Modernisation of The Crown Estate – business case

February 2023
Updated in October 2024 to remove commercially sensitive information

THE CROWN ESTATE

Executive summary: modernisation of The Crown Estate

This paper supports the case for conservative but important amendments to The Crown Estate's statutory framework

Summary and objectives

Issue

- Restrictions derived from The Crown Estate Act are limiting TCE's ability to meet its core statutory duty: to maintain and enhance the value of its portfolio and the revenues derived from it, with consequent material implications for the Exchequer. In accordance with their obligations, the TCE Commissioners have written to their principal stakeholders at HMT and the Royal Household to alert them to this.

Proposed solution

- With the support of its sponsor team, TCE is seeking changes to both legislation and its Framework Agreement to alleviate constraints to its capital structure and investment powers and enable the delivery of its ten-year strategic plan.
- This paper explains the rationale for these proposed changes by setting out a detailed breakdown of TCE's strategic plan, including the significant returns and value for money that TCE delivers for the nation.

Implications

- With the proposed changes, TCE could deliver up to £100m p.a. in additional revenues to HMT by 2030[1] as well as unlocking significant outcomes aligned to Government policy priorities, such as the acceleration of offshore wind.
- Without the proposed changes, TCE faces immediate structural challenges leading to downward pressures on both revenues and asset values (with up to £4bn of value at risk). In addition, its ability to support delivery of national policy objectives, including the acceleration of offshore wind, would be significantly compromised, as highlighted in the alternative pathways illustrated in the paper.

Recommendation

- For conservative amendments to TCE's statutory framework to address funding and investment constraints; and,
- For agreement for an enhanced transfer from revenue to capital to cover capital commitments until any legislative power to borrow is secured, and longer term for the transfer to match long-term maintenance requirements for the estate.

[1] This is against a 'constrained case' of being unable to borrow and activities being self-funded. This means significant sales from TCE's Rural and London portfolios, and the deceleration of OSW and renewables output. Weaker performance over time is driven by reduced investment and diminishing quality of TCE's assets over time. Forecast growth beyond 2030 is supressed.

Introduction to The Crown Estate

TCE manages a diverse set of assets on behalf of the nation. Valued at £16bn, it returns its profits to Treasury, amounting to more than £3bn over the last decade.

Background to TCE

- TCE is a non-financial public corporation and HMT is its government policy sponsor. Its mandate is derived from The Crown Estate Act, 1961 which sets out its core duty: ‘to maintain and enhance the value of the estate and the income derived from it’.
- The Act charges TCE with holding and managing assets ‘in right of the Crown’ and so its other principal stakeholder is the Royal Household. This gives distinction to a split between revenue (net revenue surplus, payable to HMT) and capital (asset values and sale proceeds – held and reinvested by TCE).
- TCE is overseen by an independent Board of Commissioners, but it seeks to operate in alignment with Government policy (subject to the prescribed duties of the Commissioners). Its working relationship with HMT is codified in a Framework Agreement.
- Over the last decade, TCE has returned more than £3bn in net revenues to HMT and has consistently outperformed its listed real estate peers, delivering total returns in excess of market benchmarks.
- It has also created significant value for the benefit for the country, with over 41GW of offshore wind leased, 12GW operational, and more than £5bn invested into opportunities across the country since 2010.
- Its current strategy, sets out a plan to continue to grow the returns it provides to HMT and increase the impact it has for the nation.

TCE's strategy will drive significant revenue growth and enhance returns to HMT

Financial returns

- TCE forecasts that by FY30 its underlying Net Revenue Surplus could be up to 30% higher, contingent on addressing funding and investment constraints set out in this paper.
- This increase is equivalent to:
  - Up to £100m p.a. of additional NRS by 2030[1]
  - This excludes additional revenues from offshore wind acceleration, including potential future option fees, which could be delayed or materially reduced without appropriate investment.
- In addition, TCE forecasts there is value at risk of up to £4bn over the next decade comprising:
  - An additional £2.9bn of capital value (net of funding) that our strategy could generate in the same period compared to the constrained scenario.
  - The compounding impact of obsolescence which increases the downward pressure on rents and asset values, equivalent to >£1bn of current risk against our portfolio[2]. We are already experiencing the early signs of this and this risk will grow significantly without appropriate investment.

[1] This is against a 'constrained case' of being unable to borrow and activities being self-funded. This means significant sales from TCE's Rural and London portfolios, and the deceleration of OSW and renewables output. Weaker performance over time is driven by reduced investment and diminishing quality of TCE's assets over time. Forecast growth beyond 2030 is supressed.

