BHT 23.07.2018

BHT submission re: Heads of Terms [HOT's] documents uploaded 17.07. 2018.to IWC planning website. TCP/11822/Y, P/00637/14

Dear Russell

You have highlighted some very valid concerns at CR1,2 and 3 that BHT share. The terms show a marked improvement on the applicant's approach in their May draft s106. However, there are still some large gaps and some new concerns raised by the applicant's drafting of these Heads of Terms.

- Unhelpfully the applicant leaves the demise ill-defined and seeks to set critical financial benchmarks wrongly and artificially and, yet again, to The Statutory Harbour, [BHIC]'s probable disadvantage.
- On the lease/sale terms the applicant proposes and the operating profits they declare in submissions, BHIC would immediately be made loss making, not made more sustainable.
- A s106 agreement based on these Heads of Terms [HOTs} would be flawed. Critical amounts of money for BHIC's improvement and debt reduction, required to comply with the committee resolution, would be wrongly set and/or left open to ongoing debate.
- Lease and sale contract terms and definitions and benchmarks must be tied down now before the s106 is completed. Otherwise, ongoing negotiations on the lease or sale contact, corrosive to BHIC's interest, can be anticipated after the s106 terms are fixed.
- The LPA, as we are sure they intend, must be robust in ensuring proper and independent valuations are referred to in HOTs and used in the application of the s106 clauses.
- The HOTs, if adopted as they stand, would add weight to a case for any legal challenge. A prospect that we believe both BHT and the LPA would wish to avoid through appropriate application of planning principles at this late stage.
- BHT remind the LPA that on the basis BHIC can afford to purchase, or lease at the levels suggested, it could fund the improvements directly. On the applicant's own disclosed terms there is no case to support the need for 13 Houses as "Enabling Development".

BHT COMMENTS VALUATION AND COSTS

Depressingly, this is the fourth time mis-information, illogical valuation methods, contrary s106 terms, misunderstandings (including on the DVS report) have been promoted or not been corrected by the applicant. On all occasions these have looked serve the financial interests of BIL the developer at the expense of BHIC the supposed beneficiary of the application.

Problem: Mr Thorpe's states (6th July 2017) that the average "Annual Operating Profits" of BHIC was £54,000. The rent or sale proposals look to increase BHIC costs by at least £ 80,000 to potentially well over £100,000 pa. The sale option potentially increasing BHIC indebtedness. On that basis, far from being financially helped, BHIC would be made loss making immediately and also potentially suffer a near doubling of its indebtedness.

***Partial Remedy**: The s106 should ensure that all cash profits for BIL (including the proceeds of sale of the "retained investments" to BHIC or in the open market) up to the 20% of GDV to be used to reduce BHIC debts (as set out in the applicants 28th July submission and relied upon in officer's report to committee).*

As yet this is not covered in the published s106 drafts, despite invitation to the applicant by the IWC to include such a provision.

Problem: The applicant's introduction of the entirely artificial method of calculating rent by reference to 10% of estimated costs is flawed in terms of valuation principles. This could see BHIC paying well over £100,000 pa rent, (550% of the existing rent) artificially indexed to RPI, effectively in perpetuity.

This would also have the effect of creating a very high investment value for the developer skewing the "20%" profit calculations (in favour of BIL and at the sole cost of BHIC).

In any event, the HOTs create uncertainty as the actual referenced cost and sale figures is not defined by the applicants being only loosely referenced to the DVS 06.04.2017 report. Where the precise amounts cannot be identified by the descriptions used. Even if they were, the figures are estimates only, for property without design or specification.

Whilst the LPA may have judged the projected costs and sales figures provided to be adequate to inform a recommendation for a conditional outline consent, they are not sufficient to rely on safely in the s106 calculations.

