

Part A For General Release

REPORT TO:	Cllr Simon Hall – Cabinet member for Finance and Resources
AGENDA ITEM:	N/A
SUBJECT:	Acquisition of the Freehold interest in the Colonnades Retail Leisure Park as a commercial investment
LEAD OFFICER:	Richard Simpson Executive Director(Resources) and s151 Officer
CABINET MEMBER:	Cllr Simon Hall Cabinet member for Finance and Resources
WARDS:	Waddon
<p>A new Corporate Plan and Medium Term Financial Strategy (MTFS) were agreed by Cabinet in September. The MTFS included an Asset Investment Strategy. The securing of additional net revenue through acquisitions of this type are critical to ensuring that resources are available to deliver the priorities in the Corporate Plan.</p>	

<p>FINANCIAL IMPACT</p> <p>The purchase of the freehold interest will secure a significant annual rental income and opportunities to further enhance the revenue income through active asset management</p>
<p>FORWARD PLAN KEY DECISION REFERENCE NO.: N/A</p>

The Cabinet Member for Finance and Resources, in consultation with the Leader, is asked to approve the following recommendations:

1. RECOMMENDATIONS

1.1 That the Cabinet Member for Finance and Resources agrees that pursuant to the Asset Investment Strategy contained within Medium Term Financial Strategy approved by Full Council on the 8th of October the Council purchases the freehold interest in the Colonnades Retail and Leisure Park on the terms detailed in the Part B report.

1.2 Agrees that, for the reasons detailed in paragraph 3.3-3.5 of the Part B report, the Executive Director (Resources) and s151 Officer be given delegated

authority, acting in consultation with the Cabinet Member for Finance and Resources, to make any amendments to the terms of the acquisition of the freehold interest considered necessary after the decision has been made.

Note that where any significant amendments are made under this delegation, the amended terms for the acquisition of the freehold interest for the Colonnades will be published on the Council's website within 1 month of completion of completion of the lease

2. EXECUTIVE SUMMARY

- 2.1 As part of the Council's Financial Strategy presented to Cabinet on 24th September and Full Council on 8th October 2018, the proposal to adopt a full Investment Strategy to generate income to help delivery the financial strategy of the council was formally adopted. This provided authority for property investment purchases that meet the criteria set out in the Investment Strategy to approved under delegated authority from the Cabinet member for Finance and Resources in consultation with the Leader
- 2.2 The Investment Strategy reflects the Council's aspiration to secure medium to long term revenue returns from sound property investment within Borough. It is important to acknowledge that to maximise the benefits from property investments, the assets need to be held for a longer period due to the acquisition and disposal costs and the short term fluctuations in capital values. However, if chosen carefully the revenue returns should be consistent and less prone to fluctuation due to the protection within the lease agreements.
- 2.3 On opportunity has been identified which meets these criteria to purchase a significant asset that will deliver a substantial secure income over a long period on a key strategic site on the Purley Way. This acquisition is in line with current guidance in respect of prudential borrowing.

3. DETAIL

- 3.1 The Council is looking at the opportunity that investment in property can provide to help generate a secure revenue stream over the medium to long term and also the acquisition of assets that offer future revenue potential with higher returns and unlock the development of strategic sites.
- 3.2 The adopted Investment Strategy sets out the process, targets and an assessment matrix and allows the decision making process to be delegated to senior officers and the relevant cabinet member.
- 3.3 Under the adopted Investment Strategy, all potential acquisitions will be considered against a number of key elements set out within a matrix and these will include:
 - **Location** – the proposal is to have all investments within borough unless there are exceptional circumstances to justify an out of borough purchase (eg linked to a wider portfolio of assets, supports local employment or business retention)

