Request for the Finance and Policy Committee Chairman to exercise authority delegated by the Board

Date: **27 October 2014**

Subject: **Earls Court Joint Venture Funding Request**

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1 Purpose

1.1 On 5 February 2014, the Board authorised TfL to enter into a joint venture for the development of land at Earls Court and "delegated to the Chairman of the Finance and Policy Committee (in consultation with available members of the Committee) the authority to approve any investment decisions and guarantees required within the maximum approved budget set out in the supplemental paper on Part 2 of the agenda. Any such investment decisions and guarantees to be taken in accordance with TfL's usual investment processes".

1.2 This paper requests that the Chairman of the Finance and Policy Committee (in consultation with available members of the Committee) exercises the authority delegated to him in relation to authorising further investment in the joint venture of up to £120.25m in Phase 1 of the Earls Court development in accordance with TfL's usual investment processes. This investment is included in the draft TfL Business Plan 2014.

1.3 This paper also provides an update on progress by Earls Court Partnership Limited, the joint venture formed by TTL Earls Court Properties Limited (a wholly owned subsidiary of TfL) and EC Properties LP Limited (a wholly owned subsidiary of Capital and Counties Properties PLC (Capco)) following the Board approval for the development of the Earls Court development.

2 Recommendation

2.1 **In accordance with the authority delegated from the Board, the Chairman of the Finance and Policy Committee (in consultation with available members of the Committee) is asked to:**

(a) approve the investment of up to £120.25m in Phase 1 of the development at Earls Court, as described in this paper. The investment of £120.25m is within the maximum approved budget of £150m, as set by the Board and is being made in accordance with TfL's usual investment processes; and

(b) note that in its decision of 5 February 2014, the Board delegated to TfL including Transport Trading Limited (TTL) and any other subsidiary (whether existing presently or to be formed) of TTL (and any of the directors of the relevant company shall be authorised to act for and on behalf of that company) (the Subsidiaries) and the

Commissioner, Managing Director Finance, Managing Director Rail and Underground and General Counsel (TfL Officers) the authority to approve and finalise the terms (including the financial terms) of all documentation required in relation to the creation, operation and management of the joint venture with Capco and authorise the execution (whether by deed or otherwise) on behalf of TfL or any Subsidiary (as appropriate) of any documentation to be entered into in connection with the completion (including, without limitation, all agreements, deeds, guarantees, indemnities, announcements, notices, contracts, letters or other documents).

3 Background

3.1 On 27 March 2014, following the approval of the Board, TfL entered into a suite of agreements with Capco (the Contract) for the purpose of developing the land currently occupied by the Earls Court Exhibition Centres known as EC1 and 2 (EC1&2) together with a small area of adjoining land (together the Site). The development is collectively referred to as Earls Court Village (ECV).

3.2 As part of the Contract, TfL and Capco became shareholders in Earls Court Partnership Limited (JV), the joint venture vehicle that will undertake the development of ECV. Details of both the Contract and the proposed development are set out in the Board papers of 5 February 2014, a copy of the public and private papers are attached at Appendix 1.

3.3 The Contract provides for the transfer by TfL and Capco, as the shareholders in the JV, of their respective land interests into the JV once certain conditions precedent are satisfied. The only condition precedent remaining is the provision of vacant possession of EC1&2 and associated land, which is expected to be satisfied by December 2014, allowing for transfer of the land interests in January 2015 as originally envisaged.

3.4 Under the Contract, Capco is appointed as Business Manager on behalf of the JV and as such has been managing a programme of planning and site preparation works (Implementation Works) within an agreed budget of £50m, TfL's share of which, £18.5m, was approved by the Board in February 2014.

3.5 The Contract sets out a clear governance arrangement for the management of the project and the company. Capco is the controlling shareholder with a right to appoint four members to the JV Board, which meets quarterly, while TfL has the right to appoint three. This representation is repeated at the Executive Committee, which reports to the JV Board and meets monthly. TfL enjoys certain minority protection rights which were described in detail in the February 2014 Board paper. The Contract also sets out strict controls and a scheme or delegation controlling the day to day management of the project including the ability to enter into contracts and spend money. The Business Manager is permitted to enter into low value contracts (up to £0.5m for services, £2m for works), the Executive Committee can approve contracts of limited value (up to £5m for services, £35m for works) and the JV Board reserves the approval of all other contracts and expenditure. The JV Board receives reports on expenditure at each meeting and approves a Business Plan for JV annually, all funding and other strategic decisions are reserved to JV Board.

3.6 Under the terms of the Contract, when a funding requirement is identified, the JV is required to first consider whether the funding requirement can be prudently met by raising third party debt. Should the JV determine that any funding requirement should be met with equity; the shareholders have a right, but no obligation, to provide their pro-rata share of the required equity. The Contract sets out the funding process that will be followed if a shareholder opts not to invest further.

3.7 In accordance with Contract, the JV Board has received a funding report from its funding advisor NM Rothschild & Sons (Rothschild) setting out options for the JV to fund its capital requirements over the next two years. This report concludes that the most appropriate solution is for the shareholders to fund the capital requirements of the JV over the next two years with additional equity rather than seek to introduce third party debt given the early stage of the project and extent of the site preparation works required before development can commence.

3.8 On 14 October 2014, the JV issued a Funding Notice to its shareholders requesting total equity commitments of £325m to fund:

(a) £120m for the acquisition of third party land, to both protect existing land interests and add additional value to the JV (including an £8.3m overage payment to Network Rail);

(b) £39m for Stamp Duty Land Tax (SDLT) to cover the above acquisitions and the transfer of the partners interests into the JV[1];

(c) £147m for enabling works and working capital through to the end of 2016, including demolition, infrastructure, planning and design; and

(d) £19m contingency (to be draw and invested subject to normal JV Board governance arrangements).

3.9 TfL has until 12 November 2014 (being 20 working days from issuance of the Funding Notice) to confirm whether or not it wishes to provide its pro-rata share of the Funding Notice. TfL's share, being £120.25m, is within the investment limit of £150m delegated to the Chairman of the Finance and Policy Committee (in consultation with the available members of the Committee) by the Board.

[1] The £39m estimate of SDLT is based on the JV being completed as a Limited Company and will be reduced to c£20m if the JV can be completed as an Limited Liability Partnership (LLP). The TfL Bill currently before Parliament has provisions within it that would allow TfL enter into LLPs. TfL and Capco are currently considering whether technical completion of the JV can delayed until it is known whether the Bill will become law. Should this saving materialise it will be added to the contingency and managed accordingly.

3.10 The proposed investment is expected to take the form of Shareholder Loan Notes and an associated Subscription Agreement rather than actual equity in the JV as this is a more flexible and efficient method to provide the required funding.

3.11 The £19m contingency funding will be managed by the JV Board in accordance with the governance arrangements set out in the Contract.

