will be held in a separate subsidiary vehicle (Propco). The diagram below shows the proposed structure of the Joint Venture company (JVCo).

Proposed JVCo Structure Chart



4.5 The joint venture proposes to use debt to fund the development of each property at an expected loan to development cost ratio of between 50 per cent and 65 per cent. Actual gearing levels and debt arrangements will be set at ahead of committing equity at each of the seed sites in accordance with market conditions at the time. After practical completion and letting of each property, the joint venture proposes to refinance the debt at a loan to value of up to 60 per cent of the completed property's value. Refinancing may release equity capital from the completed, income producing buildings depending on the level of leverage utilised at build phase.

4.6 The business of the joint venture will run in accordance with an agreed business plan, and the joint venture agreement will set out a list of "Reserved Matters" and "Major Reserved Matters", both of which require approval of the joint venture partners.

4.7 The joint venture will appoint a development manager, an asset manager and a property manager based on a pre-agreed scope of services. TTLP's joint venture partner will provide the development management service and is also likely to provide the asset management service.

5 Partner Procurement Process

5.1 On 20 May 2022, TfL published a Contract Notice to notify the market it was undertaking a Competitive Dialogue process in accordance with the Public Contracts Regulations 2015 to identify a joint venture partner.

5.2 Following strong Standard Selection Questionnaire (SSQ) responses, seven of London's most accomplished office investors and developers were selected in July 2022 for Stage 2 of the process, the Invitation to Submit Outline Solutions (ISOS).

5.3 The ISOS stage ran until September 2022. The three organisations with the best responses were invited to the next stage, Invitation to Participate in Dialogue. On 30 November 2022, the three short-listed potential partners submitted their final tenders.

5.4 On 15 February, TTLP selected Helical plc as the preferred partner. Helical was advised by its brokers that as a publicly listed company it was obliged to share the price sensitive information that it had been selected as the preferred bidder. An announcement was therefore made ahead of the completion of the standstill period, following the outcome letters being issued.

6 TTLP Site Handover Plan

6.1 TTLP needs to undertake preparatory works and maintain each of the Seed Sites before selling long-leasehold interests in the sites to the joint venture.

6.2 The Bank over station development is currently a worksite for the Bank Station Capacity Upgrade (BSCU) project. The BSCU project is nearing its final phases. Once BSCU works on site complete, the site will be handed over to TTLP. TTLP will then be responsible for security and drainage of the site as well as any other maintenance matters until it is leased to the joint venture. The costs associated with this site maintenance are included in extant Authorities.

6.3 The Paddington site also needs to be maintained for the period until the lease is sold to the joint venture.

6.4 To handover the Southwark site to the joint venture, the assembly of the land interests for the development needs to be completed. The next stage of this is a land exchange with the London Borough of Southwark (LBS) and an associated payment that enables LBS to build 25 new homes on its land. Authority for this exchange and payment is already in place. The exchange will be completed ahead of granting the TTLP lease for the Southwark site.

6.5 The final stage of the Southwark site assembly is Southwark station works that enable release of underutilised back-of-house space at the station that will be incorporated into the basement of the over-station development. The space released from the station must have no detrimental impact on the operation of the station or the passenger experience. Currently, this area is home to critical station systems, and these systems must be relocated, re-routed, or removed if no longer required. The area will then be physically separated from the station. To comply with transport operational fire regulations, the ticket hall internal elevation is to be reconfigured as a new party wall. The station will remain operational throughout this phase of the project.

7 Finance

Investment Performance

7.1 The projected investment performance presented below is TTLP's analysis of the Seed Site projects and informed by TTLP's advisors. The potential partners' responses are broadly consistent with this modelled performance and within the parameters of the Authority recommendations, which include a margin for TTLP as investor and shareholder to respond to changing market conditions while in joint venture with the selected partner.

7.2 The Seed Sites have planning permission for some 600,000 square feet of commercial office workspace. Once complete, TTLP can expect to receive net income of around £11m per annum from a 49 per cent equity stake in the joint venture.

7.3 The development phase of the Seed Site projects will target a 20 per cent (whole life) profit on cost and a geared internal rate of return exceeding 10 per cent.