Remedy: *The "retained investments" must be valued on completion and only let at (or below) market rent or sold at (or below) valuation. All figures to be advised by the DVS. Valuations must include: rental value, vacant possession value and value of the freehold, subject to the proposed lease (As the value the applicant could "cash in" the investment at any time, to a third party). The IWC must have ability to see any lease terms are reasonable and not altered without agreement.*

Only then can the calculations of the 20% profit properly establish any cash element. Cash can then be properly and transparently apportioned a) to reduction in BHIC debts if part of a profit under 20% and b) if an element over 20%, be controlled by the agreement and directed to actual improvements in the harbour.

3) Other issues arise and are addressed by reference to the headings in the heads of terms. Remedies to areas where misinterpretation is likely to be exploited, by any profit driven developer, are suggested.

Please publish plans associated with the lease and sale contracts , as previously requested, noting you may only have Bembridge available currently. Please publish the DVS provisional rental valuations as these are not in the April 2016 report.

Best Regards

Jeremy

Jeremy Gully as Chair Bembridge Harbour Trust

C) HEADS OF TERMS:

These points are addressed below by reference to the Heads of Terms proposed, in the order and under the headings they are presented by the applicant.

Lease:

The Duver, THE Harbour Office, St Helens: Problem: Incomplete description. *Remedy: The list should include access and all residual land not used exclusively as residential, in particular, but not exclusively, including the entertainment space used by visitors in connection with the Marina.*

Marina, Embankment Road, Bembridge: Problem: incomplete description. *Remedy: The list should include access and all residual land not used exclusively as residential within the application site.*

(Note: The pedestrian crossing cannot be part of the demise as it is on Public Highway land not owned by the contracting parties. *Remedy: Reference to the crossing in the lease HOTs should be removed from the lease, but not from the obligations in the s106)*

Ex-Silt lagoon, Embankment road, Bembridge: Problem: Whilst this land could be included in the lease to BHIC, the wording "Carry out mitigation works as agreed with Natural England" is confusing. These works form part of the mitigation obligations of BIL , rather than "Enabled" improvements to the Harbour. *Remedy: It should be clear that the cost of works is a BIL obligation in the s106.*

1 Landlord: No comment.

2 Tenant: No comment.

Note: However, whilst the IWC is not a party to the lease, and as already proposed in IWC s106 draft, the s106 must include a clause where the terms a cannot be altered without the reasonable consent of the IWC, as the landlord and tenant are not arm's length and have clearly potentially conflicting interests.

3 Property marked in red on the attached plans. Problem: As Mr Chick notes plans are critical . *Remedy: Plans identifying all residual, i.e. Non-residential land, to be attached to the documents.*

4 Annual rentals: Problem: The applicants suggested method is wholly unacceptable and artificial and would disadvantage the Harbour unreasonably. BHT support Mr Chicks reliance on DVS valuations. The applicants suggested method and drafting is flawed for reasons including:

a) Reference is made to "10% of the total costs as advised by the DVS within their report of dated 06/04/2018" This is not an adequate definition. The applicant is not clear on the referenced amount. For example: Does it apportion shared costs of sewage, drainage and electrical infrastructure works for the benefit of the residential element? Is the reference the net figure of some £1,000,000 or the figure including contingencies and fees over £1,250,000 or even the gross figure including profits around £1,500,000? This would create a range of initial rental levels from around £ 100,000 to £ 150,000.

   Note: It should be remembered that BIL advise that BHIC pay £18,000 pa rent currently. There is no prediction of increased turnover to cover this additional cost.

b) This method is not related to the actual costs, which BHT anticipate are likely to prove lower than those predicted, nor is it a proper calculation of market rent. The DVS rental figures (which are not published and BHT again request a copy) are likely to be a more appropriate general guide, as Mr Chick appears to agree. Valuations on completion are required for dependable figures. RPI is not a property index and long-term is likely to be divergent from true rental values, quite possibly to the disadvantage of BHIC. It is not an appropriate measure for agreeing rent reviews, particularly long term.