4 Project Update

4.1 The Business Manager has made satisfactory progress on its primary objectives for 2014 including:

(a) Securing detailed planning permission

Planning permission for the ECV reserved matters application was granted by the Royal Borough of Kensington and Chelsea (‘RBKC’) on 1 April 2014, and the London Borough of Hammersmith and Fulham (‘LBHF’) on 3 April 2014. This gives the JV full planning permission to allow the ECV development to be built out. The current administration at LBHF had expressed opposition to the scheme before the local elections. LBHF are understood to have reviewed their contractual position in respect of the agreement with Capco for the sale of the council estates that form part of the wider master plan site, but have accepted that the JV development will progress. Preparations are underway for enabling works in relation to the demolition of EC1 & EC2, which, subject to JV Board approval and funding, is due to commence in February 2015. RBKC and LBHF have approved the detailed documentation and provided the necessary consents required to allow demolition to commence.

(b) Facilitate vacant possession of EC1&2 and below the deck of EC2

LU is on schedule to provide vacant possession of the undercroft beneath EC2 on the contracted date of 31 March 2015. Capco is due to provide vacant possession of EC1&2 at the end of December 2014.

(c) Acquisition of third party land interests

The JV is on schedule to acquire a number of third party interests. These primarily related to three areas (see Appendix 2, where Plan A shows the areas in relation to the overall masterplan and Plan B in relation to the JV site)

- Empress Place; the acquisition of these interests was anticipated in the original JV Business Plan (appended to the February 2014 Board paper). Of the 51 freehold and long leasehold interests to be acquired, 39 (76.5 per cent) have been contracted, six are agreed and due to be completed, four are under negotiation while the remaining two have yet to engage in discussions;

- Tournament Pub; negotiations are progressing to acquire this interest which addresses the problem of a derelict building detracting from the Site’s Lillie Road frontage; and

- Interests at Eardley Crescent; selected properties are proposed to be acquired to mitigate risks around Rights of Light.

The Cluny Mews acquisition is required to provide resilience for construction access and provides a site for affordable housing linked to a future phase of the development. Discussions are also ongoing with Network Rail to re-structure its overage arrangements under a fixed pre-payment plan. The updated Development Appraisal discussed in section 6 assumes the current proposed pre-payment plan comprising three payments of around £8.3m in 2016, 2017 and 2018 with the first payment included within this funding request.

(d) Detailed design and programming for Phase 1

The proposal for the first phase of development of ECV (Phase 1) remains unchanged from the original JV Business Plan and commences in the south west corner of ECV off Lillie Road, covering West Brompton Square and extending into Empress Place and part of the Lost River Park South (Plot ‘1A’, see Plan C, Appendix 2).

This development plan is subject to further land acquisitions in Empress Place and detailed planning consent. Should the required acquisitions or planning consents be unsuccessful or delayed, the main alternative option is to extend Phase 1 North and East in an arc connecting West Brompton Station to Earls Court Station developing Phase 1b and 1c as shown on Plan C in Appendix 2. No further acquisitions are required for this second option. Both the current plan and the alternative option represent viable development routes and require the same programme of demolition and site preparation works as are to be funded by the proposed investment.

The JV will need to take a decision on whether to proceed with the current or alternative plan by mid 2015 if construction contracts and funding are to be put in place to commence the main building works as soon as demolition work is completed.

The funding of the main building works will be a separate process governed by the funding processes in the Contract. Financial modelling currently indicates that if a 60 per cent loan to cost (LTC) (including land) debt package can be secured, no further shareholder investment will be required for the main building works. Should this prove to be the case the JV will likely fund the main building works with development debt package subject to the JV Board’s views at the time on issues such as risk. The TfL Business Plan assumes no further investment will be required.

5 Current Funding Requirement

5.1 In order that the JV could progress certain implementation works between entering into the Contract and completion of the land transfers, it was agreed that a total of £50m would be provided by TfL and Capco (in their respective shares) to fund the JV’s activity up to the end of 2014. It was noted that the JV would need additional funding in order to acquire selected land interests due to transfer to the JV on completion and to continue to progress the project beyond 2014.

5.2 The JV has identified a funding requirement of £325m for the period from 1 January 2015 to the end of 2016. This funding will be used for site assembly, demolition of EC1&2 and site preparation to the point where the first section of ECV is cleared and ready for construction of buildings to commence. Table 1 summarises the costs driving this funding requirement and a full break down of the costs is included as Appendix 7.

Table 1: Overview of Funding Requirement

Cost	**£million**
Land Costs/Assembly	
• Land acquisitions at Empress Place, Lillie Road, Eardley Crescent and Cluny Mews	111.4
• SDLT	39.3
• Network Rail Overage	8.3
Total Land	159
Enabling works and working capital	147
Contingency	19
Total	**325**

5.3 The expected drawdown profile of this funding requirement is set out in Table 2:

Table 2: Profile of funding requirement

Financial Year	2014/15	2015/16				2016/17				Risk	Total
Quarter	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4		
Funding Requirement	153	25	27	24	50	11	7	8	0	19	325
TfL's 37 per cent share	57	9	10	9	19	4	3	3	0	7	120

5.4 In accordance with the Contract, the JV considered whether this funding requirement could be prudently met with third-party debt, taking into account advice from Rothschild on the options.

5.5 The JV decided, following advice from Rothschild, that because the demolition and site preparation work in question needs to be completed before a section of ECV within Phase 1 will be ready for development, it would be imprudent or impractical to raise third party debt at this stage for the following reasons:

(a) it is more difficult and, if deliverable, more expensive to seek third-party debt prior to having a development ready site and a proportion of the units pre-sold;

(b) to introduce third party debt at this stage in the project would create refinancing risk, increasing the risk profile of the project; and

(c) it would be more appropriate for discussions with prospective lenders to commence mid-2015, with the expectation that funds will be available to progress the next stage of the project through drawdown in 2016.

5.6 The Contract provides that where the JV decides not to seek third party debt a Funding Notice will be issued to shareholders giving them the opportunity to provide their pro-rata share of the funding required. A Funding Notice was issued by the JV on 14 October 2014.

5.7 In the 5 February Board Paper, it was indicated that TfL funding of around £104m might be required to complete the development of Phase 1, based on 60 per cent LTC debt funding. It was noted that the actual funding requirement could vary significantly and would be dependent on numerous factors including costs, phasing, sales values and rates and the availability of third party debt. The modelling in February did not consider the demolition and site preparation works separately to the rest of phase 1 and consequently the estimated £104m funding requirement in February and the £120.25m proposed now are not directly comparable. However, if the main building works of phase 1 are fundable at 60 per cent LTC then the £104m referred to in February and the £120.25m proposed today will take the development to the same point i.e. a completed phase 1 based on plot 1A and Empress Place.

6 Financial Analysis

6.1 This section provides a financial analysis focused on a number of perspectives of the project.

Updated Development Appraisal

6.2 Modelling indicates that the scheme is fundamentally viable, which is a prerequisite for any recommendation to invest in progressing the project.

6.3 An updated Development Appraisal and cash flow has been completed by the Business Manager, with input and advice from Business Manager’s advisors; EC Harris (cost consultancy), CBRE (market advice) and Rothschild (funding advice). The update has been overseen by the JV Executive Committee and Board, including input from the TfL members of the JV Executive Committee and JV Board advised by TfL’s advisor team comprising AECOM (cost and programme advice) and Cushman & Wakefield (commercial and property advice). A summary of this appraisal and cash flow together with assumptions can be found in Appendices 3 to 5.