[2] This can already been seen in the market, with value differentials of between 14-16% for green buildings. Source: *CBRE research Aug 22 – "The Value of Green Building Features"*

Its strategy also seeks to make TCE a more resilient business and unlock significant outcomes aligned to national policy priorities

Strategic risks TCE is addressing

- Failing to meet its obligations under the Act and, in turn, to HMT and the Royal Household
- Growing costs of maintenance and decarbonisation that, even at existing levels, have not been covered by the statutory transfer over the last 10 years
- Absent new sources of funding, TCE faces challenges from:
  - Downward pressure on asset values and revenues payable to HMT
  - Continuing to fund its activities through asset sales – reducing its national footprint
  - Reduced capacity to meet UK offshore wind deployment targets
  - Reduced capacity to respond to external economic and market shocks
- Limited investment powers that inhibit TCE’s ability to fully capitalise on digital technologies to maintain and enhance asset values

Outcomes TCE seeks to deliver

Financial

- Enhanced financial returns to HMT

Energy security and net zero

- Acceleration of offshore wind and other net zero technologies through leasing
- Support the development of UK supply chains and infrastructure to accelerate offshore wind delivery (e.g., coordinated grid, ports)
- Decarbonise emissions from real estate portfolio, including heritage assets in London

Economic growth and regeneration

- Development of assets and infrastructure that support businesses and communities in London and towns and cities across the UK
- Delivery of 20k new homes through partnership (e.g., with Homes England)

Environmental stewardship

- Enhancing marine and rural biodiversity
- A portfolio of land that supports UK food security

Capital cost of delivery, 10 years

TCE’s planned investments are aligned to its core statutory duty – to maintain and enhance the value of its estate and the related revenues

The table provides a description of TCE’s planned activities over the next decade and shows target investment returns

Investment area	Description
London development	Re-development activity to address physical and market obsolescence, meet decarbonisation targets and deliver our London strategy. Protects asset values and drives revenue growth.
Marine seabed leasing	As part of TCE’s core role of seabed leasing, investments to de-risk and accelerate the development of net zero technologies (e.g. geological surveys and spatial planning), supporting UK energy security and making revenues more certain.
Marine infrastructure	An extension of TCE’s core leasing role - investments to remove major barriers to offshore wind development (e.g. ports, coordinated grid).
Regional development	Utilising TCE’s land and property assets, investment to create long-term value through town centre regeneration and development of new housing. To be delivered with specialist partners.
Rural	Investment into diversified regenerative agricultural land holdings to support UK food security and create long-term value potential.
Digital and innovation	Delivering foundational data and technologies to create new capabilities; investment in new technologies and innovation to maintain and enhance asset values and revenues and support the decarbonisation of the business.
Maintenance & sustainability	To maintain the core estate, underpinning revenues to HMT and maintaining asset values. Also includes investment in sustainability priorities such as decarbonisation (to meet net zero targets), biodiversity and nature based solutions.

All spend by TCE is on a commercial basis and must demonstrate value for money for the taxpayer

Ensuring value for money

- **TCE is obliged by the Act to demonstrate value for money in line with its obligations under the Act and its responsibilities for managing public money. It is one of few public bodies that generates a positive return for the public purse.**
- **Over the last decade, it has returned more than £3bn in revenues to the Exchequer and consistently outperformed its peers, as measured by independent benchmarks.**
- **It will continue to demonstrate value for money from its activities through:**
  - **Continued benchmarking against its peers, administered independently by MSCI;**
  - **Through its strategy, continuing to demonstrate 'value-add' in its activities relative to other businesses and public sector organisations;**
  - **Approval of major investment decisions by its Board;**
  - **Adherence to the Nolan principles;**
  - **Abiding by the principles of Managing Public Money;**
  - **Oversight of its Chief Executive as Accounting Officer;**
  - **Continuing and regular oversight by its sponsor team at HMT;**
  - **Publishing its annual report and accounts detailing performance and all other information and disclosures as directed by HMT;**
  - **Annual audits by the NAO, who have full audit rights including over VFM**

To deliver its strategy, TCE must modernise its capital structure and secure fresh sources of funding

