

CABINET MEETING:

15 November 2018

INDOOR ARENA – NEXT STEPS

INVESTMENT & DEVELOPMENT (CLLR RUSSELL GOODWAY)

AGENDA ITEM:

PORTFOLIO: INVESTMENT & DEVELOPMENT

The Appendices– are not for publication as they contain exempt information of the description contained in paragraphs 14 and 21 of Schedule 12A of the Local Government Act 1972.

Reason for this Report

1. To provide Cabinet with an update on negotiations to secure control of the site selected by Cabinet in February 2018 as the preferred location for the delivery of a new 15,000 capacity Indoor Arena.
2. To seek delegated authority to negotiate Heads of Terms with the landowner and to commit Council expenditure to produce a detailed business case and delivery strategy for the new Indoor Arena for consideration by Cabinet in March 2019.

Background

3. Delivery of a new Indoor Arena is one of two key strategic employment/regeneration priorities set out by the political administration in its strategic policy document *Capital Ambition*. In February 2018, Cabinet identified the site of the Red Dragon Centre as its preferred location for delivery of the project and delegated authority to the Director of Economic Development in consultation with the Cabinet Member for Investment & Development and relevant officers to develop a detailed delivery strategy including detailed financial implications and to return to a future meeting of Cabinet for authority to proceed.
4. The preferred site is owned by British Airways Pension Fund (“BAPTL”). To enable delivery of the site of the new Indoor Arena, there is a need for the Council to work in partnership with BAPTL and their partners to secure

the land, agree the wider masterplan opportunities to enable the Council to deliver a world-class mixed-use development.

5. The report to Cabinet in February noted the requirement for a public-sector funding contribution towards the Indoor Arena and proposed that the Council acquires the freehold interest of the Red Dragon Centre site from BAPTL.
6. In order that a detailed business case and delivery strategy can be undertaken there will need to be a period of time whereby the Council works with Reef Group (“Reef”) who are retained by BAPTL as their Development Partner for the development of a suitable replacement for the existing Red Dragon Centre and to agree the phasing, procurement and wider delivery strategy for the development.

Development Approach

7. The Red Dragon Centre (RDC) is a leisure development with associated surface car parking. The scheme is anchored by a cinema, a bowling complex, a casino and a number of bars and restaurants. It currently extends to 176,607 sq ft and produces annual rental income as outlined in Confidential Appendix 1. The total site comprises circa 13 acres. The Red Dragon Centre is owned in its entirety by British Airways Pension Fund (“BAPTL”).
8. Working with the Council, Reef has produced an outline development strategy and appraisal for the site, which is set out in Confidential Appendix 1. In summary, the proposal is to build a new public Multi Storey Car Park (MSCP) to be located on the area of the current surface overflow car park to consolidate all of the car parking requirements onto one smaller plot of land. This will release the site of the existing main surface car park for development. A new leisure/retail complex will be constructed in this area and will enable the relocation of existing tenants as well as attracting new leisure and retail tenants. This replacement for the RDC will free up the site of the existing RDC building to enable the development of the new Indoor Arena by the Council, fronting Lloyd George Avenue and the Oval Basin. The potential to incorporate the site of the existing County Hall surface car park as a second phase has also been considered in high-level terms. This would require a second MSCP to be constructed within the extended development, once again free-up existing surface car park land for development. This exercise has been undertaken simply to demonstrate the potential to expand the capacity of the development in the future and to consider any associated marriage value that could potentially be realised by the Council without necessarily needing to redevelop County Hall. At present the second phase proposal has no status and would require the relevant Council approvals before being able to be properly considered. An early illustration of the proposed phase one scheme is contained within Confidential Appendix 1, alongside an illustration of the future potential that could be realised through a phase two.
9. There are a number of potential funding options available to the Council to enable the acquisition of the site and the delivery of the new Indoor Arena.

All of these options will need to be explored in substantial detail to establish the Council's best value approach, before taking a formal decision to proceed with the project in March 2019.

10. It is proposed that the Council will fund the acquisition of the site and the development of the new MSCP. Reef will fund and deliver the replacement for the RDC consisting of circa 200,000 sq ft. This will free up the site of the existing RDC building for delivery of the new Indoor Arena. Reef will be obliged to acquire the site of the new retail development from the Council at an agreed price, which will generate a contribution to the cost of the arena.
11. Ongoing due diligence on the RDC site follows on from the site selection/appraisal exercise reported to Cabinet in February 2018. This work concluded that the Atlantic Wharf site in Cardiff Bay, incorporating the RDC site and the County Hall site, represents the best all-round opportunity, and is the preferred location for a number of reasons including alignment with the city development strategy, the scale of the site and its ancillary development potential, the location at the heart of Cardiff Bay, and the willingness of the owner to participate in a wider redevelopment scheme.
12. It is recommended that a detailed feasibility study on the RDC site should now be completed to enable a formal decision by Cabinet in March 2019. Whilst the RDC site is clearly the Administration's preferred location, in the event that the due diligence prevents the development from being able to be progressed at this site, the Council would then need to consider an alternative site which would result in an element of abortive costs as outlined in Confidential Appendix 4.