c) The proposal by BIL would create a property investment with income effectively in perpetuity (as BHIC have nowhere else to go to secure facilities). The rent potentially set at an artificially high initial figure and index linked. By way of illustration: Even using a moderate gross rate of return of 7% (6.5% over Bank of England base rate) for an investment income secured against a Statutory Body. Despite some artificiality, this might create a (saleable) property investment with a value of some £1,485,000 (off £100,000 rent pa) and in extreme even around or over £2,000,000. In any event this well over the 20% profit used in calculation by the DVS. A complicated claw back mechanism would be required.

d) There is no justification for indexing the DVS estimated costs to practical completion. In the event that this flawed method (market rent as a proportion of cost) were to be considered, the actual cost figures should be used.

Remedy: The DVS should provide an initial rental valuation on completion, when design and specification and level of fitout are defined and demonstrated. Rent reviews, with normal disregards such as tenants improvements, should be conventionally negotiated. Whilst the parties remain "not at arm's length" BHIC must be independently professionally represented and provisional rent review agreements be referred to the IWC for approval IWC should have the ability to refer to the DVS or RICS for expert ruling if required.

5. Rent free period: Problem: It appears that the property will be provided in shell form? If the property is to be fitted out by the tenant, presumably at their own expense, it reduces the benefit to BHIC. *Remedy: The DVS should provide a rental valuation to set the initial rent with due regard to the condition and fitout provided by the developer. The costs figures in any profit calculation must take account of actual developer/ landlord's costs.*

6. Lease: Problem: A ten-year period is not acceptable in BHT's eyes, it does not reflect the life (and therefore the full value) of the improvements funded through the "Enabling Development". The Harbour needs access to the facilities long term. We note the red underlined text and assume it is added by the LPA, *Remedy: a mechanism for extension needs to be defined along the lines:*

At each tenth anniversary BHIC can renew the lease on the same demise, lease length and in the same terms except for rent. Rent to be market rent to be independently assessed by the DVS or reference to RICS as experts.

Lease must be drafted to provide the tenant with the protection of the security of tenure provisions of the Landlord and Tenant Act.

7. Rent reviews: Problem: RPI is not a suitable index for rental valuation long term. Particularly if it has set the benchmark rent on lease renewals. *Remedy: As above, rent reviews to take account of the condition of the premises taken, with normal disregards including tenants fit out (carried out at the tenant's expense).*

8.No Break Clauses: No comment

9.Full repairing and insuring lease: Problem: Not “all premiums”. *Remedy: reference to the proper premium, without fees, for the buildings insurance only;*

NOTE: To be equitable, BHIC must have the right to recover a proper proportion of the costs of operating facilities used by the residential properties, including the sewage facilities at the Duver and the costs of maintenance of the shared access ways. Similarly, as Officers of BIL, BBS and HAWK use the offices a suitable mechanism for subletting and recovery of costs is needed if BHIC, (whose finances are ruled by Act of Parliament), is not to be out of pocket.

10.Dilapidations: Problem: The reference to “prior to termination” is unhelpful and troubling. It should not be anticipated that the Harbour will have the lease terminated [at 10 years?]. *Remedy: Dilapidations can be dealt with in the normal way without a specific clause. Lease renewals should be provided for as at 6 above.*

11.Local Authority rates: Problem: Clearly this must relate to the property exclusively used by BHIC. It is disclosed that BIL (and BBS and Hawk) use the BHIC offices. *Remedy: Arrangements for subletting including rental levels and apportion costs and rates should be disclosed and BHIC see proper payment at market levels. As in note at 9 above.*

12.Permitted Use: Problem: This is confusing: There is no “adjacent property in harbour use” owned by BIL. All such BIL property is (or should be demised) as they are the facilities. The facilities are used in conjunction with BHIC’s Harbour land. The use of the offices by BIL, BBS and HAWKS directors is not taken into account. *Remedy: as at 9 and 11): Arrangements for subletting including rental levels and apportion costs and rates should be disclosed and BHIC see proper payment at market levels.*