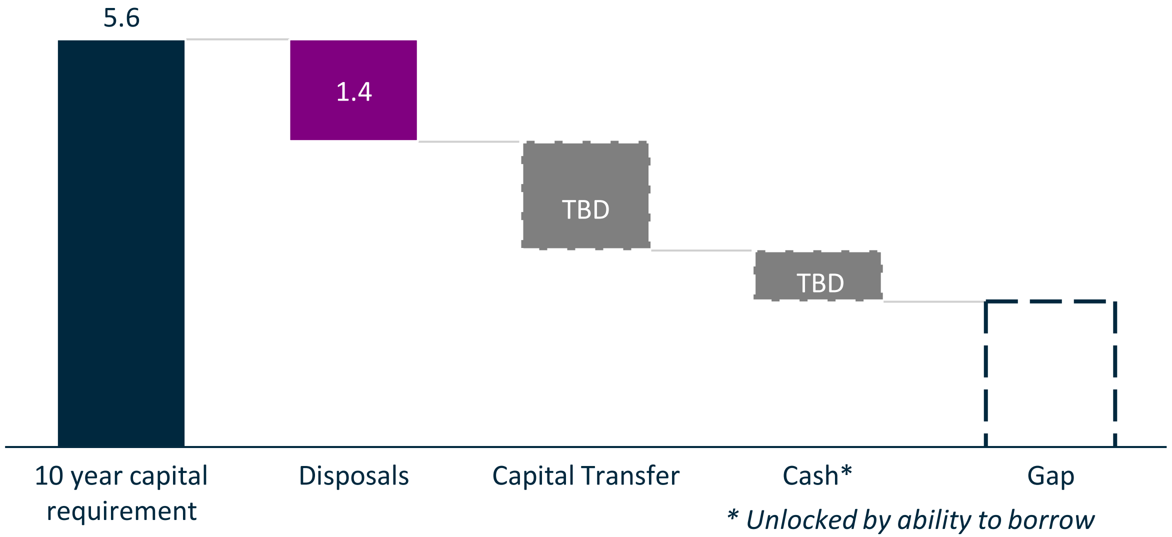
Sources of capital

- As TCE pays across 100% of its profits to HMT each year it has no reserves. Its going concern status depends on having sufficient cash or liquid assets to fund its commitments.
- TCE's sources of capital funding are limited to:
  - Cash on hand: required to fund ongoing commitments
  - Disposals: over the last decade TCE has extracted more than £3bn through asset sales to fund its activities and drive returns for the Exchequer.

    Beyond the £1.4bn of disposals currently in the plan, there are no other sources of capital available.
  - Statutory transfer from revenue to capital: the Act includes a provision for a percentage transfer from revenue to capital. This has been used to support the ongoing maintenance of TCE's assets and is analogous to a listed business retaining profits for reinvestment. See pages 10-11 for more detail.
- Unlocking conservative borrowing powers would significantly increase the flexibility available to TCE. This is set out in more detail on pages 10-11.

Funding gap

- Having the ability to make multi-year capital commitments is critical to TCE's business.
- At present, TCE has a funding shortfall that means it will not be able to make all of its commitments with confidence.
- Without certainty on funding, TCE must reprioritise its strategy in the next 12-18 months or face a going concern risk due to the scale of its commitment pipeline.
- This is due to a long-term structural issue with TCE's funding model.



** Unlocked by ability to borrow*

TCE’s capital and investment restrictions derive from The Crown Estate Act 1961 – TCE’s governing statute

Context

- **The Act sets out the core duty of TCE is “to maintain and enhance the value of the estate and the return derived from it”**
- **The Commissioners consider that they are at serious risk of being unable to fully meet that obligation, owing to two principal constraints under the Act. These are set out below.**

Key constraints

Principal constraints under the Act are twofold:

1. TCE is effectively unable to borrow:
    - Impact: A significantly constrained capital structure. The business has extensively self-funded over the last decade and these options are now exhausted. Additional disposals risk materially altering the shape and nature of the business.
    - The funding requirements of TCE’s core business are comparable with its operations over the past 10+ years – the need for greater investment is driven by the growing cost of decarbonisation and the acceleration of offshore wind. Any alternative set of strategic choices would need to address the same structural issues around funding.
    - To note: the Act does include a provision for the transfer of revenue to capital for maintenance costs. This is expanded upon later in this paper.
2. TCE’s investment powers are effectively limited to having ‘interests in land:’
    - Impact: This constrains the extent to which TCE can adopt digital technologies or develop new products or services that are for the purposes of enhancing or maintaining its revenues and asset values.
    - Restrictions on the type of investments TCE can make are blocking opportunities that are consistent with TCE’s core duty and are routinely available to TCE’s peers. This can negatively impact TCE’s ability to compete and put downward pressure on revenues and asset values.