6.4 The headline outputs from the Development Appraisal (on a nominal/outturn basis) are:

(a) total Development Costs of £3,202m;

(b) total Income of £6,672m, of which £6,270m relates to private residential sales;

(c) peak equity funding of £349m, of which TfL’s peak funding would be £129m (assuming that TfL retains its 37 per cent holding);

(d) the remainder of the development is assumed to be funded through the re-investment of sales proceeds and through third party development finance, with a peak debt of £1,150m;

(e) gross return to TfL of £1,415m and a net return to TfL of £1,284m. (Net return defined as the TfL share of revenue less funding provided by TfL); £800m of this gross income has been included in the TfL Business Plan (adjusted down to reflect the both the risk to values and the risk that returns may be delayed to beyond the Business Plan period); and

(f) cash positive date (i.e. date by which TfL will have received all of its cash investment back) of July 2021.

6.5 Based on the estimated transfer valuation of TfL’s land interests in the JV at inception of £215m, as reported to the Board in February 2014, this equates to a:

(a) net profit to TfL of £1,069m; and

(b) geared IRR of 21.9 per cent and Equity Multiple of 4.1 times;

6.6 The headline assumptions in the updated Development Appraisal are set out in Appendix 5. The revised Business Plan shows a £367m (17 per cent) increase in the total development cost budget (on a real basis), offset by a £1,013m (28 per cent) increase in the forecast income. A comparison of the current financial analysis compared to that at the time of the original JV Business Plan is included in Appendix 6.

6.7 AECOM has reviewed the cost plan produced by EC Harris and are comfortable that the cost estimates are reasonable. They are of the opinion that the build costs for residential development are higher than they would expect for the specification provided with an over estimation of around £100m. Given this issue represents a potentially overly conservative view of construction costs, it is not considered a cause for concern and will be monitored as the cost plan develops.

6.8 Cushman & Wakefield have reviewed the Development Appraisal and cash flow provided by the Business Manager and consider that the methodologies, general assumptions and outputs from the model to be appropriate and in line with market standards. The viability of ECV is largely predicated on the performance of the private residential sales where the model reflects 35 per cent uplift in value as compared with the figures used in the original Business Plan, specifically £1,492 to £2,000 per sq ft. This increase results from more certainty on design evolution; adjustments made over the period to the unit size mix, improved critical mass through proposed incorporation of Empress Place, optimising unit specification, place making and greater confidence over the values achievable based on Capco's experience at Lillie Square development site across the road.

6.9 Cushman & Wakefield have advised that whilst an uplift in values is justifiable based on a combination of scheme adjustments, comparable evidence and weight of demand in the market place, an uplift to around £1,800 per sq ft would be prudent but there is potential to secure values in excess of this up to an upper range of £2,000 per sq ft given the potential to capture momentum off the back of Lillie Square.

6.10 Cushman & Wakefield have advised that the take-up forecasts provided by CBRE with peak sales in excess of 150-200 units per annum, whilst reflective of comparable evidence most notably Lillie Square, are slightly optimistic and the development pipeline of competing schemes around delivery of Phase 1a will need to be closely monitored. Cushman & Wakefield have indicated that the combination of competition and growth forecasts provide a more realistic take up rate assumption of around 100 units – 150 per annum.

6.11 In terms of growth, Cushman & Wakefield have advised that whilst they anticipate that residential value growth will remain positive over the next 24 months, they believe that growth rates will temper over the same period as compared with 2013 and 2014. Cushman & Wakefield have stated whilst they do not disagree with CBRE's approach to forecasting applying five per cent per annum in 2015 and three per cent in 2016 given their approach on the take up forecasts it might be more prudent to be slightly more conservative at 0 per cent and five per cent in 2015 and 2016, respectively.

6.12 Although a smaller proportion of the overall master plan the commercial values are deemed to be consistent with Cushman & Wakefield's opinion on the market.

Value Added by Specific Components of the Investment

6.13 The proposed investment can also be considered in terms of the effect on value in the short to medium-term rather than as a step in the full long-term development of ECV.

Land Acquisitions

6.14 The investment in acquiring additional land interests is a direct investment in a tangible asset. As is normal during site assembly for a project of this nature, sites are being acquired at a premium to the current market value which is justified by the value these interests add to ECV.

6.15 The acquisition of 2-26 Lillie Road, and 1-18 Empress Place allows the inclusion of a 1.04 acre site within the existing developable site at ECV, which when combined with adjoining plots produces a significant increase in density of 238,000 sq ft of residential NIA and 26,000 sq ft of retail above the existing masterplan floor space.

6.16 The inclusion has both a positive impact on sales values of units within the existing masterplan by allowing an improved configuration and better outlook; and removes a significant risk from potential Rights of Light claims.

6.17 This strategy also allows greater flexibility in the delivery of residential units and a smoother delivery of completed units to market, addressing a gap in the programme between the delivery of units in the different sub-phases within Phase 1.

6.18 The current estimated acquisition cost of £70m compares with an estimated net increase in land value of £53m together with an increased development profit of £74m. However if planning consent is not forthcoming, then a mitigation scheme can be implemented to refurbish the properties, improve the entrance into the wider masterplan area, remove the Rights of Light risk and resell the properties. The net financial impact of this mitigation plan would depend on the resale value achieved and would be expected to range from a £10m loss if resale occurred at today’s market values to a £10m profit if there is an element of value growth in the next 12 months.

Enabling and Infrastructure Works/Future Design

6.19 The investment in direct costs necessary for the long-term redevelopment of the Site adds value by reducing the size of the remaining investment required in the Site and eliminating risk associated with demolition and site preparation work.

6.20 The Business Manager has estimated that the approximate £150m of enabling, infrastructure, design, planning and marketing works to be undertaken during 2015/16 (excluding the land assembly) will result in a uplift in the valuation of the initial demise of around £195m, equating to a 30 per cent profit on cost.

6.21 Furthermore, on the basis that the development progresses in line with the latest JV Business Plan and Development Appraisal, Cushman & Wakefield has estimated that the total value of ECPL’s interests at the end of the 2016 could be c.£1.3bn or higher. As illustrated in Table 3, this would imply a net return to TfL of £352m and an equity multiple of 1.28x were those asset values to be realised.

Table 3: ECPL and TfL Returns to end of 2016

£m	ECPL	TfL's Interests in ECPL
Initial Site Value	581	215
Shareholder Funding to the end of 2016	349	129
Estimated Value of ECPL at end of 2016	1,300	481
Net Return	861	352
Net Profit	280	137
Equity Multiple	1.28x	1.28x

7 Key Development Risks

Values and Sales Rates

7.1 As highlighted in paragraph 6.8, the viability of ECV is largely predicated on the performance of the private residential sales. Table 4 illustrates the returns to TfL under a range of average residential sales values. With regards to the C&W position below the input values reflect those set out in paragraphs 6.8 – 6.11 above.

