TEES VALLEY COMBINED AUTHORITY | TEES VALLEY MAYOR

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AGENDA ITEM 8

REPORT TO THE TEES VALLEY COMBINED AUTHORITY CABINET

11 SEPTEMBER 2020

REPORT OF CHIEF EXECUTIVE

ACQUISITION OF SOUTH TEES SITE COMPANY LIMITED BY SOUTH TEES DEVELOPMENT CORPORATION

SUMMARY

On 29th July 2020, the South Tees Development Corporation Board gave approval, for the Group Chief Executive, in consultation with the Mayor, Group Director of Finance and Resources, and Monitoring Officer to:

i. Conclude an agreement with the department of Business Energy and Industrial Strategy to acquire 100% of the share capital of South Tees Site Company ("STSC")
ii. Complete all due diligence, sign all documents, and complete all other actions required to give effect to this Report

The approval was contingent upon:

- Future approval by TVCA Cabinet to accept the funding from central Government and agree to the use of the Tees Valley Assurance framework to manage the STDC programme arrangements; and,
- STDC's business case to government to secure funding for the acquisition of STSC being successful

TVCA's approval for the acquisition is necessary at the request of government, as funding will be channelled into the STDC Group via TVCA and government departments will gain their assurance through the application of the TVCA assurance framework to the STDC programme.

The purpose of this paper is to provide Cabinet with details of the proposals regarding the acquisition of the South Tees Site Company and secure TVCA Cabinet approval to accept the funding from central Government and agree to the use of the Tees Valley Assurance framework to manage the STDC programme arrangements; thus giving effect to the earlier STDC board decision.

RECOMMENDATIONS

Subject to STDC's business case to Government being successful, TVCA Cabinet is, recommended to approve: -

i. the acceptance of funding from central Government;
ii. the use of TVCA borrowing, within the appropriate Treasury Management limits set out at Appendix 1 and paragraphs 18-23;
iii. the use of the Tees Valley Assurance framework to manage the STDC programme arrangements.

This approval will lead to the: -

- Conclusion of an agreement between South Tees Development Corporation and the department of Business Energy and Industrial Strategy for STDC to acquire 100% of the share capital of South Tees Site Company Limited.
- Completion of all due diligence, signature of all relevant documentation, and completion of all other actions required to give effect to this Report

BACKGROUND INFORMATION

1. STSC is responsible for keep safe, security and decontamination of the former SSI assets situated on the STDC site and is wholly owned by the Department for Business Energy and Industrial Strategy ("BEIS"). STSC operates under the direction of the Official Receiver, who assumed responsibility for the former SSI steelworks site and assets following its liquidation in 2015.

2. The former SSI site is categorised as an "Upper Tier" site under the Control of Major Accident Hazards (COMAH) Regulations and presents a significant safety and environmental risk if not properly managed. STDC's compulsory purchase order and recent vesting declaration will bring this site into STDC group ownership, ending the Official Receiver's role on site and transferring responsibility for site management and safety to STDC. Accordingly, STDC intends to acquire STSC from BEIS to ensure continuity of safety critical site management operations.

3. STDC's business case to government to regenerate the STDC site assumes the redirection to STDC of any unspent funds earmarked by BEIS to support future activities of STSC (the "Redirected Funds"). The estimated value of the Redirected Funds reflected in STDC's business case submission is £71m of c £117m originally earmarked by BEIS to fund STSC's activities.

4. Accordingly, a successful outcome in relation to business case funding will be a key precondition of proceeding with the transition of STSC. The current timeline suggests that transition can take place in early October following a final funding decision by Government on STDC's business case in mid- August.

5. A copy of STDC's business case to government is included as Appendix 2 to this report for information.

TRANSACTION AND FUTURE GROUP STRUCTURE

6. The headline proposed terms for of the transaction are that STDC will acquire 100% of the issued share capital of South Tees Site Company Limited for nominal consideration, subject to BEIS assigning the Redirected Funds to STDC. More detailed contractual negotiations have yet to commence, pending completion of financial and legal due diligence exercises.