13.Specifications: Problem: The “Final specification” must be known before any accurate valuations are possible. All improvements detail should be further resolved at reserved matters stage, so the LPA ensure the improvements anticipated actually to be delivered and to an appropriate standard. Any agreement to deliver benefits without them being defined by a specification is open to abuse and misinterpretation. Any valuation of the benefits without a schedule is inevitably flawed except on completion of works. *Remedy: A clause providing for a schedule to be attached that refers to a detailed specification to be agreed with the LPA at reserved matters stage. All valuations independently carried out on completion.*

14.Conditions: No Comment except as at 13 above.

15.Legal costs: Problem: It is arguable that the applicant BIL, having allowed for legal costs in their appraisals, and being the beneficiary of the value of the rental stream, should cover the costs of the tenant, which the same directors control and influence drafting. *Remedy: Either BIL pay fees or a cap on fee contribution by BHIC of say £1,500 plus VAT.*

16.Subject to formal contract. No comment

Heads of terms sale of freehold:

Description of the facilities:

ITEMS 1,2,3 Problem: As in lease HOTs. Remedy see comments on Lease HOT's

4. Sale Price. Problem: There is no specific reference made for this definition. The DVS does not specify a "Sale Consideration" in the 06.04.2017 report. However, if this may be a reference to the Figure £946,500 that the DVS adopt as Mr Thorpe's valuation figure for the retained investments it is a composite figure of some costs and some valuation advice from HRD. As fitout may now fall on the tenant and specification, design and cost remain uncertain a better valuation mechanism is required: Remedy: DVS to be instructed to provide a valuation of the assets including all non-residential land with VP and based on the specification they are delivered to BHIC. A valuation of the investment created by any letting (prior to sale to a third party after letting) must also be provided and the higher valuation used in calculations of "20%" profit.

5. Fit out Period: Problem: The rationale, purpose or mechanics of this are unclear. If the proposal is for and exchange of contracts on Practical Completion (of the shell finish) and a licence granted to fit out prior to completion this seems Ok. However, it should be noted, in valuation terms, that the property is to be fitted out by the tenant, presumably at their own expense. Also estimated build costs to not specifically exclude fit out. Remedy. Valuation subject to specification as at 4 above. Final cost analysis in s106 to take account of actual costs to level of finish provided by the developer.

6. Title: Problem: Does not confirm/limit any restrictive covenants: Remedy: Freehold is obviously acceptable, however the relationship with users of the houses in terms of contribution to shared facilities (including sewage treatment plant and accessways) should be documented. No adverse covenants (for example in favour of BIL, BBS or HAWK and the residential properties) can be permitted.

Cases of noise nuisance of marine related activities closing down adjacent marine works are well known. If the Harbour facilities are to remain in useful it is critical that the Residential properties do not have any controlling covenants over the commercial activities of the Harbour facilities.

7. Permitted use. 8 Specifications, 9 Condition, 11, subject to formal contract. BHT comments are the same as under those headings in the lease heads of terms.

NOTES:

FOR THE AVOIDANCE OF CONFUSSION AND PROTRACTED NEGOTIATIONS:

By far the best solution would be to agree the final form of lease and sale contract and attach them to the s106 prior to signing. This would avoid a position where the LPA are forced to negotiate the meaning of loose terms in the HOT's after the s106 is completed, when, with the consent issued the IWC have little or no leverage in negotiation.

This need not cost the developer time, processing can be carried out in parallel (and the developer has already said they expect to delay a start to late this Autumn or beyond). It need not cost the IWC as legal costs should be paid by the developer. The planning officer's time is an inevitability, whether negotiating now or later.

The developer was not proactive in detailing the s106 prior to committee, leaving open room to promote negative suggestions (for BHIC) as above and since committee. We speculate that if the Lease and sale contract are not finalised at this stage that the LPA must anticipate the possibility of similar negotiations, corrosive to BHIC's interests, after the s106 is signed.