Table 4: Residential Sales Value Sensitivity Analysis

	Funding Breakeven (Zero Net Return)	**Profitability Breakeven (Zero Profit)**	**C&W Values**	**CapCo Base Case**	**CBRE Values**
Average Values (£psf NIA)					
Today's Values (Real)	**915**	**1,090**	**1,800**	**2,000**	**2,142**
Inflated Values (Nominal)	1,338	1,593	2,632	2,924	3,131
TfL Returns (nominal)					
Total Funding (£m)	129	129	129	129	129
Total Receipts (£m)	129	344	1,185	1,413	1,574
Net Return (£m)	0	215	1,056	1,284	1,445
Net Profit (£m)	(215)	0	841	1,069	1,230
Equity Multiple	0.4x	1.0x	3.4x	4.1x	4.6x
Geared IRR	0.0%	0.0%	18.7%	21.9%	23.9%

7.2 Whilst the base case Development Appraisal assumes average sales values of £2,000 per sq ft net internal area (in today's values), TfL would show a profit on its land and cash investments should average values of above £1,090 per sq ft be achieved (£1,593 per sq ft with inflation). Furthermore, at values of £915 per sq ft (£1,338 per sq ft inflated) TfL would still receive back its cash investment, albeit with zero return on its land investment. This sensitivity analysis indicates that the assumed total receipt of £800m in the TfL Business Plan is suitably prudent from a sales value perspective and provides a degree of flexibility to accommodate adverse movements in construction costs and programme.

Cost and Value Inflation

7.3 Table 5 illustrates the returns and funding requirements for TfL under upside and downside inflation scenarios.

Table 5: Inflation Sensitivity Analysis

	Downside	**Cap Co Base Case**	**Upside**
Value Inflation	**2.0%**	**5.5%**	**8.0%**
Cost Inflation	**4.5%**	**4.5%**	**4.5%**
TfL Returns (nominal)			
Total Funding £m	129	129	129
Total Receipts £m	952	1,413	1,805
Net Return £m	823	1,284	1,676
Net Profit £m	608	1,069	1,461
Equity Multiple	2.8x	4.1x	5.2x
Geared IRR	14.9%	21.9%	26.5%

7.4 In a low value inflationary environment (two per cent per annum), this analysis still shows a net return to TfL of £823m and an equity multiple of 2.8x.

7.5 It should be noted that the residential value inflation assumptions in the above scenarios (between two per cent and eight per cent) compare with a long-running historic growth in values within the RBKC of around 10 per cent per annum.

Funding Risk

7.6 The current Development Appraisal assumes that all of the future funding requirements from 1 January 2017 onwards can be satisfied through a combination of third party debt finance and recycled sales proceeds. However, there are a number of factors that may result in additional shareholder funding being required later in the development, and in particular reduced liquidity in the debt markets.

7.7 Table 6 illustrates the impact on the development returns and TfL's funding requirements due to lower quantum of available debt:

Table 6

£m, nominal	**Base Case**	**£800m Peak Debt**	**£400m Peak Debt**	**Unleveraged**
Peak Equity	349	635	990	1,360
Peak Debt	1,148	800	400	-
TfL Returns (nominal)				
Total Funding £m	129	235	366	503
Total Receipts £m	1,413	1,551	1,709	1,865
Net Return £m	1,284	1,316	1,342	1,362
Net Profit £m	1,069	1,101	1,127	1,147
Equity Multiple	4.1x	3.3x	2.8x	2.3x
Geared IRR	21.9%	20.8%	20.4%	20.4%

Rights of Light

7.8 A strategy addressing Rights of Light has been adopted which includes a budget of £12m for compensation and the procurement of an insurance policy to cover the potential loss in land values of £350m. The strategy includes the acquisition of key properties where insurance is not possible or where acquisition is more economical than compensation.

Capco Funding Risk

7.9 While Capco has advised that it expects to elect to provide its share of the required funding there is a risk that it will not do so. If Capco were to elect not to provide its share of the required funding, the same provisions apply as if TfL elects not to provide funding. The JV would consider the potential for third party debt funding; TfL would have the ability to negotiate to provide some or all of the required funding in return for some of Capco's interest in the JV.

Alternatively a process of seeking third party equity investment to dilute Capco's interest would take place.

7.10 There is a risk that Capco may elect to provide the required funding but fail to actually do so (the drawdown of all funds into the JV will be on an 'as required basis'). In this situation the Contract provides that TfL may provide the required funding or a competitive process will be completed to dilute Capco's interest in the JV. A due diligence report on Capco was prepared at the time of entry into the Contract and forms part of the February Board paper at Appendix 1.

7.11 These risks are mitigated by the fact that following completion Capco will have transferred its interests in Earls Court to the JV and the JV itself will own assets of significant value meaning that the provisions of the Contract that provide for an enforced sale of some or all of Capco's interest in the JV offer a degree of certainty that the required funding will be provided by Capco or an alternative investor.

7.12 As Capco is a PLC it was not possible to impose change of control restrictions at the highest level of the organisation and therefore the risk of a change of control at Capco. The corporate JV structure and legally binding nature of funding commitments, minority interest protections and governance arrangements help to mitigate against this risk.

8 Other Considerations

Dilution implications of Not Funding

8.1 The Contract (specifically the shareholders' agreement governing the JV) contains provisions whereby, if TfL does not wish to fund its share requested pursuant to a Funding Notice, then the JV will instruct its funding advisers to advise on the availability and likely impact of third party funding to fund TfL's share. If the JV resolves to raise the funding via third party equity then it will undertake a competitive process to do so and Capco are permitted to bid to provide that equity.

8.2 The table in Appendix 7 illustrates the possible dilution of TfL's ownership and returns if it opts not to provide any additional funding. Under this analysis, if a third party funder provided TfL's pro-rata share of this Funding Notice based upon an initial Net Asset Value (NAV) of TfL's interests in ECPL of 215m, then:

(a) TfL's shareholdings in ECPL would be diluted from 37 per cent to 25 per cent by the end of 2016; and

(b) TfL's net profit would fall by £354m (from £1,069m to £715m).

8.3 TfL’s returns may be further impacted if the price achieved from a third party is lower than the initial NAV. A price of a 10 per cent discount to NAV would see TfL’s net profit reduced by a further £52m to £663m, around £405m lower than the base case under which TfL funds.

8.4 This analysis assumes that the development programme would be unaffected by a decision by TfL not to fund its pro-rata share of the Funding Notice. In practice, a third party equity raising process is likely to have an impact on the development, both in terms of scheduled activities being deferred until funding can be put in place and also in terms of the diverting management time and attention to the equity raising process.

8.5 Interest from third party investors and therefore pricing that could be achieved through an equity raising process could be influenced by factors other than the investor’s valuation of the ECP’s net assets, and in particular the rights and obligations of this shareholder relative to the existing shareholder base and the liquidity of the shares.

8.6 The Contract sets a number of Member Protection Matters, being actions that cannot be undertaken without certain a majority of shareholder approval (such as changes to the Shareholder Agreement). Certain matters require shareholders holding 75 per cent of the shares between them to vote on certain matters and certain other matters require shareholders holding 90 per cent of the shares between them to vote on certain matters. Further protections are afforded to TfL provided it holds at least 10 per cent of the shares. If TfL’s shareholding were diluted below these thresholds then it would lose the associated protections.