7. Post -acquisition STSC will become a 100% owned subsidiary of STDC retaining its own board drawn from a combination of existing board members (several of whom also currently sit on the STDC board) and new appointees to fill gaps left by any exiting BEIS appointees.

8. STDC Board will ensure all the necessary detailed governance arrangements are in place to integrate STSC into the STDC Group structure on transition. Work is underway to develop detailed governance structures for the enlarged STDC group following the integration of STSC which will be considered by the STDC board in September.

ACQUISITION PROGRESS TO DATE

9. In anticipation of the transition of STSC into the STDC Group, the management teams of both organisations have worked together closely in recent months with STSC providing input into STDC's business case and the development of a joint approach to the decontamination and demolition assets on the former SSI site

10. In addition, integration at a senior management level has begun and STDC and STSC share a Chief Executive and STSC's Site Director sits as part of STDC's Senior Management Team as well as the newly established STDC Delivery Group which exists to monitor and manage progress against STDC's operational programme.

11. KPMG UK has also been engaged to provide financial and technical due diligence and to advise upon the most appropriate organisational and governance structures to effectively integrate STSC into the STDC group. These engagements are well progressed, and KPMG has provided an interim report to the STDC Board on 29th July which was considered as part of STDC's decision to proceed with the acquisition of STSC. Copies of these interim reports are included as Appendix 3.

12. Legal support has been instructed in connection with the transaction and a process of legal due diligence has commenced. This work will cover all the appropriate legal actions arising from the KPMG UK due diligence reports.

13. Whilst several risks have so far been identified in relation to the acquisition of STSC, no significant issues have been identified that were not already known or anticipated by STDC's Board and management team. These risks have been logged and mitigation strategies and action plans are being put in place.

14. Key risks identified cover the following areas:

15. **Increased operating/ EHS risk** – The operations of STSC are inherently risky given the nature of the assets and site managed. This risk is being assessed and mitigated through technical due diligence work and planning (supported by the work of KPMG) to ensure appropriate governance and oversight of STSC's operations post acquisition.

16. In addition, an STDC group-wide review of insurance is being undertaken to ensure that the financial impact of any future unforeseen events is limited as far as possible.

17. It is also important to consider that environmental, health and safety risks arise because of site ownership and cannot be avoided if STDC wishes to take over and regenerate the former SSI steelworks site. Accordingly, from the overall STDC group perspective the acquisition of STSC is considered the most appropriate risk mitigation strategy given the years of experience the STSC team has of managing the former SSI assets.

18. **Financial/funding** - The principal financial risk linked to the acquisition is the adequacy and flexibility of funding to ensure, where possible, STDC is not exposed to unforeseen costs or a shortage of funding. These risks are being addressed through appropriate due diligence, consideration (and where appropriate) renegotiation of certain commercial agreements and appropriate structuring of the funding and payment mechanism from central government into STDC. The funding from Government has been reflected in a draft memorandum of Understanding that is currently being finalised with STDC management team. This incorporates advance funding to enable operational activity, flexibility to reprofile funding to reflect the complex nature of the site and the full sums set out in the preferred option within the full business case.

19. KPMG is also due to commence a third work stream which will undertake a zero-based budgeting exercise designed to ensure that resourcing post acquisition is appropriately planned and allocated. This activity will ensure the delivery of services by STSC post transition remain value for money. These specific financial risks, along with other key risks related to the transition of STSC have been captured in a transaction specific risk log which is attached at Appendix 4. Risks are presented alongside key mitigating actions.

20. The full programme business case also includes a financial model over 40 years with detailed modelling assumptions reviewed by both MHCLG/BEIS, Government independent assurance teams and Investment Committee. This model is predicated on initial government regeneration funding to decontaminate and demolish assets and remediate the site. This funding enables STDC to simultaneously secure leasehold income, with strong covenants.

21. Once leases are secured STDC, will seek to realise the value inherent in the lease up-front through an "income strip" or similar transaction (preferred) or by accessing secured borrowing. This will provide an investment fund to deliver the ongoing development of the whole site. This model was also considered at the public CPO inquiry in April 2020 where the Planning Inspector confirmed the CPO without modifications and was satisfied that the model demonstrated a robust and comprehensive funding plan for the site.