7.4 TTLP will manage its investment in the completed buildings through the joint venture, which has been designed to provide liquidity that is market-standard for investment property joint ventures.

7.5 The investment performance of the portfolio of Seed Sites, as assessed and modelled by TTLP, meets TTLP's Business Plan metrics and investment strategy requirements, as endorsed by the Land and Property Committee in June 2022, as summarised in the table below.

Metric	TTLP Business Plan Investment Strategy Metrics
Net Present Value (NPV)[1] @ 6.29% (for the base-case 10-year build and hold scenario)	>0
Unlevered Internal Rate of Return (IRR)[2] for the development period	7-15%
Return on Capital Employed on development projects[3]	20%
Incremental Yield on Expenditure (assessed at stabilisation of asset income)[4]	> 3.6%

[1] Each project is assessed against an IRR hurdle rate equivalent to the market risk rate of return relevant to the asset class, risk and complexity of the project of 6.29%
[2] The average whole life annual return without debt finance, expressed as percentage.
[3] Net Operating profit (or earnings before interest and taxes (EBITDA) divided by capital employed.
[4] Yearly rent (pre-interest deduction, including voids) at stabilisation over total development costs to stabilisation (includes capitalised interest).

8 Additional Benefits

8.1 The Seed Site buildings' scale and locations provide additional benefits. Together the Seed Sites provide approximately 6,000 new workspaces with excellent proximity to several modes of TfL public transport. When occupied the buildings are anticipated to increase public transport ridership, with sustainable public transport prioritised. The buildings will be designed to modern occupier requirements, which will include plentiful capacity and high-quality arrival experiences for cyclists as well as pedestrians. This will serve to support TfL, GLA and HM Government's commitments to Active Travel, improving adoption of walking and cycling for London.

8.2 Operational improvements to Southwark station that are required to enable the development and are funded by TTLP, provide improved and renewed operational systems for the station, enabling TfL to reduce and defer significant associated maintenance expenditure.

8.3 Employment, skills, and training benefits will accrue from the buildings, through both the construction phase and once the buildings are occupied. With our promotion of equality, diversity, and inclusion procurement policies many parts of our society should benefit. These social value benefits will be for London, but also for other parts of the UK and Europe involved in the manufacturing building components. The promotion of Modern Methods of Construction will provide additional benefits for the construction industry and the people employed in it.

8.4 By creating commercial office assets with best-in-class environmental and wellbeing credentials we set an important example to others responsible for the built environment, in London and elsewhere in the world.

8.5 TfL may opt to lease space in the completed buildings. Being located near London Underground stations provides operational benefits and efficiencies for TfL. The benefits associated with the Seed Sites are further explained in the exempt appendix.

8.6 The buildings will also facilitate and provide significant improvements to public spaces, providing healthier, safer, and more enjoyable spaces and streets for the public at and around these important transport nodes.

8.7 The implications of TTLP not being authorised to implement the recommendations set out in this paper to deliver on the business plan and investment strategy include deferral of the associated benefits, both financial and non-financial for TTLP and London.

9 Guarantees

9.1 The JVCo will need to enter into Works Agreements with London Underground Limited (LUL) for each of the Seed Sites. In addition to securing insurances, the Works Agreements require the JVCo to put in place any mitigations required by LUL's engineers and indemnify LUL against any breaches of the Works Agreement. Other Guarantees are covered in the exempt appendix.