Liquidity / Exit Options for TfL

8.7 Under the current Development Appraisal, it is forecast that distributions to shareholders would commence in 2021, with TfL having received its full cash investment back by the end of 2021. Under this distribution profile, the development would be in profit, with TfL having additionally received the value of its land contributed to the JV (£215m), by the end of 2022.

8.8 However, should TfL decide to realise some value on its investment earlier than this timeline, then the Contract allows a partial or full disposal of interests in the development by selling interests in either the JV or in the TfL holding company that owns TfL’s shares in the JV, TTL Earls Court Properties Limited.

8.9 While there are no provisions in the Contract restricting the timing of the sale of either the JV or TTL Earls Court Properties Limited interests, there are logical exit points at which a sale would be more straightforward, easier for prospective investors to underwrite and should maximise values. These would be the major project milestones, such as:

(a) completion of the demolition and site preparation works at the end of 2016. At this time, the key risks of site assembly, planning, demolition and infrastructure construction will have been largely addressed;

(b) completion of the first blocks/buildings in Phase 1, by which time the sales values will have been evidenced; and

(c) completion of Phase 1, at which point ECV will have been established as a desirable residential destination.

Compatibility with Commercial Development Plan and Impact on TfL Business Plan

8.10 It is important to consider the investment decision in Earls Court in the context of the wider plan to deliver £3.4bn net commercial revenues over the ten year Business Plan.

Available funding

8.11 The 2013 Business Plan provided for £220m of investment by Commercial Development to deliver the £3.5bn revenue target. The proposal to exercise this delegation of authority to invest a further £120.25m in Earls Court represents the commitment of a significant portion of the £220m total funding set aside for Commercial Development investments in the plan.

8.12 The current draft Business Plan provides for the proposed investment (subject to the proposed approvals) and assumes a receipt of £800m in 2023.

8.13 This commitment of resource is consistent with the wider Commercial Development business plan expenditure requirements. To the extent other investment opportunities arise in the future that require capital investment, or additional capital is required to deliver existing schemes, TfL has the ability to sell down all or part of its stake in Earls Court or to otherwise refinance the project to recycle this capital.

8.14 The other schemes most likely to require significant capital investment are other property development schemes or joint ventures. Work is underway to examine the viability of taking a portfolio of development sites forward on a joint venture basis. Initial modelling indicates that on the majority of sites the land value is sufficient to secure an interest in the joint venture of around 50 per cent without the need for significant additional cash investment. The total value of cash and land invested in these joint ventures is expected to run to several hundred million pounds but the actual cash funding requirement is estimated to be in the region of £150 – 250m. The precise details of the transaction structures and targeted ownership stakes will drive the actual level of investment required. A key advantage of the joint venture approach is that TfL can be flexible and commit as much or as little additional capital as it wishes. The decision as to whether to dispose of shares within one or another joint venture entity will depend on a comparison of the future returns from each investment. If it were decided that TfL preferred to leave the capital committed in the Earls Court JV it would simply invest less additional capital in other schemes.

Management resourcing

8.15 As a minority shareholder in ECP TfL is entitled to appoint three members to the JV Board and three members to the JV Executive Committee. TfL's Directors on the JV Board currently comprises Graeme Craig, Director of Commercial Development, Andrew Pollins, Interim Chief Finance Officer and Jonathan Cornelius, Senior Development Manager. TfL's Executive Committee Members are Jonathan Cornelius, Henry Gervaise-Jones, Interim Head of Finance for Commercial Development and Neil Kedar, Head of Consents. This team supported by internal resource from LU, TfL Finance and TfL Legal and external resource from Cushman Wakefield, Eversheds and Aecom work to represent TfL's interests in the JV.

8.16 This extensive resourcing is appropriate to Earls Court due to its scale and complexity. As the number of projects grows specific resources will need to be brought in to manage these interests.

8.17 The Commercial Development plan is predicated on establishing a number of JV's with key development partners. A similar level of resource will therefore be required to input into and manage each of these partnerships. It is proposed that this resourcing approach will remain in place for Earls Court and be reviewed when resource is being put in place for other partnerships.

8.18 It is envisaged that the resource required to establish and manage these partnerships will include a mixture of property development and investment / fund management experience.

Strategic Fit

8.19 The Earls Court JV is the first corporate joint venture TfL has undertaken and is the largest envisaged in the TfL Business Plan. In order to realise its full value TfL will need to invest further funds in order that a development platform can be created that will be attractive to third party funders. At this point opportunities for third party debt, disposal of shareholdings all become viable options. Even if TfL subsequently sells down its interests in the JV, by funding this phase itself, TfL achieves the strategic aim of demonstrating the capacity and intent to leverage our position as owner of the infrastructure and invest in taking forward the development of its assets.

9 Conclusions

9.1 The proposed investment is consistent with the authority delegated to the Chairman of the Finance and Policy Committee on this matter.

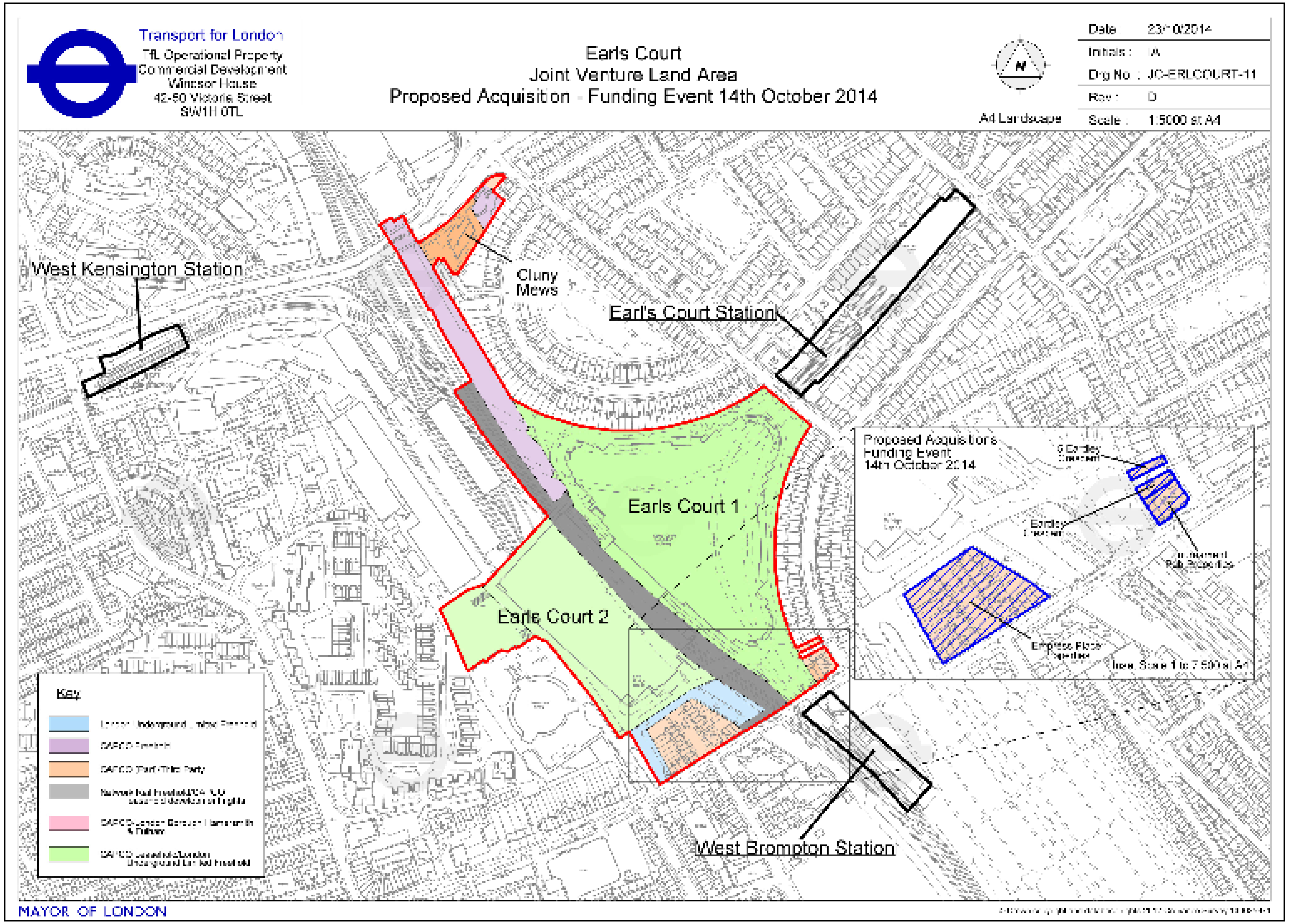
9.2 The programme of works proposed to be funded by this investment offers a level of return commensurate with the risk involved and represents an **excellent strategic fit** for TfL in seeking to achieve increased value from its property portfolio by participating in development risk.