- **Covenant Strength** – to secure the required security of revenue it is important to secure grade A covenants. By exception, weaker covenants may be considered if there are refurbishment/redevelopment benefits.
- **Tenure** – unencumbered freehold or long leasehold titles without any restrictive covenant terms
- **Lease terms** – ideally 15-20 years on Full Repairing basis in a single occupation to minimise management costs.
- **Building Age** – new build or have been subject to a comprehensive refurbishment. Older buildings in sound condition, such as Davis House, may also be considered on the right terms
- **Lot size** – This will reflect the quality of the above requirements but a range of values should be considered to help reduce risk and offer some flexibility.
- **Net Yields** - These must reflect the total costs including SDLT, Agents fees and legal costs together with the cost of borrowing to give a true return on the investment to the Council
- **Property use** – certain uses will not be considered and it is suggested that these follow the requirements of the pension fund
- **Portfolio mix** – to spread the type of investment so that not all investments are in one market sector (Suggested 30% Offices, 20% industrial, 40% other and 10% retail)

The investment will be considered against these criteria and categorised into Excellent, Good, Fair and Marginal investments

- 3.4 The Council have commissioned external advice from CBRE in respect of investment opportunities. This advice has been used together with the experience from other Council's and guidance from CIPFA to help formulate the proposed strategy.
- 3.5 An opportunity to acquire the freehold interest in the Colonnades Retail Leisure Park has been identified and the Council has an opportunity to acquire this as an off market purchase. This is seen as a key asset location offering a very secure income stream from the existing tenants together with further opportunities to enhance the income generating potential through active asset management. These future opportunities have already been identified by the current owners and early positive discussions have been taken place
- 3.6 The Colonnades Leisure Park was constructed in 1999 on a site formerly owned by the Council and is held in a single freehold title. It provides a mid-sized purpose built leisure park on an 8 acre site and offers approximately 162,000sq ft of accommodation, 408 car spaces and bus stop for the 119 service on site. It is approximately 1 mile from Waddon Station Although initially a purely leisure park, it now includes a more diverse mix of uses including a Wickes store, Premier Inn, restaurants and a gym. There is a good tenant mix including some very strong covenants with long leases.
- 3.7 The site has been, and has ongoing redevelopment to enhance the facilities. Recent changes include the refurbishment of part of the main building to create the Wickes unit and the development of a new drive through Costa Coffee unit. The current owners are also in the process of redeveloping part of the site to create 3 new units in place of the old Gypsy Moth pub. The asset is being purchased on a phased basis to reflect the ongoing redevelopment which helps

to minimize any risk. An overall purchase price has been agreed but the purchase will be phased so that the initial acquisition will be for the existing premises and then phase two will be completed once the redevelopment has been finished and practical completion certificates issued and the leases to the two main tenants have been signed.

- 3.8 The current lettings have a secure income stream of £2.3m with a further £600k secured either through agreement for lease or rent guarantees from the existing owners. The details of the tenancy schedule are included within the Part B report
- 3.9 In addition to the existing tenancies there are a number of potential future asset management initiatives that are being considered with existing tenants. These largely involve the re-gear of existing tenancies to secure longer term and extension to premises which would require some capital investment. These initiatives could effectively add an additional £8m capital value and £500k per annum rental increase:
- 3.10 The terms of the acquisition are detailed in Part B of this report but offer a secure significant rental income over the medium term of the lease.
- 3.11 The vendors have provided significant background information and advice on the existing use value and enhanced asset opportunities have been obtained by specialist valuers. A further advantage to this site is its immediate proximity to the Purley Way playing fields where significant improvements through the Park Life scheme are being proposed. This asset would complement those proposals and potentially enhance access to them.
- 3.12 The estate is currently managed by Cushman and Wakefield and it is proposed that for at least the first 12 months they are retained to manage the portfolio as they have a good track record and have an established relationship with the tenants. Their current annual fee is £30,000
- 3.13 The Council have been invited to make an off market bid for the property which has helped to reduce uncertainty through the negotiation process
- 3.14 The terms detailed in the Part B report are considered to be favourably and would offer a sound medium to long term investment
- 3.15 The potential acquisition of the asset has been carefully considered in line with the adopted Investment Strategy and a matrix assessment has been completed as set out in the strategy. On balance it is considered that this opportunity represents a “good to excellent” investment that meets the requirements of the Investment Strategy. The Matrix is included within Appendix 1 of this report. The only slight deviation is in relation to the mix of property investments as this acquisition slightly exceeds the guidance for proposed purchases within the “other” and “retail” categories within the property type recommendation. However, as this asset consists of 12 separate units with good quality covenants this is considered to be acceptable. It is however recommended that any future investment acquisitions look to the office and industrial sectors.