Modernising TCE's capital structure will require access to debt and an enhancement to the statutory transfer

Statutory transfer

- The Act permits appropriate transfers from revenue to capital to ensure TCE's Commissioners can meet their core obligations.
- For the past decade the transfer has been set at 9% by agreement between TCE and HMT, but that has led to a shortfall of more than £240m on costs associated with maintaining the estate, which TCE has met through its own capital (raised via asset sales).
- In the future, TCE expects the costs of maintaining its assets to increase, particularly with the obligation to decarbonise.
- TCE's going concern status currently depends on having sufficient cash or liquid assets available to fund its forward commitments.
- Pending a positive legislative outcome on access to debt, the table illustrates that TCE would need an enhanced short term transfer to support the level of commitments that it would make over the next 12-24 months.
- This additional short term funding will provide the assurance necessary for TCE to commit to funding its strategic activities, including investment to support the acceleration of offshore wind.
- Based on current revenue forecasts we think a long term range of 10-12% may be appropriate for the capital transfer but this would be agreed with HMT in due course.

FORECAST YEAR END CAPITAL COMMITMENTS					
	31/3/24	**31/3/25**	**31/3/26**	**31/3/27**	**31/3/28**
TOTAL YEAR END COMMITMENT	**606**	**804**	**761**	**890**	**636**
Total Commitments (incl capital buffer)	**906**	**1,104**	**1,061**	**1,190**	**936**
Statutory Transfer (at an enhanced 27% then 12%)	**385**	**390**	**400**	**141**	**137**

Debt Requirement					
Capital cash including statutory transfer- excess / (deficit) vs commitments	417	398	397	(202)	(425)
Potential debt funding	*Assumed period for legislative change*			202	425
Implied Loan to Value %		*n/a*		1%	3%

An enhanced statutory transfer[1] of 27% during the period of uncertainty provides the assurance for TCE to be able to enter into significant capital commitments whilst the legislative bid proceeds.

TCE's proposal is to:

- Agree an enhanced transfer of 27% for the first 3 years (or until TCE has a conclusion on access to debt if sooner). This level is informed by TCE's capital commitments.
- Discuss an appropriate ongoing % transfer level with HMT once we have a conclusion on debt, to ensure the business is appropriately funded going forward but not overcapitalised.

[1] *Enhanced transfer primarily supports acceleration of Marine leasing and early de-risking projects in London. Buffer covers contingent liabilities and timing risks on disposal of assets.*

Borrowing levels would be modest, aimed at mitigating strategic risks and subject to appropriate governance arrangements with HMT

Borrowing / debt

- The ability to borrow would allow TCE to better manage the risk, volatility and liabilities that the business is exposed to in its markets.
- Although, pending legislation there is an immediate need for additional short term funding through the statutory transfer, we believe that if TCE has access to borrowing then the transfer should primarily apply to the investment needed to maintain the estate (including requirements driven by sustainability and/or regulation), with investment for growth to be primarily funded through debt.
- The security of alternative sources of funding would also enable TCE to draw down further on existing cash reserves of up to £1bn (as it would no longer need to maintain such a large going concern buffer), driving enhanced returns to HMT.
- Any debt would be at modest levels, benchmarked against peers such as the Duchies and Grosvenor, limited to public/government sources (to avoid credit arbitrage) and subject to appropriate governance arrangements with HMT.   The appendix includes peer comparisons on debt levels.
- Importantly, all of TCE's investments are individually assessed on a commercial basis with hurdle rate returns of between 5-15%, dependent on risk. This ensures that TCE generates a positive return for the public purse while satisfying its value for money obligations.
- Without access to debt, future outcomes would be significantly compromised.
- Unlocking TCE's capital structure is therefore a low risk opportunity for HMT to protect the long term value potential of TCE whilst creating significant optionality for the future.