10 Risks and Opportunities

10.1 The table below summarises some of the key risks identified and their associated mitigations.

Potential Risk	Proposed Mitigation
Market downturn An occupational market downturn could harm the letting of the sites and hence TTLP's cashflow. A weaker capital market at the time the joint venture looks to dispose of one or more of the assets or when TTLP looks to dispose of its interest in the joint venture could reduce TTLP's capital receipts.	The joint venture will consider pre-let both before and during construction in order to limit market risk on delivery. Active asset management will be required in the investment phase in order to further limit this risk. The joint venture and TTLP will be strategic in choosing when to recycle capital into and out of the portfolio in order to best exploit capital market cycles.
Cost overrun The financial modelling is based on cost reports and builds in an allowance for inflation, however, there is a risk associated with an inflationary shock driving up construction cost or unforeseen project factors leading to increased cost. This would have the effect of increasing TTLP's required equity investment in the development phase.	A proactive procurement strategy will be required to ensure that the inflation risk associated with procuring contractor work packages is effectively limited. Ongoing due diligence is required at later design stages to limit the scope for potential cost overruns, and where possible identify efficiencies and savings.
Leveraging TTLP's strategy calls for project level debt in both the development and investment phases. Whilst this increases returns, it does present risks for the portfolio. Examples include equity call risk and increased downside risk in a downturn.	The loan to cost ratio in the development period and loan to value ratio in the investment period will be managed to ensure they remain at reasonable levels as agreed with the joint venture in order to limit the effects of excessive levels of leverage. The debt funding will be raised on a site-by-site basis providing an opportunity to assess risk exposure before commencement.

Potential Risk	Proposed Mitigation
Project obsolesce and depreciation There is a risk posed by changing occupier demand and associated rental depreciation and obsolescence. This could reduce rental values of the buildings or require capital intensive refurbishments.	The Seed Sites have been designed with industry-leading ESG credentials in order to align with occupier demand to mitigate this risk in the short to medium term. In the longer term, active maintenance and asset management will be required to mitigate the operational impacts on LUL and appropriately consider the disposal of assets with significant depreciation risk.

11 Assurance and Consultation

11.1 TfL Project Assurance and the Independent Investment Programme Advisory Group (IIPAG) were briefed on this authority submission on 15 December 2022 and on this paper in February 2023. Project Assurance is providing assurance on an ongoing basis and Targeted Assurance Reviews will be arranged to support future investment decisions.

11.2 TfL Infrastructure Protection (IP) has been involved in the design development of the three Seed Sites to ensure protection of the retained transport assets and premises. IP has been consulted and provided support in collating the technical due diligence and in drafting the legal agreements during the various stages of the procurement process.

List of appendices to this report:

Appendix 1: Executive Summary of the Heads of Terms

An appendix that contains supplementary information that is exempt from publication

List of Background Papers:

Land and Property Committee paper, 30 June 2022, TTLP's Investment Strategy and Business plan
Land and Property Committee paper, 16 January 2023, Commercial Office Investment Portfolio Joint Venture

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Appendix 1

Executive Summary of Heads of Terms

This document describes the principal terms of the joint venture (the "**JV**") between TTL Properties Limited ("**TTLP**") and the preferred applicant. Please note that this document is a headline summary of the principal terms only and you should refer to the long form legal agreements for the detailed terms of the JV. For full definitions of the capitalised terms used in this document (which are not otherwise defined in this document), please refer to the JV Agreement.

JOINT VENTURE STRUCTURE AND OBJECTIVE	
JV Participants	The participants in the JV will be a TTLP subsidiary vehicle ("**TfL Partner**") and the selected applicant's vehicle ("**JV Partner**" and, together with the TfL Partner, the "**JV Participants**"). The anticipated initial ownership interests in the JV will be that TfL Partner will hold a [49]% ownership interest and the JV Partner will hold a [51]% ownership interest in the JV. Guarantees will be provided from the JV Participants' parent companies, to guarantee the JV Participants' equity contributions to the JV. The JV Partner's parent company will also guarantee the JV Partner's share of liability to TfL under the Works Agreement.
JV Objective	The objective of the JV is to acquire, develop, manage and hold the Southwark OSD, Bank OSD and Paddington Triangle OSD properties (the "**Properties**" and each a "**Property**") for investment purposes with a view to optimising income and capital returns for the JV Participants (the "**Project**"). The JV is formed with the intention that further properties will be added in the future, subject to the approval of the JV Participants.
Property Acquisition	The JV will acquire the Properties on an unconditional basis at the agreed individual completion dates for an agreed land price (without overage). The acquisitions are expected to take the form of assignments to the relevant Propcos of existing long leases held by TTLP. The acquisition of future sites may be subject to conditions agreed between the parties on a site-by-site basis including a planning condition, site assembly condition, site valuation condition, TfL consent condition