Indoor Arena Delivery

13. Specialist advisors Mott MacDonald have provided advice on the latest innovations and trends in the Arena market and will work with the developer and the Council to identify sustainable revenue streams and to negotiate a lease for the operation of the new Arena. An interim summary report has been provided in Confidential Appendix 2 to provide examples of the costs associated with the construction of recently delivered Arenas in the UK and Europe and to provide interim advice on the Council's proposed budget for the delivery of an Arena in Cardiff.
14. Whilst the Council's indicative budget is regarded as sufficient (as set out in Confidential Appendix 2) the final cost will ultimately depend on the agreed specification of the building and the level of income that can be generated, primarily through a long-term lease agreement with an operator. At this stage in the process, the affordability of the development is based on a capital contribution from the Council of £30m from within existing allocated capital budgets and earmarked future capital receipts, as well as assumptions relating to the estimated value of the proposed operator lease, and other potential sources of capital realised through the redevelopment of the Atlantic Wharf site. All of these budget assumptions will need to be confirmed before a final decision is taken by Cabinet. Suffice to say, at this

point in the process, Mott MacDonald is satisfied that the Council's budget assumptions are reasonable.

15. A crucial factor in the successful delivery of Arena projects is the choice of commercial operator. It is an absolute pre-requisite that the operation of the Arena will be managed commercially without Council subsidy. This is the normal situation in the UK. As Cabinet would expect, there has been significant interest in the project from numerous arena operators in the UK and beyond.
16. The Council has also been approached by Live Nation, the current operator of the Motorpoint Arena, seeking to expand their existing capacity in the city. Live Nation is a significant operator in the UK market in their own right and one of the world's leading event promoters. Live Nation's incumbent position in the local market gives them a degree of competitive advantage in terms of competing for the operator lease. In particular, the on-going operation of the existing Motorpoint Arena would inevitably have an impact on the revenue potential of the new Arena. Live Nation has confirmed in writing (see Confidential Appendix 3) that they will cease to operate the existing arena if they are successful in securing the operator lease for the new Arena. They have also confirmed that they will terminate their leasehold interest in the Motorpoint Arena site, the freehold interest of which is held by the Council, to enable the Council to dispose of the site to generate a capital receipt towards the new Arena project. Nonetheless, the Council will need to demonstrate that the award of the lease to the operator of the Arena represents value for money and is State Aid compliant and will therefore be required to undertake a tender exercise in respect of the proposed lease.

Issues

17. It is intended that the detailed business case and delivery strategy requested by Cabinet in February 2018 will be presented to Cabinet in March 2019. It is at that point that the full due diligence to enable a final decision will be presented both in terms of the delivery of the new Indoor Arena, and the affordability, deliverability and value for money of the preferred location.
18. In order to prepare for a Cabinet decision, Reef will need to confirm their current commercial assumptions for the replacement RDC through the delivery of a series of Agreements to Lease that will confirm the development appraisal and demonstrate vacant possession of the existing building. As existing Asset Managers of the RDC, Reef is best placed to manage the transition of existing lease arrangements into the new RDC. The current masterplan will also need to be developed to the point where plans are ready to be submitted for consideration by the Local Planning Authority (i.e. to RIBA Stage 3). This will enable detailed cost analysis to be undertaken with certainty.
19. Confidential Appendix 4 sets out the level of expenditure that needs to be undertaken between now and March 2019 to get the Council to a position of greater certainty in terms of the costs, risks and opportunities associated

with the delivery of the Indoor Arena; as well as the justification for proceeding with the project at the preferred location.

