



WALES **AUDIT** OFFICE
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City and County of Swansea

Celtic Marine lease negotiation

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Status of report

No responsibility is accepted in relation to any officer, member or any other person in their individual capacity or any third party

The PwC team that assisted me in preparing this report comprised Kevin Williams and Sophie Taylor, with input from a specialist property team.

Anthony Barrett
Appointed Auditor of the City and County of Swansea
Wales Audit Office, 24 Cathedral Road, Cardiff CF11 9LJ

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Background

1. The Waterfront area at Swansea Marina has seen significant residential development in the last decade and has been allocated in the City and County of Swansea's ("the Council") Unitary Development Plan as an area where they intend to maximise the number of new homes.
2. The Swansea Marina (West) Storage Yard ("the premises"), located within the Swansea Marina, is owned by the Council and is leased to Celtic Marine Instrumentation Limited ("Celtic Marine"). Celtic Marine has occupied the premises since 16th March 2001 following the assignment of two separate leases that, taken together, comprise the premises that is currently used by the tenant to operate a boatyard and repair service business. The two leases were each of 10 years commencing in 1992 and 1997.
3. In 2006, Celtic Marine expressed an interest in investing in the site to enhance the facilities to support its ongoing commercial activities and sought an extended lease term to provide a longer period to benefit from the intended investment. Following negotiation, in November 2006 Celtic Marine was granted a five year Agreement to Lease ('the Agreement') by the Council. This required Celtic Marine to complete a schedule of works to the satisfaction of the Council, at which point it would be granted a 99 year lease in order to secure its business interest over the longer term.
4. In 2009 Celtic Marine entered into discussions with the Council regarding its plans for the incorporation of residential units and commercial space into the site. In order to meet the requirements of potential development partners, Celtic Marine requested that the lease to be granted on completion of the schedule of works referred above be increased to a term of 250 years, and that provision for residential use be made within the lease. Notwithstanding the reference to residential use within the lease, Celtic Marine will be required to obtain planning permission for any proposed development in accordance with the Council's normal planning application process.
5. Member and officer consultation took place in relation to the amendment of the lease terms, considering the increase in value of the property, which would occur should residential units be included on the site.
6. Comparison with similar residential schemes was done to structure a lease agreement whereby the Council would continue to receive rental income from Celtic Marine and, potentially, additional capital payments ("overage"), which would be based on future sales of residential units, should the envisaged development proceed.
7. The decision to amend the lease terms was made through delegated officer powers by the Head of Corporate Property in February 2010, and the lease was signed on 3rd October 2011.
8. The Council has recently received a planning application for the site from Celtic Marine. This includes residential and retail units and provides for continued use by Celtic Marine in the conduct of its business.

Objectives and approach

9. The key objectives of our review which relate to the lease dated 3rd October 2011 are as follows:

- Consideration of the governance arrangements in place, including whether the decision of February 2010 was made in line with the Council's constitution;
- Consideration of the rationale for extending the lease term, and whether alternative options were considered;
- Consideration of the lease terms negotiated by the Council, and whether they represented good value to the Council;
- Consideration of the Council's responses to related Freedom of Information requests and other correspondence.

10. As the planning application for residential development of the land in question is currently being considered by the Council, we have not included examination of the application or the process of approval within the scope of our review.

11. We have conducted our work by reviewing documents relating to the lease agreement, and interviewing key members of staff involved in the negotiations. We have also received information from and met with members of the public. We have taken into account the information provided by these individuals in determining our findings.

Conclusion

12. The evidence provided to us during the course of the review has led to the following conclusions, in the 4 key areas covered by the review:

Area	Conclusions
Governance	The Council followed its documented procedures in granting the lease dated 3 rd October 2011. The decision was taken by officers under delegated authority as the value of the transaction was assessed to be less than £500k. However, whilst we have concluded that this valuation lies within a range of potential values that we consider to be reasonable, relatively modest changes to the underlying assumptions would increase the value to more than £500k, resulting in the need to report to Cabinet and obtain Cabinet approval. In such circumstances, it may have been more prudent not to rely on delegated powers.