Appendix 1: 5 February 2014 Board Papers

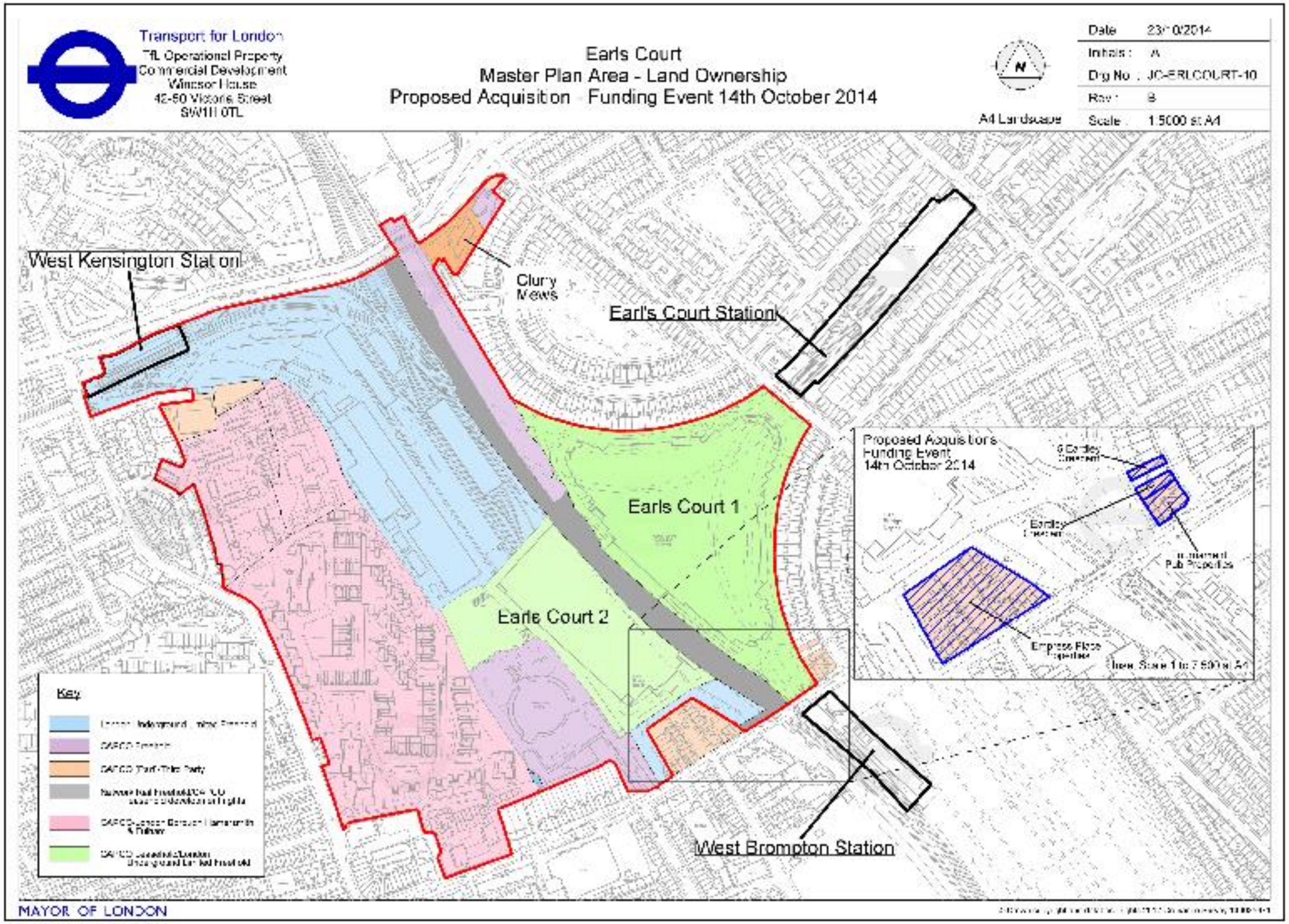
Enclosed as a separate document

Appendix 2: Plans

Plan A: Land Acquisitions – Overall Masterplan Area



Plan B: Land Acquisitions – JV Land Area



Plan C: Development Plans

Potential first phase of development

Appendix 3: Full Development Appraisal

£million	**Real**	**Nominal / Outturn**
Income		
Private Residential Sale Income	4,288.8	6,270.0
Private car parking income	75.5	109.9
Capitalised ground rents	11.1	18.0
Sales agent and legal fees	(65.5)	(95.7)
Intermediate Income	29.7	33.9
Non-residential Income	260.3	332.3
Sale of Assets	3.5	3.5
Total Income	4,603.4	6,671.9
Costs		
Private Residential Construction	986.2	1,214.9
Intermediate Construction	46.0	57.4
Non-residential Construction	103.7	133.6
Enabling, Utilities & infrastructure	462.3	557.5
Plot Related Infrastructure	179.6	209.6
Other Development Costs	53.0	59.3
Fees/S106		
Section 106 costs	22.8	25.8
CIL costs	9.0	11.1
Professional fees	195.5	223.0
Marketing Costs	65.5	96.0
Letting Costs	2.0	2.5
Site wide branding	5.5	5.8
Business Management Fee	53.3	65.2
Project Insurance	17.8	21.7
Development Contingency	108.9	132.8
Land Payments	175.2	175.2
Finance Costs	184.2	210.3
Total	2,670.3	3,201.7
Land Opportunity Cost	581.1	581.1
Total Including Land Opportunity Cost	3,251.4	3,782.8
Key Development Metrics		
Development Funding		
Equity	349.0	349.0
Third Party Debt	984.1	1,147.6
Recycled Sales Receipts	1,337.2	1,705.1
Net Return	1,933.1	3,470.2
Net Profit	1,352.0	2,889.1
Ungeared IRR	12.7%	20.4%
Profit on Cost	41.6%	76.4%
Geared IRR	13.2%	21.9%
Equity Multiple	2.4x	4.1x
Cash Positive Date	Oct 21	Jul 21
Average Values £psf NIA		
Private Resi	2,000	2,924
Intermediate	230	263
Commercial	568	725