4. CONSULTATION

- 4.1 Consultation regarding general investment strategy and advice has been obtained from CBRE and specialist valuation advice from Copping Joyce.

5 FINANCIAL AND RISK ASSESSMENT CONSIDERATIONS

1. Risks

The principle risk is the commitment of a significant capital sum against the receipt of a rental income stream.

The existing leases have varied expiry dates but approximately half the annual income offers at least a 12 year income stream (much of this is for significantly longer) and the remainder offering an average of at least 5 years with significant opportunities to secure much longer leases through ongoing discussions which are expected to secure long term leases within the next 2 months. All leases are on effective full repairing and insuring basis which will minimise the risks for the landlord. The majority of tenants are established companies with very low risk ratings as identified in the valuer's report and the lease payment schedules demonstrate no current arrears and sound payment record by the tenants. There is always a risk that the tenants could default but the leases are in a standard form that would allow the landlord to take action should difficulties arise. The covenant strength of the majority of the tenants is also likely to help minimise this risk

The acquisition cost is classed as capital expenditure. The council has the opportunity in the current market to purchase at relatively low fixed interest rates which limit the revenue cost of the purchase.

The site is also in a prime location and therefore offers a good opportunity for future redevelopment and consideration has been given to this option as part of the process.

2 Options

As this is the purchase of a freehold subject to a number of leases in place there are few options available other than not to purchase the asset. The Seller requires a straightforward clean disposal as is common with investments and therefore there are no alternative options around the purchase. The Council do not have to purchase the asset but opportunities of this type are very limited

3 Future savings/efficiencies

This property will be purchased specifically to generate a net revenue stream after financing costs in the short to medium term.

(Approved by: Richard Simpson, Executive Director Resources and S151 Officer)

6. COMMENTS OF THE COUNCIL SOLICITOR AND MONITORING OFFICER

- 6.1 The Solicitor to the Council comments that under section 120 of the Local Government Act 1972, the Council has the power to acquire land for the purposes of

any of its function. In addition under section 12 of the Local Government Act 2003, the Council has a broad power of investment and may invest for any purpose relevant to the Council's functions under any enactment or for the purposes of the prudent management of its financial affairs. The recommendations in this report are therefore within the powers of the Council.

Approved by Sean Murphy, Head of Commercial and Property Law & Deputy Monitoring Officer, on behalf of the Director of Law and Governance and Monitoring Officer.

(Approved by: Sean Murphy, Head of Commercial and Property Law and Deputy Monitoring Officer on behalf of the Director of Law and Monitoring Officer)

7. HUMAN RESOURCES IMPACT

7.1 There are no human resources impacts.

8. EQUALITIES IMPACT

8.1 An initial equality impact assessment has been undertaken and determined that:

- No major change - the Equality Analysis indicates that the proposal to secure the asset through the purchase of the freehold interest will have a neutral effect.

9. ENVIRONMENTAL IMPACT

9.1 The purchase of the hotel will have no environmental impact. Any future changes to the buildings or redevelopment will be in line with current legislation.

10. CRIME AND DISORDER REDUCTION IMPACT

10.1 The site will continue to be managed responsibly and will look to minimise any risks.

11. REASONS FOR RECOMMENDATIONS/PROPOSED DECISION

The acquisition of the freehold asset will provide a significant rental income in the medium term and could offer possible redevelopment opportunities in the longer term.

12. ALTERNATIVE OPTIONS CONSIDERED

The opportunity to acquire this asset has arisen through the work currently being done by the Assets team as part of the investment strategy and secure future revenue to support the Councils key service and strategy delivery. The only alternative option would be to reject the opportunity on the grounds that it did not represent value for money, was of unsuitable quality or did not meet the proposed investment requirements. The detail provided in the body of the report demonstrates this is not the case,

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BACKGROUND PAPERS:

Appendix 1 – Investment Matrix