Area	Conclusions
Lease duration	<p>The lease was granted based upon an assessment that Celtic Marine had a statutory right to the grant of a new lease at the expiry of the existing lease and we have concluded that this assessment is supported by appropriate evidence. In addition, other options were considered by officers of the Council but were reasonably dismissed as not appropriate in the specific circumstances.</p> <p>The 250 year term of the lease is not out of line with common practice for a development of the nature envisaged within the lease dated 3rd October 2011 and, as such, we do not consider it to be unreasonable.</p>
Revised terms	<p>The revised terms of the lease provide an 'upside' to the Council should property market conditions improve and the sale proceeds from the proposed apartments increase over and above the prices assessed to be achievable in 2011. We have identified nothing to suggest that the other revisions made to the lease agreed in 2006 are anything other than the result of negotiation between Celtic Marine and the Council or that the Council failed to achieve good value in granting the 2011 lease. We also note that the revised lease does not take into account any potential additional costs associated with the residential development in order to retain the functionality of the boat yard.</p>
Freedom of Information requests	<p>The Council has utilised the 'commercially sensitive' exemption when responding to the Freedom of Information requests received, it has responded to two out of three requests within the timeframe required and responded in full to all other correspondence received.</p> <p>The Council has, however, provided two pieces of inaccurate information in response to correspondence received.</p>

13. In summary, we have identified nothing which we believe to be unreasonable in respect of the Council's grant of the 250 year lease in 2011 and we do not propose to take any further action in connection with this lease transaction.

Acknowledgements

14. I wish to express my appreciation to officers, Members of the Council and members of the public for their co-operation during my review.

Governance

15. Under the Council's constitution certain decisions are delegated to officers. The constitution sets out the procedures to follow in these circumstances. However, there are no specific requirements in the constitution relating to the extension of leases and the associated lease terms. Officers are subject to Contract Procedure Rules, which set out the financial limits applicable to transactions authorised by each officer within the Council.
16. Part 3, page 8 and 9 of the constitution states that:
The exercise of Executive functions by Responsible Officers in relation to the acquisition or disposal of property shall be limited as follows:
- a. *Acquisition of freehold or leasehold property (where a premium only is payable) up to £250,000;*
 - b. *Acquisition of freehold or leasehold property where a rent is payable – up to £50,000 per annum;*
 - c. *Disposal of freehold property or leasehold property (where a premium only is payable) up to £500,000 or for anything other than best consideration;*
 - d. *Disposal of leasehold property where a rent is payable – up to £50,000 per annum.*
17. In determining the process to follow in dealing with Celtic Marine's approach in 2010, the planning department applied a value test (per paragraph 16c) to assess whether it was appropriate to use delegated powers. It is not clear whether this was strictly required under the provisions of the constitution set out above but it is consistent with the department's normal practice when disposing of a significant (i.e. long term) interest in Council property.
18. The total value of the lease has been calculated by property officers as approximately , at which value it falls below the £500,000 threshold referred to in paragraph 16 above, allowing the Head of Corporate Property to make a delegated officer decision relating to the lease.
19. However, we note that the valuation is sensitive to changes in the assumptions used to determine the value, for example the discount rate used and level of overage payments assumed. We are of the opinion that the value calculated by the Council is within a reasonable range, albeit at the lower end. A range of potential values that straddle £500,000 could have been anticipated, which would have resulted in a requirement that the proposed transaction be reported to and approved by Cabinet.
20. We understand that there may be additional costs associated with the residential development in order to maintain the functionality of the boat yard (for example, the inclusion of soundproofing measures). Whilst this has been considered in development appraisal valuations, the initial valuation of the lease does not appear to take account of these costs.
21. Council officers are also required to consider the Contract Procedure Rules ("CPRs") included within the constitution when entering into property transactions. Paragraph 1.1.8

of the contract procedure rules states 'the acquisition and disposal of land and buildings shall be subject to Annex A of these CPRs'. The table below sets out the requirements of Annex A, along with our comments on compliance with the requirements:

Extract from the Constitution	Consideration
<p>In any dealings with land, proper regard will be had to the professional advice from the Head of Corporate Building & Property Services and/or the Head of Legal, Democratic Services & Procurement (as appropriate) at all relevant stages during the process. No disposal shall be proposed except in consultation with the Head of Corporate Building & Property Services.</p>	<p>Review of the documentation and correspondence relating to this deal shows that that the Head of Corporate Building & Property Services and the Head of Legal, Democratic Services & Procurement were consulted regularly during the process.</p>
<p>Procedures will be followed precisely so that due probity and accountability can be demonstrated and value for money achieved. Further and in order to provide for transparency and a proper audit trail, every Procedure step or decision taken under these rules must be recorded in writing and be available for inspection at any time by the Head of Legal, Democratic Services & Procurement and/or the Head of Finance.</p>	<p>Review of the documentation retained on this case shows that each stage of the process has been fully documented and the documentation retained. The file supporting the decision includes file notes, meeting minutes, reports and other correspondence which shows the decisions made by officers and the rationale behind these decisions.</p>
<p>In any disposals or acquisitions of land which do not fall within the delegated authority of responsible officers and have to be reported to Cabinet, the responsible officers shall consult with the relevant Electoral Division Members and any responses received from Electoral Divisions Members shall be reported to Cabinet. On any proposed disposals or acquisitions falling within the delegated authority of the responsible officers, the officers shall consult with Electoral Division Members where the proposal under consideration would involve a change of use in the land requiring planning consent. Any consultation required to be carried out under this paragraph shall be in writing (letter, e-mail or fax) and any Members consulted shall be given 7 working days in which to respond. If there is no response within this timescale it shall be assumed that the member has no comments to make. Responsible officers shall take any consultation responses received into account in making their decision</p>	<p>The Council invited all ward members to a meeting to discuss the proposed award of the lease, and a room was booked but no one attended or provided comments. The ward members were notified of the meeting in writing and given 7 days to respond per Council procedures.</p>