Average Build Cost £psf GIA		
Private Resi	366	451
Intermediate	283	353
Commercial	195	252

Appendix 4: Development Cash Flow

YEAR ENDING	TOTAL	Mar 13	Mar 14	Mar 15	Mar 16	Mar 17	Mar 18	Mar 19	Mar 20	Mar 21	Mar 22	Mar 23	Mar 24	Mar 25	Mar 26
£m, Nominal / Outturn															
Income															
Private Residential	6,302.2	-	-	-	-	-	-	245.3	20.3	669.4	3,317.7	1,945.4	104.3	-	-
Intermediate Residential	33.9	-	-	-	-	-	4.8	3.0	3.0	5.6	8.8	8.8	-	-	-
Non-residential Uses	332.3	-	-	-	-	-	-	6.5	-	20.3	35.7	56.6	213.2	-	-
Sale of assets	3.5	-	-	-	-	-	3.5	-	-	-	-	-	-	-	-
Total Income	6,671.9	-	-	-	-	-	8.3	254.8	23.2	695.2	3,362.1	2,010.7	317.5	-	-
Development Costs															
Private Residential Construction	1,214.9	-	-	-	-	8.5	47.0	85.1	297.8	473.2	264.9	38.4	-	-	-
Intermediate Construction	57.4	-	-	-	-	-	1.8	12.9	12.7	1.9	16.0	12.2	-	-	-
Non-residential Construction	133.6	-	-	-	-	0.2	1.2	2.6	8.8	37.0	58.4	25.5	-	-	-
Enabling, Utilities & infrastructure	557.5	0.1	2.8	19.0	42.0	30.6	19.2	64.7	99.1	119.9	119.6	40.5	-	-	-
Plot Related Infrastructure	209.6	-	-	-	-	24.2	50.0	44.5	67.5	21.9	1.7	-	-	-	-
Other Development Costs	59.3	-	0.4	2.2	2.9	1.9	7.0	7.2	7.3	7.5	7.7	7.8	3.7	3.7	-
Fees / S106	583.9	2.6	12.5	23.3	35.3	31.2	55.8	75.4	79.3	106.1	106.4	49.1	3.9	1.5	-
Land Cost / Assembly	175.2	-	-	123.3	19.1	24.4	8.3	-	-	-	-	-	-	-	-
Finance Costs	210.3	-	-	-	-	23.0	28.2	35.5	51.7	66.8	5.0	-	-	-	-
Total Development Costs	3,201.7	2.7	15.7	167.8	99.4	144.0	218.4	327.8	624.3	834.1	579.7	173.5	7.6	5.2	-
JV Net CF	**3,470.2**	**(2.7)**	**(15.7)**	**(167.8)**	**(99.4)**	**(144.0)**	**(210.1)**	**(73.0)**	**(601.0)**	**(138.9)**	**2,782.4**	**1,837.2**	**309.9**	**(5.2)**	**-**
Shareholder CF															
Additional Funding	(349.0)	(2.7)	(15.7)	(167.8)	(99.4)	(63.4)	-	-	-	-	-	-	-	-	-
Distributions	3,819.2	-	-	-	-	-	-	-	0.0	-	1,678.8	1,837.2	309.9	(5.2)	-
Net Return	**3,470.2**	**(2.7)**	**(15.7)**	**(167.8)**	**(99.4)**	**(63.4)**	**-**	**-**	**0.0**	**-**	**1,678.8**	**1,837.2**	**309.9**	**(5.2)**	**-**
Debt Drawn / Repaid	0.0	-	-	-	-	80.5	210.1	73.0	601.0	138.9	(1,103.6)	-	-	(0.0)	-
TfL CF															
Additional Funding	(129.1)	(1.0)	(5.8)	(62.1)	(36.8)	(23.5)	-	-	-	-	-	-	-	-	-
Distributions	1,413.1	-	-	-	-	-	-	-	0.0	-	621.2	679.8	114.7	(1.9)	-
Net Return	**1,284.0**	**(1.0)**	**(5.8)**	**(62.1)**	**(36.8)**	**(23.5)**	**-**	**-**	**0.0**	**-**	**621.2**	**679.8**	**114.7**	**(1.9)**	**-**

Appendix 5: Overview of Development Appraisal Assumptions

Values

Private Residential Sales

- Average residential values of £2,000 per sq ft NIA (in today's values)
- Sales rates of 125 units per annum for each block. 60% assumed to be sold off-plan sales, 40% sold post practical completion
- Private parking spaces at £75,000 per space. Parking ratio of 60% (i.e. 1 space for every 0.6 flats)
- Ground rent per unit of £400 per annum for flats. Assumed sold on PC of final unit in 2023 at cap rate of 5.5%.
- Sales Agents and Legal Fees of 1.5%

Intermediate Income

- Average intermediate values of £230 psf, receivable 25% at start of construction, 50% during construction and 25% on Practical Completion

Commercial Values

	Office	**Cultural**	**Community**	**Hotel**	**Leisure**	**Retail**
Rent £psf NIA	45.00	10.00	5.00		15.00	40.00
Net Initial Yield	5.50%	7.00%	6.00%		6.50%	5.25%
Rent Free Period (months)	24	18	24		18	18
Marketing Void (month)	12	12	6		6	6
Purchaser's costs	5.80%	5.80%	5.80%		5.80%	5.80%
Vendor's Costs	1.50%	1.50%	1.50%		1.50%	1.50%
Capital Value psf NIA	649	112	67	607	189	640

Assets Acquired

- Undeveloped Eardley Land assumed to be sold for £3.5m in 2017

Costs

Construction Costs

£ psf GIA	**Average**	**Range**
Private Residential	£385	£322 - £423
Intermediate Residential	£280	£280
Commercial		
Office	£194	£177 – £200
Cultural	£244	£220 - £250
Community	£134	£134
Hotel	£330	£330
Leisure	£231	£111 - £250
Retail	£129	£107 - £174

Fees/106

- Professional Fees: 11% of Construction and Infrastructure Costs - 5% pre-contract and 6% post contract
- Marketing Costs: 1.5% of Private Residential Sales Values and Parking Revenue
- Commercial Letting Costs: 12.5% of ERV
- Site-wide branding: £2 per sq ft NIA
- Business Management Fee: 3.0% of Construction and Infrastructure Costs
- Project Insurance: 1.0% of Construction and Infrastructure Costs
- Development Contingency: 5.0% of all Development Costs, excluding Letting Fees, s106 payments and land assembly costs