Absent new sources of funding, alternative choices will have significant implications for TCE, its returns, and the risks TCE and HMT may face

To a great extent these alternative pathways overlap and are interdependent, but in each case TCE faces the risk that it is unable to satisfy its statutory role, and in turn, meet its obligations to HMT and the Royal Household

Significantly defer Real Estate development activity in London and regionally

Financial impact: up to £70m additional NRS p.a. foregone by 2030; structural long-term implications for revenue and capital values (up to £2bn of value at risk)

TCE risks

- **Significant and potentially structural downward pressure on asset values and revenues. Performance relative to market would suffer.**
- **Significant value creation opportunity foregone in Regional, and challenge to TCE's UK-wide presence**
- **Risk of TCE not meeting its statutory obligations**

HMT risks

- **Risk of TCE not meeting its statutory obligations**
- **Downward pressure on NRS**
- **Potential implications for the Sovereign Grant**

Scale back Marine leasing and enabling investments

Financial impact: highly material (NRS and capital), from both delays and potentially diminished revenues and option fee receipts

TCE risks

- **Risk of TCE not meeting its statutory obligations**
- **Failure to optimise value from seabed leasing**
- **Material risks to both NRS and capital value**

HMT risks

- **Risks to key policy areas, including potentially failing to meet UK energy targets and economic opportunity foregone by failure to maximise growth of UK offshore wind sector**
- **Significant reduction in NRS payable to HMT**

Pursue asset sales to fund business model (e.g. Rural or London disposals)

Financial impact: Significant permanent reduction in NRS and foregoing material future value potential

TCE risks

- **Would only provide 1-2 years capital at predicted run rates and potentially difficult to realise receipts in current markets**
- **Risk of TCE not meeting its statutory obligations**
- **Sale of Rural carries significant reputational risks**

HMT risks

- **Risk of TCE not meeting its obligations**
- **Reputation risk associated with selling Rural land**
- **Significant reduction in NRS**
- **Potential implications for the Sovereign Grant**

Conclusion

Amending both legislation and the Framework Agreement would enable TCE to deliver its ten year strategic plan to the benefit of the Exchequer and the nation

Summary

- The proposed amendments are critical for TCE's ability to satisfy its statutory remit and meet its obligations to HMT and the Royal Household. Not addressing these issues may create significant risks for both TCE and HMT.
- Proposed amendments would also increase returns payable to the Exchequer and unlock TCE's ability to deliver against significant national policy priorities.
- The nature of the proposed changes is conservative and has been benchmarked to both public and private sector comparators. TCE is not seeking wholesale changes to the Act and its status, and purpose will remain unchanged.
- TCE has a long history of demonstrating value for money and is subject to oversight from HMT and the NAO.
- Any additional powers would be subject to limits and oversight from Parliament and Government.

Recommendations

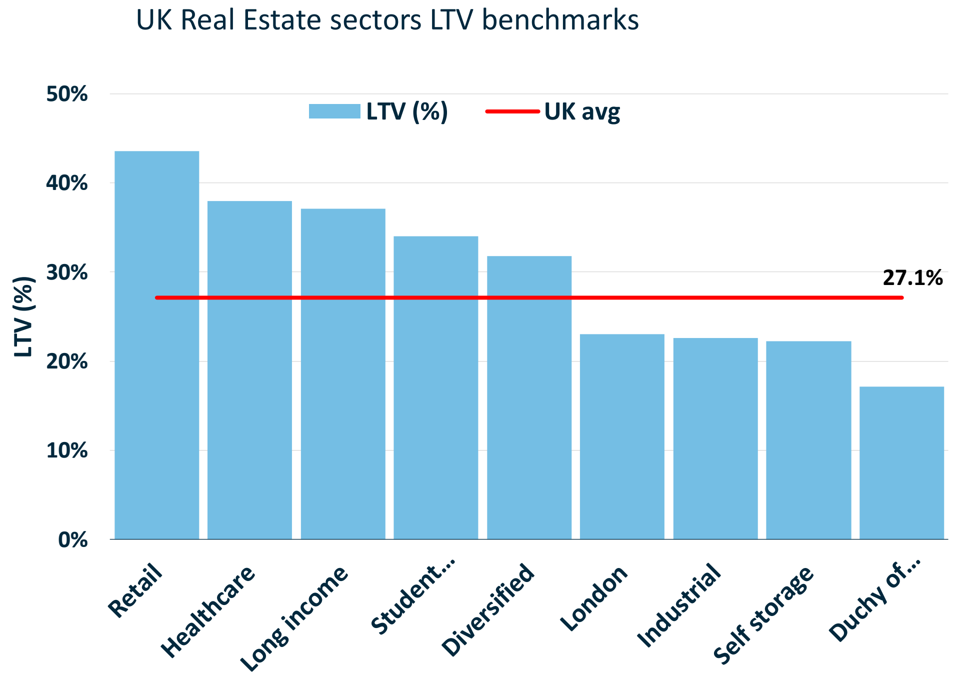
- To support a Treasury bid for primary legislation required to grant TCE additional borrowing powers and expand its investment powers.
- To support an update to the Framework Agreement between HMT and TCE that enhances the amount of revenue retained by TCE for reinvestment. Specifically:
    - For a period of three years this should increase to 27% to enable TCE to fund its capital commitments whilst borrowing powers are pursued through legislation;
    - After three years or upon passing of legislation, whichever is sooner, the percentage transfer should decrease significantly to a level that covers the maintenance costs of the business only. TCE and HMT to agree that at the time.