	and other site specific conditions, and may include planning overage. TTLP will have the option to reacquire a property at its market value if development has not commenced by an ultimate longstop date (which for the initial Properties is the date 5 years from completion), subject to non-default extensions.
Works Agreement and Infrastructure Protection	A Works Agreement will be entered into with the relevant TfL landowner in respect of each of the Properties (and any future sites), ensuring the development works are carried out in accordance with TfL's standard infrastructure protection requirements.
FUNDING	
Equity funding	The JV Participants commit to fund the JV up to an agreed level of commitment in respect of each Property (the "**Commitments**"), with the TfL Partner committing to provide [49%] of the total Commitments and the JV Partner [51%]. Neither of the JV Participants shall be obliged to increase their Commitments without their agreement. The JV Agreement will contain customary provisions regarding the provision of further funding, if required, including a priority return on any unmatched shortfall funding.
Debt funding	It is the intention of the JV to raise debt funding on each Property at an expected loan to cost ratio of up to [60]%. Following the end of the Development Phase, it is envisaged that construction debt will be refinanced with third party investment debt funding at a maximum of LTV of [60]%.
MANAGEMENT	
Management of JVCo	The JV Agreement contains customary provisions regarding management and joint decision making, conflicts and disenfranchisement.
Business Plan	The business of the JV will be run in accordance with the agreed business plan (the "**Business Plan**"). The Business Plan will be reviewed on an on-going basis and approved on an annual basis.

Deadlock Provision	The JV Agreement contains typical provisions for resolving deadlock matters, involving escalation to senior executives, resolution by an expert (where appropriate in respect of technical matters), or continuation of status quo, save that where the deadlock relates to a Major Reserved Matter (being a Reserved Matter which requires resolution for the JV to continue) either JV Participant can trigger a sale process, subject to a first right for TfL to acquire the relevant interest at market value.
Development, Asset and Property Management	The JV shall appoint a Development Manager and an Asset Manager and shall delegate certain matters to them in relation to (respectively) the management of the development of the Properties and the management of the portfolio and the JV Group. The initial Development Manager and Asset Manager will be affiliates of the JV Partner. The JV shall also appoint a Property Manager to manage the Properties on a day-to-day basis.
PROFIT SHARING AND DISTRIBUTIONS	
Profits and distributions	Net Income and capital receipts of JVCo shall be distributed pari passu, subject to a priority return in respect of any shortfall funding provided by either JV Participant.
TRANSFERS OF JV INTERESTS AND DISPOSAL OF THE PROPERTY	
Transfers	Save for transfers to affiliates, no transfers of any interests in JVCo shall be permitted without the consent of the other JV Participant prior to the last to expire of the Propco Lock-in Periods relating to the initial Properties (the “**JV Lock-in Period**”). **"Propco Lock-in Period"** means in relation to each Property, the period unitl the earlier of (a) the first anniversary of PC and (b) the relevant Propco letting threshold having been achieved post-PC.
Transfers – JV level	After the expiry of the JV Lock-in Period, if either JV Participant wishes to transfer its interest in the JV (other than to an affiliate), it may do so subject to a right of first refusal in favour of the non-selling JV Participant. If the non-selling JV Participant does not offer to purchase the interest, the selling JV Participant shall then be entitled to sell the interest to a third party at a price no less than 97.5% of the price offered

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	within a period of 6 months.
Transfers – individual Properties	After the expiry of the Propco Lock-in Period, if either JV Participant wishes to transfer its interest in an individual Property, an equivalent right of first offer mechanism will apply, save that if the other JV Participant does not wish to acquire at the price offered, the Property (or Propco) will be marketed as a whole and if the price achieved is above the price offered then both parties will agree to sell.
MISCELLANEOUS	
Default Buy-Out	The JV Agreement contains customary provisions regarding events of default for insolvency and material breach, including rights for the non-defaulting party to acquire the interests of the defaulting party at a 10% discount (or as an alternative the right for the non-defaulting party to require a sale and receive a 10% premium from the proceeds).

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