22. The Delegated Officer report was also approved by the then Leader of the Council, and the Cabinet Member for Economic Regeneration and Planning.

23. We also note that sufficient and appropriate documentation had been retained by the Council in support of their decision to extend the lease terms.

Decision to extend the lease terms

Consideration of options available

24. When reviewing the Council's decision to extend the lease to a 250 year term, we have considered the other options available to the Council in relation to this land, for example, refusing to grant the tenant a new lease.
25. The Landlord and Tenant Act 1954 ("the Act") Part II grants business tenants the statutory right to the grant of a new lease at the expiry of their existing lease. Under Section 25 of the Act the landlord can only refuse the grant of a new lease on one of the following conditions:
- The tenant is in breach of their repairing covenants;
 - The tenant is in rent arrears or has persistently failed to pay the rent at the time stated in the lease;
 - The tenant is in breach of their other lease obligations;
 - The landlord requires vacant possession of the area of the property so that they can let the property as a whole;
 - The landlord intends to demolish or re-construct the property;
 - The landlord intends to occupy the property themselves.
26. Celtic Marine was party to a 99 year lease based upon the 2006 Agreement at the time that the 2011 lease was granted, as set out in paragraph 38. Had that not been the case then Section 25 conditions would have applied at the expiry of the 2001 and 2002 leases.
27. To refuse the grant of a new lease on the basis of one of the conditions above at the end of an existing lease the landlord would need to serve a Section 25 notice and pay the tenant compensation. We have considered whether any of these six conditions would have been applicable in paragraphs 28 to 36 below.
28. We have confirmed that the first two scenarios did not apply to Celtic Marine.
29. In order to confirm whether the tenant is in breach of any other lease obligations, we have reviewed the terms of the 2006 agreement. There is a usage clause included, which specifies that the boatyard may be used for marine maintenance, storage, sales of marine chandlery and ancillary use. The site is not currently being used by the tenant as a boatyard and we have been told by members of the public that this has been the case since 2008.
30. Use clauses which impose a positive obligation on a tenant can be interpreted as implied 'keep open' clauses. The clause in question is an example of this and, therefore, to the extent that the tenant was not using the property for the required uses, there was a breach of the lease.
31. However, in our experience, the remedies available for breaches of this type of provision do not normally extend to lease termination. The courts would tend to award damages for the breach, although there would be a question of whether any loss was caused to

the Council as a result of the tenant not using the site, and of how any loss could be evidenced or quantified.

32. The fourth scenario does not apply, as Celtic Marine is in occupation of the whole property.
33. The Council had no interest in occupying the property themselves, and by doing so would lose out on rental income previously received from Celtic Marine.
34. Therefore, the only option available to the Council would be to demolish or reconstruct the site. There would be little economic benefit to the Council as a result of demolishing the site, and, as noted above, it would lose a previous source of rental income.
35. Were the Council to want to develop the land, for a Section 25 notice to be granted they would have to have evidence that a scheme had been prepared, have obtained planning consent and have funding in place. Otherwise, it is likely that the notice would have been challenged by Celtic Marine.
36. The Council would also have to pay compensation to Celtic Marine, and would have exposed themselves to economic risk through spending a great deal of money developing a site for residential accommodation with no guarantee of returns. Accordingly, we accept the Council's assessment of the risk involved in pursuing this approach.
37. Based on the above assessment, we have concluded that the tenant had a statutory right to extend their lease at the expiry of the previous lease term.