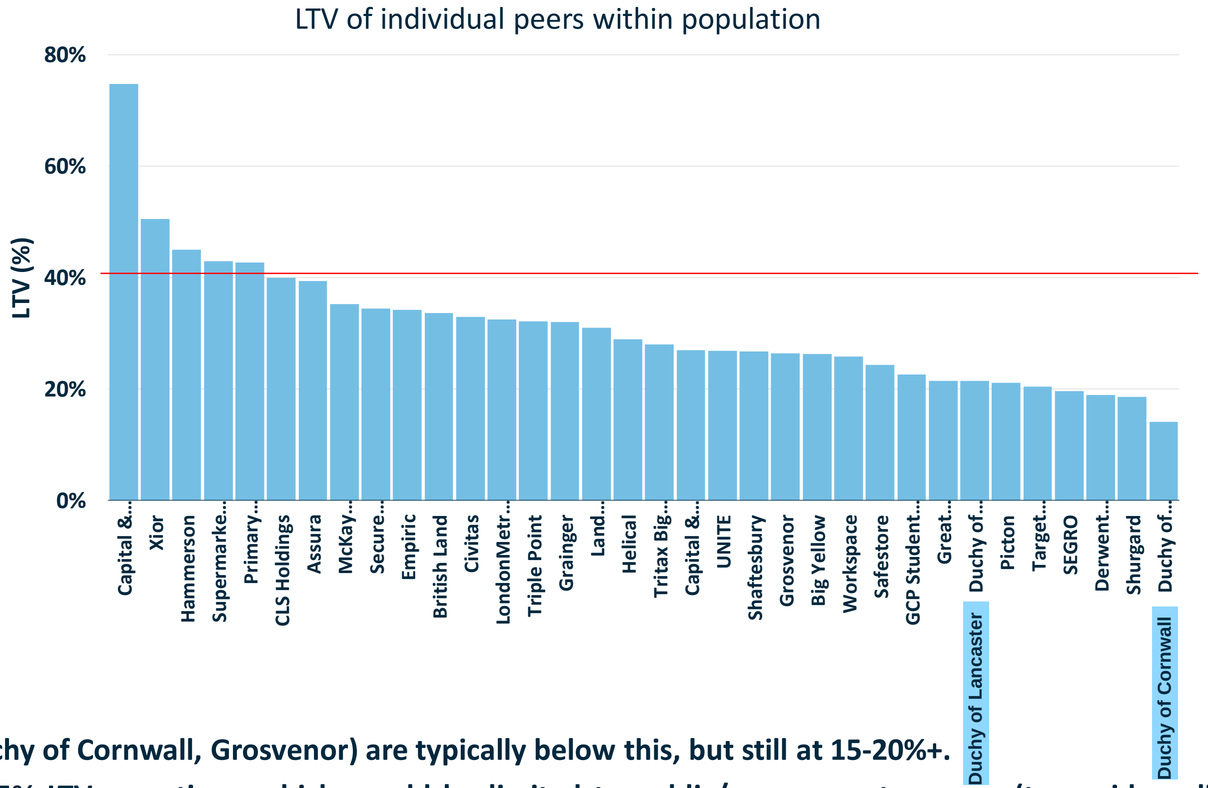
Annexes

Annex: debt benchmarking

UK Real Estate sectors average 27% LTV, with the Duchies and unlisted peers at the lower end of the scale

Borrowing - peer comparisons on Loan to Value ratios





- **The UK average real estate LTV [1] is c27%; unlisted peers (Duchy of Lancaster, Duchy of Cornwall, Grosvenor) are typically below this, but still at 15-20%+.**
- **TCE's strategic requirements would see borrowing increasing to between 5-15% LTV over time, which would be limited to public/government sources (to avoid credit arbitrage) and subject to appropriate governance arrangements with HMT**

Source: Company reports, Panmure Gordon, Stifel

[1]: 1-year forward LTV based on Panmure Gordon/Stifel forecast for listed REITs. Duchy of Lancaster, Duchy of Cornwall and Grosvenor based on 2020 annual report