5. BEDFORD ROW – EQUITY ISSUES

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The purpose of this report is to present potential mechanisms on "the concept of the Council taking an equity interest in projects rather than making cash grants" and seeks resolution on a method to be adopted for the refurbishment of the building in Bedford Row owned by Off Shore Holdings Ltd.

BACKGROUND

At its meeting on 27 May 2004 the Council considered a report from this Committee on a request from Mr Denis Harwood on behalf of Off Shore Holdings Ltd seeking funding of $150,000 to assist in the refurbishment of the Bedford Row buildings owned by the company. The allocation of funding of $105,000 was also sought for street improvements on the south side of Bedford Row. The Council resolved:

1. *"That Council agree, in principle, to the streetworks expenditure and financial assistance to Mr Harwood for the same amounts and subject to conditions to be negotiated, including an expiry clause of 31 December 2004.*

2. *That $150,000 be sourced from the Central City Project Operational Account (2003/04).*

3. *That the Annual Plan Subcommittee be requested to consider whether to commit the additional funding.*

4. *That staff report on the concept of the Council taking an equity interest in such projects rather than making cash grants, starting with this project."*

Subsequently the Annual Plan Subcommittee reported to the 30 June Council meeting recommending:

1. *"(a) That $105,000 be allocated in the 2004/05 year for Bedford Row street improvements, with $70,000 to be brought forward from the Major Amenity Improvements Output (2205/06 projects to be identified line item) and $35,000 from the 2004/05 Urban Renewal Budget.*

   (b) That the work only proceed if the refurbishment of the buildings owned by the companies represented by Mr Harwood goes ahead.

2. *That the application for additional funding to assist refurbishment of the buildings owned by the companies represented by Mr Harwood beyond the $150,000 be declined."*

The above recommendation was adopted by the Council.

OPTIONS

This report is in response to part 4 of the resolution passed at the 27 May Council meeting. The options are outlined below:

Equity Interest in Assets

This would involve having an ownership status in either the land or the buildings. In this case, as with the majority of cases this option would be fraught with difficulties and would be hard to establish on an equitable basis, given that the owner would be taking all the risks.

Advantages

- Share in any capital growth.

Disadvantages

- Share in any capital loss.
- Creates ongoing liability in terms of maintenance, upgrade and replacement.
- Very difficult to set up and administer.
- Confusion over future roles and relationships.

Memorandum of Encumbrance

The encumbrance takes the form of a document registered against the title that sets out the rules and conditions for the granting of the money for restoration works and streetworks. This is the form of agreement that has been proposed for this project and discussed previously with the owner.

Advantages

- Easy to document.
- Conditions can be imposed to meet Council objectives.

Disadvantages

- Imposes constraints against the owner
- In this case, restricts the owner from altering or demolishing the building for 5 years, without repaying the money.
- Does not provide a return in terms of equity.

In this case there is a restriction on demolition for a period of five years included in the encumbrance agreement along with a requirement for the buildings to be 60% tenanted before the money is granted. The fulfilment of these requirements will achieve the outcomes desired by the Council.

Loan Arrangement

Providing a suspensory loan is an alternative to a grant. The loan could be written-off after a specified period of time if covenants are fulfilled with repayment of the full amount including interest should the covenants not be fulfilled. Covenants could include:

- No demolition for a set period of time.
- No selling the property for a set time.

Advantages

- Provides incentive to ensure delivery of outcomes.
- Provides protection of security where large sums of money are concerned.

Disadvantages

- Set up costs and administration of the loan.
- Restrains the owner from dealing with the property in a commercial manner.
- May restrict lending from other sources.
- Security risk as lowest ranked mortgagee.
- Does not provide a return in terms of equity.

Unless interest is charged this option does not benefit the Council and gives no further return than the encumbrance on the title.

ISSUES

The establishment of an "equity interest" in relationship to what is essentially grant funding contains some fundamental flaws. The difficulties arise in trying to translate the funding into an investment. Approaching funding applications in this nature poses very difficult and quite likely unpalatable issues in terms of:

- Establishing equitable arrangements around returns, risks and rewards.
- Appointment and creation of value/ownership
- Some assets/interests come with liabilities.

The Council in this case is not taking any business risk and therefore it is unreasonable for the Council to expect a return on any capital growth of the properties referred to within this report.

CONCLUSION

The proposal with Mr Harwood for Off Shore Holdings Limited includes terms within the agreement, which require the owner to use the grant solely for the purposes of strengthening and preservation of the building. The company also covenants that it will not demolish or remove, or permit to be demolished or removed, in whole or in part any buildings on the land within five years of the date on which the first payment of the grant is made by the Council to the owner. This agreement is recorded in a Memorandum of Encumbrance, which is currently under negotiation with the owner.

Having an equity interest, which provides a return on the money invested, is fraught with difficulties and would be very hard to establish given that the owner is taking the development risk. By requesting a return on the money in relation to any profit that the owner achieves we are also exposing the Council to any losses that may occur, as well as ongoing property ownership responsibilities.

In this particular project an equity interest which provides for a return on the money granted by Council would not work for the above reasons.

Staff Recommendation:

1. That the Facility Assets Manager and Legal Services Manager be delegated authority to conclude a Memorandum of Encumbrance and Agreement with the owner of 8-12 Bedford Row as generally provided for in this report and the previous Council resolutions.

2. That should agreement not be reached and documented by 31 December 2004, all Council support be withdrawn, and all previous resolutions relating to it be automatically rescinded.

Chair's Recommendation: That the above recommendation be adopted.