20. As the Council is unable to provide Reef and BAPTL with certainty until March 2019, Cabinet is requested to authorise the underwriting of costs to be incurred by the Developer and Landowner between now and March 2019. If the scheme proceeds, these costs will be absorbed by the development. However, if the Council takes a decision not to proceed with the project on this site, there is an element of site specific costs incurred that will be abortive as outlined in Confidential Appendix 4. In addition to underwriting costs, the Council will also need to incur costs associated with the appointment of independent advisors to undertake due diligence also set out in Confidential Appendix 4.
21. Given the level of costs the Council is being asked to underwrite at this point in the process, and the fact that some of these costs could potentially be abortive, Cabinet needs to have confidence there are no fundamental impediments that could stop the project from proceeding should a decision to proceed be taken in March. In particular, Cabinet will need to be satisfied that the development of the Arena on the RDC site is deliverable and that the site itself can be secured on a value for money basis. To that end, CBRE Ltd has been appointed by the Council to provide independent valuation advice and to review the outline development proposal provided by Reef.

Development Appraisal

22. The work undertaken by CBRE presented in Confidential Appendix 4 also includes a review of the Reef development proposal for the new RDC. In particular, the work provides a review of the receipt the Council (as would-be landowner) will receive to off-set against the cost of acquiring the site and supports the validation of the purchase price. In addition, CBRE has provided an independent review of the proposed pre-development costs that need to be underwritten by the Council in advance of the Cabinet decision in March 2019 to enable the scheme to be progressed and full due diligence to be undertaken.
23. Cabinet should note there will be a significant amount of further work undertaken by the Council, and its appointed consultants CBRE and the wider appointed team, to test the latest cost assumptions to ensure the best possible due diligence is available to support the decision to be taken by Cabinet in March 2019. It should be noted that the success of any construction and/or development is dependent on many factors that the Council and/or its consultant team cannot control such as market conditions; economic events and market / operator appetite. As such, the only way to understand what the actual costs might be is to engage a team and prepare designs / specifications / output requirements to a suitable stage in order that competitive cost feedback and/or tenders can be obtained from the construction and operator markets. Following this work, the proposal will also be ready to be submitted for planning approval.

Procurement

24. The Council also needs to be satisfied that it's dealings with third parties (such as Reef in this case) comply with the Council's standing orders and procurement and contracts rules and regulations. In regards to Reef specifically, BAPTL has confirmed in writing (attached as Confidential Appendix 5) that Reef are retained as their development partner with exclusive rights in regard to new RDC and their involvement in the future development of the site is a condition of the sale. The Public Contracts Regulations 2015 provide that a contracting authority can contract with an entity that has exclusive rights without competition.
25. With the exception of Reef, given their exclusivity with BAPTL, the Council will ensure all members of the professional team; contractor(s) and operator(s) will be competitively procured via a tendering process that demonstrates value for money. CBRE, acting as the Council's advisors, will ensure compliance with procurement rules / best practice / tendering and will work with Reef in regard to the new RDC to ensure suitably qualified and experienced organisations are engaged via an approved process. It should be noted that all appointments will be made following industry-accepted public procurement processes and EU Procurement Regulations where they apply.

State Aid

26. As with any development of this nature, the Council will need to be satisfied that its investments in support of this project does not constitute State Aid.

Developer Capability

27. CBRE has reviewed Reef's financial standing and credentials as a development partner for schemes of the scale and nature of the new RDC. There is no reason, based on the information received, why Reef aren't to be deemed competent, experienced and capable of working with the Council in this regard and therefore Cabinet should be assured that the proposed team is ideally placed and capable to deliver the outcomes of the project.

Next Steps

28. Officers are proposing that, once approval is given to this report, the appointed team do all the necessary work to build a detailed business case and present a further report to Cabinet in March 2019 with a view to a planning application being progressed in readiness for submission in July 2019.
29. As part of this, the Developer will begin to engage with existing tenants of the RDC; potential new tenants; and the Car Park operator with a view to establishing a series of Agreements for Lease that demonstrate development viability as part of the business case.

Reasons for Recommendation

30. To enable the required due diligence to test the value for money of the Council's preferred site and proposal for delivery of a new Indoor Arena and to progress work towards a final decision on delivery strategy for the new Arena in March 2019.

Legal Implications

31. Cabinet members need to take account of the following when considering the recommendations contained in this report:
 - (a) The need to obtain value for money pursuant to the Council's fiduciary duty to the local taxpayers.
 - (b) The need for independent valuation advice in regard to the proposed acquisition of the Red Dragon Centre site in terms of there being no State Aid in favour of the existing landowner.
 - (c) The procurement and tendering arrangements which are being proposed including the "exclusive rights" of Reef in regard to the Red Dragon Centre redevelopment.
 - (d) The external advice provided in relation to initial projected costs and values and the need to demonstrate prudence in regard to Council borrowing and funding for the purposes of the Local Government Act 2003.
 - (e) There can be lawful State Aid in relation to the cost of arenas provided that:
 - (i) there is a need for additional capacity for sports or cultural events or a new arena is complementary to existing facilities.
 - (ii) there is no practical alternative to the construction of a new arena for the purpose of increasing the number of events (sporting and cultural) that can take place in an area or for the purpose of increasing the number of spectators.
 - (iii) public co-financing is limited to the amount strictly necessary for the project to be realised.
 - (iv) the arena is multifunctional and open to any user on non-discriminatory terms.
 - (v) the effect on trade and competition is limited by keeping the project to an appropriate size for the area or the arena is located far from international borders.
 - (vi) excessive investment aid or any operating subsidy is unlikely to be acceptable.