Consideration of lease term

38. We understand that the 250 year lease term was initially considered due to a request from potential developers, in order to provide them with the security they sought. The Council also noted that the 250 year lease term was a doubling of the previous lease term of 125 years. When we reviewed the documentation, it was apparent that the initial agreement to lease was actually for a term of 99 years rather than the 125 years stated in the delegated officer report. This was confirmed as an error on the part of the officer preparing the report. We do not consider this error to be of significance in the context of what was agreed.
39. We have been informed that the reason for the increase from the 99 year lease (as stated in the Agreement to Lease 2006) to the 250 year lease (as stated in the Lease dated 3 October 2011) was to allow Celtic Marine to grant sufficient length long leaseholds of the residential units (often these are 125 years).
40. While a 250 year lease is not a demonstrable industry standard, it is not uncommon for long leasehold agreements for development sites to extend to 999 years. In that context a 250 year lease is not considered to be unreasonable.
41. Council officers have advised that, currently, it is common for developers to request lease terms of at least 400 years.
42. We also note from discussions with officers that the Council were keen to pursue the opportunity to develop the land, particularly as this is in line with their Unitary Development Policy which states that SA1 and Lower Swansea Valley riverfront have

been designated as areas to support house building within the County and that the reintroduction of residential units will help to reinforce the image and role of Swansea as a 'Waterfront City'.

Consideration of additional lease clauses

43. When negotiating with Celtic Marine on the revised lease terms, the Council ensured that they incorporated into the agreement potential value enhancement from the residential development.
44. As a result of granting the lease the Council has been able to secure a rent increase from Celtic Marine.
45. As well as receiving rental income from Celtic Marine, the lease agreement provides the Council with additional capital payments linked to the number and price of any residential units sold should the development proceed.
46. The proceeds per unit expected to be achieved from the arrangement, as set out within the lease, was benchmarked by the Council against other recent developments which had been completed in the County, and was shown to be in line with these.
47. The lease negotiation process has therefore taken into account the potential increase in value inherent within the proposed development and the terms of the lease ensure that the Council will be appropriately rewarded for such increases.

Negotiation of revised lease terms

48. The 2006 Agreement to Lease provided for development works associated with the construction of a building for a workshop and administrative offices and yard for marine chandlery (the "Works") at Swansea Marina (West) Storage Yard (the "Site") to be carried out and completed within five years of the date of the Agreement. We understand that:
 - No substantive development of the Site has yet taken place; and
 - The present intention of Celtic Marine is to develop the Site as residential units or on a mixed use basis to include residential and commercial uses.
49. From review of the lease terms we noted that the obligation to grant the Lease under the Agreement only arises at the point of practical completion of the Works. The Works had a relatively limited and defined scope. However, the Agreement does contain provisions that allowed the Works to be varied with the Council's consent. These provisions were utilised when a revised schedule of works was agreed with Celtic Marine on 17th February 2010; the revised schedule was due to the change in the future plans for the boat yard (to include mixed use), and triggered the 99 lease in order to secure developer interest in the land. The revision was agreed by the officers within the surveyor department. Celtic Marine substantially completed the revised works in November 2010.
50. The lease to be granted was in an agreed form as annexed to the Agreement. However, there are substantive differences between the lease dated 3rd October 2011 and the version annexed to the Agreement. The more significant differences include:
 - Several restrictions in the lease, including the requirement to obtain consent to any structural alterations to the Site, have been limited in time to the first 25 years

of the term of the Lease, whereas previously they covered the entire lease period;

- The obligation to repair the Site has been limited to the first 25 years of the term of the Lease and does also not reflect the full repair covenant present in the agreed form lease;
- The permitted use of the Site has been significantly extended to include, amongst other things, residential and retail uses;
- Some of the rights reserved to the Council over the Site have been removed from the Lease, including the right to minerals in the subterranean part of it; and
- The right for the Council to forfeit the Lease, and re-enter the Site, in the event that covenants in the Lease are not observed (including payment of rent) is not included in the Lease.

51. It is not possible to terminate the Lease because it does not contain forfeiture provisions (see above). The Council also cannot rely on any statutory mechanism to terminate the Lease (including under the Landlord and Tenant Act 1954) until the end of the term of the Lease (which expires in 2261). To the extent that the items mentioned above contradict or do not comply with the terms of the Agreement, we have not identified any evidence to suggest that it was anything other than the result of a re-negotiation of the commercial terms of the transaction. The Legal Department and the Head of Service agreed the final legal documentation, including carrying out due diligence checks on the validity of the legal title prior to completing. The process involved an element of discussion and negotiation with Celtic Marine's solicitors to determine mutually agreeable terms.