22. Whilst the income strip model (where lease income is assigned to a third-party investor in return for an up-front capital sum payable to STDC) is the preferred commercial approach to financing projects as parcels of the site become investor-ready, financial modelling assumes that all non-Government/non-TVCA funding is borrowed. This establishes as theoretical maximum borrowing requirement for the STDC programme which has in turn been tested against TVCA Group borrowing limits (set out for the medium term in Appendix 1a). The analysis indicates that, as modelled, the group has the required borrowing capacity over the medium term without the need to call upon further Investment Plan funding from TVCA. If, due to an unforeseen issue or event,

STDC were required to call upon further TVCA investment plan funding this would be subject to a referral decision to TVCA cabinet.

23. Where required, borrowing will be drawn down on the basis of robust business proposals that will be taken to STDC Board and will remain within the limits set by TVCA Cabinet as part of its own Treasury Management Strategy and as set out at Appendix 1b to this report. STDC Board borrowing decisions will also require the approval of the STDC statutory officers as part of this decision-making process

24. The funding set out within the business case includes split of business rates 50:50 with Redcar and Cleveland Council as part of the implementation of Special Economic Area status. The implementation of the necessary legislation for this status is currently in progress with MHCLG engaging with STDC and Redcar and Cleveland Council to put in place the necessary information to enable a statutory instrument to be passed and given effect from 1 April 2021. The legislation has already been agreed by the MHCLG Secretary of State.

25. **Programme and performance management**- also present a significant risk in relation to successful decontamination of the former SSI assets by STSC and in this regard steps have been taken to ensure performance is properly appraised by the creation of the STDC delivery group, which draws together the senior management of STDC, STSC and private sector delivery partners to oversee and drive the programme from an operational level. TVCA will also monitor overall programme performance through its assurance framework (see below).

POST ACQUSITION ASSURANCE AND MONITORING

26. To provide ongoing assurance a separate STDC Programme Assurance Framework has been developed by TVCA encompassing all aspects of the STDC programme including the post transition operations of STSC. This includes a full monitoring and evaluation plan which has been agreed with government.

27. A copy of the STDC's Programme Assurance Framework is included as Annexe 6.3 of STDC's Business Case to Government (See Appendix 2).

FINANCIAL IMPLICATIONS

28. The main financial implications associated with this report are set out in the body of the report.

29. Implementation of the recommendations of this report requires TVCA to manage receipts and payments of central government funding allocations and the requirement to resource this process.

30. Funding for the post acquisition activities of STSC and those of the wider STDC group has been secured through existing allocations from within the TVCA investment plan alongside additional central government funding secured through the recent business case to government. Ultimately, these funds will be used to ensure that STDC site is remediated to a level such that the commercial activities of STDC and its delivery partners will support the ongoing management of the site.

31. Whilst significant funds have been allocated from these sources and the intention is that future investment will be funded through private sector investment and borrowing, largely secured against income streams from tenants (as described in paragraphs 21-24), there may also be a need to borrow in advance to address specific cashflow requirements. The source of any borrowings will need to be assessed by Statutory Officers as required to comply with the Prudential Code, meet obligations and ensure value for money.

32. Borrowing will be in line with the agreed TVCA Treasury Management Strategy limits set for STDC. The STDC Board will manage the arrangements for borrowing within these limits and subject to the normal prudential borrowing requirements in terms of affordability and sustainability.

33. The implementation of the necessary statutory instrument in respect of Special Economic Area status is an important element of the funding associated with the business case and work is ongoing with MHCLG, STDC and Redcar and Cleveland Council to implement this for an effective date of 1 April 2021.

LEGAL IMPLICATIONS

34. Further to s201(1) the object of STDC is to secure the regeneration of its area. STDC has powers to pursuant to Chapter 2 Section 201 (2) of the Localism Act 2011 to “do anything it considers appropriate for the purposes of its object or for purposes incidental to those purposes”.

35. Article 4 of the Tees Valley Combined Authority (Functions) Order 2017 specifically applied Chapter 2 Part 8 of the Localism Act 2011 to the Tees Valley Combined Authority, and enabled the South Tees Development Corporation (Establishment) Order 2017 by virtue of those powers.