Inflation

- Average inflation over the period 2015 to 2020 of 4.5% cost inflation and 5.5% private residential value inflation

Inflation Item	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Private Sales	3.00%	5.00%	3.00%	6.00%	7.00%	7.00%	5.00%
Commercial Values							
Office	0.00%	0.32%	3.50%	3.50%	3.50%	3.50%	3.50%
Cultural	0.00%	2.72%	2.63%	2.68%	2.72%	2.72%	2.72%
Community	0.00%	2.72%	2.63%	2.68%	2.72%	2.72%	2.72%
Hotel	0.00%	2.72%	2.63%	2.68%	2.72%	2.72%	2.72%
Leisure	0.00%	1.57%	4.00%	4.00%	4.00%	4.00%	4.00%
Retail	0.00%	1.57%	4.00%	4.00%	4.00%	4.00%	4.00%
RPI	0.00%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%
Build Costs	0.98%	4.90%	4.70%	4.50%	4.00%	4.40%	4.40%
Infrastructure Costs	0.98%	4.90%	4.70%	4.50%	4.00%	4.40%	4.40%

Financing

- All development funding from 1st January 2017 onwards funding through the re-investment of sales proceeds and through single third party revolving credit facility
- Peak debt of £1,148m (on a nominal basis).
- Full cash-sweep to repay debt, with facility fully repaid by 2021
- Fees of:
    - Margin of 350bps over LIBOR
    - 1.5% up-front arrangement fee
    - 1.75% commitment/non-utilisation fee
    - £100k per annum bank monitoring/admin fee

Appendix 6: Reconciliation of 2015 Business Plan to 2014 Business Plan

£million, real	**2014 Business Plan**	**2015 Business Plan**	**Change**	**% Change**	**Notes**
Income	3,590.8	4,603.4	1,012.6	28.2%	Average residential values now £2,000 psf NIA, compared to £1,493 psf NIA in the 2014 Business Plan. £2,000psf calculated as a 6.6% discount to the CBRE average values of £2,142 psf NIA
Costs					
Construction & Infrastructure Costs	1,598.7	1,830.7	231.9	14.5%	- Private residential build costs increased by 12.6% to £366 psf GIA (compared to £325 psf in the 2104 Business Plan). - 44% increase in intermediate construction costs from £197 psf GIA to £283 psf.
Fees/S106	381.7	480.2	98.5	25.8%	- Development contingency increased by £70.5m - now 5% of development costs compared to 2% previously. - Marketing budget also increased by £26m, offset by expected savings on Professional Fees (down from 13.5% to 11%)
Land Assembly	138.3	175.2	36.9	26.7%	
Total Costs	2,118.7	2,486.1	367.3	17.3%	
Balance Before Finance	**1,472.0**	**2,117.3**	**645.3**	**43.8%**	
GIA (sq ft)	3,309,252	3,384,867	75,615	2.3%	
NIA (sq ft)	2,736,395	2,732,045	(4,350)	(0.2%)	
NIA:GIA	82.7%	80.7%	-2.0%		
NIA by Use (sq ft)					
Private Resi	2,184,459	2,144,384	(40,075)	(1.8%)	
Intermediate	58,285	129,107	70,822	121.5%	Private resi and commercial space reduced to allow for additional 71,000 sq ft NIA of affordable space within Empress Place
Commercial	493,651	458,554	(35,097)	(7.1%)	
No. of Private Units	1,617	1,677	60	3.7%	Additional 60 private resi units, achieved through smaller average unit size - see below
Average Private Resi Unit Size (sq ft)	1,351	1,279	(72)	(5.3%)	Average unit size reduced from 1,351 sq ft NIA to 1,279 sq ft
Resi Values £psf NIA					
Private Resi	1,493	2,000	507	33.9%	
Intermediate	228	230	2	1.0%	
Commercial	577	568	-10	(1.7%)	
Build Cost £psf GIA					
Private Resi	325	366	41	12.6%	
Intermediate	197	283	86	43.7%	
Commercial	186	195	10	5.2%	

Appendix 7: 2015/16 Funding Requirement

€m, nominal	**2015**	**2016**	**Total**
Land Assembly			
Empress Place	69.7	-	69.7
Old Brompton Road	11.8	-	11.8
Eardley Crescent	7.0	-	7.0
SDLT	39.3	-	39.3
Cluny Mews	5.9	16.1	21.9
Lease Surrenders	0.4	-	0.4
NR Overage	-	8.3	8.3
Total Land Assembly	**134.1**	**24.4**	**158.5**
Enabling Works & Working Capital			
ECV Site Wide			
Planning	9.7	5.0	14.8
Detailed Design	10.2	6.5	16.6
Demolition	30.7	10.3	41.0
Construction	5.0	0.3	5.2
ECV Phase 1a			
Planning	1.0	0.2	1.1
Detailed Design	3.3	4.0	7.3
Development	1.7	2.0	3.7
Construction		2.0	2.0
Lost River Park South			
Planning	0.1	0.1	0.2
Detailed Design	0.7	0.4	1.1
Construction	7.5	8.3	15.8
Northern Access Road			
Planning	0.1	-	0.1
Detailed Design	0.1	-	0.1
Construction	3.5	-	3.5
Phase 1 B/C - Planning	4.0	-	4.0
Empress Place - Planning	0.5	-	0.5
Comms/Marketing/Branding - EC Site Wide	5.0	5.0	10.0
Contingency	8.3	4.4	12.7
Inflation	1.1	1.3	2.4
Business Manager Fee /Funding			
Business Manager Fee 3%	2.5	1.3	3.8
Admin Allowance	0.5	0.5	1.0
Total Enabling Works & Working Capital	**95.3**	**51.4**	**146.8**
Total Costs Excl Contingency	**229.5**	**75.8**	**305.3**
Contingency	14.8	4.9	19.7
Total Funding Requirement incl Contingency	**244.3**	**80.7**	**325.0**

Appendix 8: Dilution Analysis

The table below illustrates the potential dilution of TfL's shareholding in ECPL and the subsequent impact on its returns over the full development if TfL decides not to provide its pro-rata share of this Funding Notice.

Note that this analysis assumes that the development programme would be unaffected by a decision by TfL not to fund its pro-rata share of this £325m Funding Notice. In practice, a third party equity raising process is likely to have an impact on the development, both in terms of scheduled activities being deferred until funding can be put in place and also in terms of the diverting management time and attention to the equity raising process.

£million, outturn	**TfL Equity Invested ***	**TfL Share of Revenue**	**TfL Net Return**	**TfL Net Profit**	**Equity Multiple**	**TfL Interest after Dilution**
TfL provides 100% of Funding Notice	344	1,413	1,284	1,069	4.1x	37%
Third party provides TfL's share of Funding Notice						
@ 10% Premium to NAV	230	988	973	758	4.3x	26%
@ NAV	230	946	930	715	4.1x	25%
@ 10% Discount to NAV	230	894	878	663	3.9x	23%

* TfL Equity comprises Land Contribution (£215m), Implementation Works Funding (£15.3m) and equity forecast to be drawn from current Funding Notice (£113.8m)