52. Overage clauses have been included in the lease dated 3 October 2011. The overage clauses relate to the residential and commercial accommodation.

- *Residential:* The lease allows for a payment of [REDACTED] of the difference between the Agreed Values and the sale price of each residential unit (assuming that the leases granted are in excess of 25 years). The Agreed Values are specified within the lease.
- *Commercial:* For the convenience store overage, the payment calculation = (Enhanced Value less Base Value) x [REDACTED]. The Enhanced Value is market value of land with benefit of convenience store planning permission; Base Value is the market value of the land with benefit of A1 consent.

53. We have researched the average value of apartment sales in Swansea Marina and the comparable sale prices were approximately in line with the Agreed Values as at October 2011, i.e. the Council will only receive overage payment once the units have been sold if the residential market in this area improves such that sale prices increase. This is considered to be reasonable and protects the Council's position should the housing market improve.

54. As far as we are aware, convenience store planning permission falls within Use Class A1 of The Town and Country Planning (Use Classes) Order 1987, therefore there is currently no evidence of a difference between the two values specified; as such, at

present, it is not apparent that the Council will receive an overage payment relating to the commercial aspect of the proposed development. This overage clause does not, therefore, appear currently to benefit or disadvantage the Council.

Consideration of Freedom of Information requests and other correspondence

55. The Council has received three Freedom of Information requests in relating to the granting of the extended lease to Celtic Marine.
56. The requests received are summarised below:
- i) A request for information regarding the rationale for granting the lease extension, who authorised it and how much consideration was paid for the lease.
 - ii) A request for information regarding the number of leases which had been increased to over 250 years.
 - iii) A request for the names of individuals involved with authorising the lease extension, and a copy of the report relating to this decision.
57. In two of these instances, the Council provided only part of the information requested. Two items requested were considered to be exempt under section 43(2) of the Freedom of Information Act, as they related to information concerning the price that the tenant had paid for the lease.
58. Section 43(2) of the Act states 'Information is exempt information if its disclosure under this Act would, or would be likely to, prejudice the commercial interests of any person (including the public authority holding it)'.
59. The Council refused to release this information, as they considered that it would be likely to prejudice the commercial interest of the tenant by giving an indication of the price they would be prepared to accept for each unit of the property. This report has not considered the reasonableness of the use of these exemptions.
60. The Council has responded in full to all other elements of the requests received.
61. One instance was noted where the Council took longer than the required 20 working days to respond to the request. We were advised that this was due to the length of time needed to gather the information requested.
62. The Council wrote to the individual to advise of this delay in responding to the request.
63. In all responses to requests for information the Council has included appropriate guidance for the individual regarding the course of action they should take if they are not satisfied with the response received.
64. The Council has also received a number of letters and emails relating to the granting of the lease. Each item of correspondence has received consideration from officers within the Council, and has been responded to in a timely manner.
65. However, we noted two instances where information was provided in answer to a question which is inconsistent with our understanding of the circumstances. In a letter dated 9th February 2012, the Council asserted that the land was 'currently vacant'. However, discussions with Council officers have confirmed that the tenant was in

occupation of part of the site at this time, while trying to sublet part to assist in the payment of rent. In a further letter dated 5th March 2013, the Council stated that there were seven years remaining on the tenant's lease in 2005. This information was incorrect. The Council acknowledges that inconsistencies occurred due to a number of different officers handling the case, and has now put a process in place to ensure accuracy and consistency of responses.

Appendix 1

PwC team

- Kevin Williams (ACA)
- Sophie Taylor (ACA)
- Hywel Pullen (CPFA)
- Craig Davies (Chartered Surveyor and Registered RICS Valuer)
- Hannah Prideaux (Registered RICS Valuer)
- Peter Nicholson LLB (Solicitor)

Key client contacts

- Phillip Holmes (Head of Economic Regeneration and Planning)
- Lee Richards (Lead Development Surveyor)



WALES AUDIT OFFICE

SWYDDFA ARCHWILIO CYMRU

Wales Audit Office
24 Cathedral Road
Cardiff CF11 9LJ

Tel: 029 2032 0500

Fax: 029 2032 0600

Textphone: 029 2032 0660

E-mail: info@wao.gov.uk

Website: www.wao.gov.uk

Swyddfa Archwilio Cymru

24 Heol y Gadeirlan

Caerdydd CF11 9LJ

Ffôn: 029 2032 0500

Ffacs: 029 2032 0600

Ffôn Testun: 029 2032 0660

E-bost: info@wao.gov.uk

Gwefan: www.wao.gov.uk