36. Paragraph 4a of the STDC constitution describes STDC’s principal objective which is “To further the economic development and regeneration of the South Tees area, so that it becomes a major contributor to the Tees Valley economy and the delivery of the Tees Valley’s Strategic Economic Plan”.

37. In accordance with paragraph 25 of its constitution STDC is also empowered to “do anything it considers appropriate for the purposes of securing the regeneration of its area, or for purposes incidental to that objective”” which includes the power “To form or acquire interests in any business or company” (Para 26.e.ii).

38. These powers enable STDC to enact the acquisition of STSC.

39. The implementation of the necessary statutory instrument to give effect to Special Economic Area status form 1 April 2021 is in progress.

RISK ASSESSMENT

40. An outline of the key risks of the STSC acquisition to the STDC group are included in paragraph’s 15 to 25 and a log of STDC’s specific risks related to the acquisition of STSC is included as Appendix to this report. This log also summarises the mitigation strategies that are being implemented to ensure these risks are brought to an acceptable level

41. Risks directly attributable to TVCA are principally reputational through association should STDC's acquisition of STSC and/or the wider STDC programme fail to deliver the outputs required over the coming years.

42. Underlying this reputational risk is the commercial risk linked to STDC's ability to find appropriate end user tenants for the site within the timescales necessary to meet delivery milestone. In particular, (following the regeneration phase funded by central government) STDC's financing model is predicated on realising up-front value from leasehold tenants. This brings the risk that finance may be constrained if tenant take up is slower than anticipated or agreed commercial terms do not align with current financial modelling assumptions. Should this risk crystallise STDC's risk management strategy would be to rephase the programme to align activity with available finance. Should any decision require additional funding support over and above what STDC has from Government/TVCA and is able to generate from leaseholders this would require a referral decision to TVCA prior to any decision being taken.

43. TVCA's mitigation strategy in relation to these risks has been to incorporate the STDC programme as a strand within the TVCA assurance framework. A bespoke framework and monitoring plan has been developed and dedicated resource will be allocated to monitoring of STDC's performance. This should in turn ensure any emerging issues in relation to outputs or financing are identified in good time and managed to ensure the minimum possible impact

44. Commercial risks are specifically addressed through STDC's chosen approach of partnering with experienced private sector operators through the Teesworks Limited Joint Venture. These delivery partners bring significant experience of commercialising regeneration sites and negotiating lease financing arrangements. Accordingly, their involvement, alongside the current pipeline of investor interest and significant work already undertaken to benchmark commercial assumptions during STDC's planning and modelling phase, have given STDC's Board and wider government stakeholders assurance that the plans for the STDC site can be delivered within the delivery and financing parameters that have been set in the business case.

45. The above risks are considered unavoidable without potentially compromising the impacts and outputs from regeneration of the former SSI steel works site with alternative courses of action being either:
    - **Not to proceed with the regeneration of the former SSI site** – and thereby losing a significant proportion of the STDC programme outputs and impacts and missing an opportunity to access significant amounts of central government regeneration funding; or,
    - **Making arrangements other than the acquisition of STSC to manage the risks inherent with the former SSI site** – which is considered unacceptable given the need for continuity of site management and the significantly increased risk and costs associated with a potential transfer of these responsibilities.

CONSULTATION & COMMUNICATION

46. The STDC Masterplan was consulted extensively prior to approval. The successful CPO process to acquire the necessary land to deliver the masterplan included engagement with landholders, stakeholders and led to the public inquiry that concluded with a positive planning inspector decision on 29 April 2020.

47. The recommendations contained in this report form part of the required implementation steps to move the STSC site management resources into local control alongside the local control of land across the STDC area.

48. A detailed report concerning the acquisition of STSC, including funding considerations, risk and governance alongside initial feedback from external due diligence providers was presented to STDC board on 29 June 2020 resulting in their approval of the acquisition subject to confirmation of funding and TVCA board approval

EQUALITY & DIVERSITY

49. No specific impacts on groups of people with protected characteristics have been identified

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