OVERALL IMPACT ON THE HARBOUR AND VALIDITY OF ANY CONSENT:

If, for example, BHIC buy at £946,500, plus, fit out cost, stamp and fees, finance costs would be costs around £93,000 pa (1m amortised at 7% over 20 Years). If BHIC lease at the applicant's apparent desire for rents around or over £100,000 pa (10% of some assumed net costs) These figures contrast markedly the current costs of rent at £18,000 pa i.e. being 516% to 550% of current passing rent.

No evidence of anticipated increased Harbour incomes has provided by the applicant. BHT remind the LPA that it is difficult to see the advantage BHIC gain and that if BHIC can afford to take up either of the Applicants proposals in these HOT's then BHIC can afford to fund the improvements themselves and there is no justification for the 13 houses as an "Enabling Development" at all.

Without a reduction in BHIC indebtedness (by the cash element up to 20%) BHIC's borrowings could increase from a current 1.2M (to Hawk Developments), in the event of a purchase debts could increase to over £2,200,000 a level which it is difficult to see as sustainable based on the limited accounting information the BHIC directors are prepared to release. In particular, by reference to Mr Thorpe's advice of operating profits averaging £54,000 pa.

IN THE SALE SENARIO AND DEBT REDUCTION:

If BHIC buy "retained investments" at around £1m (BIL's provisional valuation plus stamp and fees). If funded at 7% BHIC face additional interest charges of 70k pa. Capital repayments would take the annual cost to around £93,000 if amortised over 20 years, higher if a shorter mortgage term.

BHIC's position, if the situation is not properly addressed:

Debts increase from existing 1.2m + to around or over £2.2m and interest costs increase from around £84k to around £154 k pa. (Cash flow costs would be higher including capital repayments).

However, if sale proceeds (now cash after BIL sale), and any other profits up to the DVS suggested 20% profit threshold, were used to reduce BHIC indebtedness in line with the applicant's 28th July statement and as relied upon in in the officer's report to committee then:

BHIC indebtedness to Hawk, and possibly some borrowings from Handelsbanken would be paid off and BHIC's final position would be improved:

BHIC borrowings for new facilities of some £1,000,000 would mean an ongoing cost amortised at £93K pa. However, BHIC would have reduced borrowings to around 1m (down from I.2m +) and interest costs of around £70,000 (down from 84k pa) and an improved asset base.

In turn Hawk (and or BIL's) indebtedness to Handlesbanken could be reduced by use of the sale proceeds.

Mr and Mrs Thorpe, as owners of Hawk, BIL and BHIC, set the situation out as if acting in benign partnership. As such, in principle, this mechanism should not cause them difficulty or be resisted. Any practical complications argued would simply speak to the proposition that the Companies do not actually act in a benign partnership.

IN THE LEASE SENARIO:

As set out by the applicant BHIC incur significant, but ill-defined rental costs of around or over £100,000 pa an increase of at or over £82,000pa form the current £18,000 pa disclosed.

BHT's indebtedness to Hawk (and possibly Handelsbanken) is not reduced so would stay at £1.2m

The artificial rental valuation methodology and RPI rent review proposal compound to create additional value for BIL at the expense of (i.e. funded by) BHIC's cashflow. This would be contrary to the applicant's suggestion that BIL and BHIC are in benign partnership misleadingly named as if Bembridge "Harbour Authority" .

The short lease period of 10 years does not transfer the benefit of or allow use of the improvements funded through Enabling Development for their useful life, that might reasonably be assumed at +/- 35 years.

The lease does not preclude a sale and as set out is (despite its artificiality) likely to create a market value of the property investment more than it VP value, entirely at the expense of BHIC and the benefit of BIL. As well as a VP valuation, a valuation of the investment created must be provided and, if higher, used in any calculation of the profits and a mechanism provided for claw back if the value (or sale proceed in a sale to a third party) is higher than the 20% profit threshold advised by the DVS.