Financial Implications

32. Contained within this report there are two appendices, which between them provide independent advice and a high-level review of the development proposals submitted in order to provide a degree of independent and constructive challenge to the assumptions, inclusions and exclusions contained within the appraisals. Whilst, not restricted to these matters specific consideration is given to income potential, profit allocation between respective parties.
33. Contained within the confidential appendices is the total estimated cost associated with due diligence, design and pre-development costs to be incurred in association with the financial cap. The Council will need to ensure that these due diligence costs, including those incurred by Reef, are justifiable and provide good value for money before committing to fund these, paying particular attention to the independent professional advice received on appraisal costs shown in confidential appendix 4. The funding source for these costs have been identified from a reserve and in the event of a decision not to proceed with the development will result in a sum of abortive costs.
34. By March 2019 significant due diligence will need to be undertaken to provide confidence to Cardiff Council, Developers, Investors and Operators that the overall development is deliverable and represents good value for money for all parties. This will need to include the production of a detailed business case and delivery strategy with robust projections for expenditure including site acquisition, constructions costs and professional fees as well as being supported by achievable valuations and income streams projections.
35. In building up the Business case, consideration needs to be given to the robustness of the identified funding source in terms of both risk, likelihood and quantum. The Business case will also review the profiling of cash inflows / outflows, the life of the asset created against the length of the debt repayment schedule, the robustness of rental / capital values, the appropriate basis of indexation for both costs and income, the allocation of risk across all phases of the project. Contained within the business case there will be a section carrying out sensitivity analysis in order to ensure that there is a level of mitigation against optimism bias.
35. Whilst the final construction costs paid will reflect the final specification of the Indoor Arena building, Appendix 2 provides independent assurance that the identified budget for the delivery of the Indoor Arena, 'whilst at the mid to lower end of the scale, is a reasonable assumption' at this stage.
36. The business case will provide clarity on any VAT, SDLT issues, cost of procurement, Public realm costs (on-going maintenance) and Value For Money in respect to Arena operator and developer relationships.
37. As highlighted in the body of the overall report, the funding identified is partly reliant on disposal of capital receipts yet to be realised. This

combined with the level of income to be generated through the life of the development highlights a key risk of affordability that needs to be fully understood before progressing to a final decision.

38. A base budget provision of £1.5m is already in place to fund the annual revenue costs of borrowing associated with the Indoor Arena. Based on current PWLB rates in October 2018, this base budget would be sufficient to cover circa £36.5 million of borrowing over a 45 year period. However, this budget is currently being used to fund debt repayments on Dumballs Rd acquisition, which further highlights the importance of the realisation of said capital receipt in the near future.

RECOMMENDATION

Cabinet is recommended to:

- (i) Note progress on securing the Council's preferred location for delivery of the new Indoor Arena project.
- (ii) Agree to meet the Council's due diligence costs and underwrite the design and pre-development costs to be incurred by the Developer and Landowner as estimated in Confidential Appendix 4 and in accordance with the financial cap and processes also outlined in Confidential Appendix 4.
- (iii) Delegate authority to the Director of Economic Development in consultation with the Cabinet Member for Investment and Development and the Section 151 Officer to deal with all aspects of the procurement of independent advisors as set out in Confidential Appendix 4.
- (iv) Delegate authority to the Director of Economic Development in consultation with the Cabinet Member for Investment and Development and the Cabinet Member for Finance, Modernisation & Performance, the Section 151 Officer to explore the best financial approach to deliver the project and to present details back to Cabinet as part of the arena business case and delivery strategy in March 2019.

NEIL HANRATTY
DIRECTOR OF ECONOMIC DEVELOPMENT

Appendices

1. CONFIDENTIAL Developer's Proposal
2. CONFIDENTIAL Mott MacDonald Arena Report
3. CONFIDENTIAL Live Nation Letter
4. CONFIDENTIAL CBRE Independent Valuation Letter and Appraisal

5. CONFIDENTIAL BAPTL Letter