

London Borough of Hammersmith & Fulham

Report to: Cabinet

Date: 06 January 2020

Subject: **ACQUISITION OF FREEHOLD INTEREST – 145/155 KING STREET, W6**

Report of: Cabinet Member for Finance and Commercial Services - Councillor Schmid

Summary

The report seeks approval to acquire the freehold interest of 145-155 King Street, a Council operational building currently leased from Canada Life. External property advice has been secured and a negotiated price has been provisionally agreed subject to Cabinet's approval.

The acquisition of the freehold interest will result in several financial and strategic benefits including

- No ongoing rental payments;
- Flexibility to share partner use of the property, making more efficient use of the asset
- Planning short term improvements to the property
- Allow the Council to consider further place-making along King Street following the completion of the new Civic Campus site.

The financial business case supports acquiring the freehold asset as the current rental payments are in excess of the capital repayment charges and supports the Council's underlying Ruthlessly Financial Efficient agenda.

Recommendations

1. To note that appendices 1 and 2 are not for publication on the basis that they contain information relating to the financial or business affairs of any person (including the authority holding that information) as set out in paragraph 3 of Schedule 12A of the Local Government Act 1972 (as amended).
2. To delegate to the Strategic Director for the Economy, in consultation with the Borough Solicitor and Cabinet Member for Finance and Commercial Services to agree the property legal agreements to acquire the freehold interest of 145-155 King Street, W6 on the terms set out in Appendix 2.

3. To approve a capital budget of up to £19.81 million in 2019/20, to be funded by borrowing, represented by an increase in the Council's Capital Financing Requirement.

Wards Affected: Hammersmith Broadway

H&F Priorities

Our Priorities	Summary of how this report aligns to the H&F Priorities
<ul style="list-style-type: none"> • Building shared prosperity 	<p>In the medium term the Council may consider wider place making proposals that contribute to wider prosperity for all.</p>
<ul style="list-style-type: none"> • Being ruthlessly financially efficient 	<p>The Council's acquisition will remove its rental expenditure under the current lease.</p>
<ul style="list-style-type: none"> • Taking pride in H&F 	<p>The Council's acquisition of the freehold it will allow the Council to consider further place making transformation in the medium term following the new Civic Campus is completed in 2022.</p>

Financial Impact

The acquisition of the freehold for 145/155 King Street at up to £19.81m (including the acquisition price, SDLT and other related fees and charges such as legal costs) is capital expenditure that will need to be financed from borrowing, represented by an increase in the Council's Capital Financing Requirement.

The acquisition will result in increased revenue borrowing costs but enable the current rental payment to cease. Financial analysis indicates that the borrowing costs (both external interest and the minimum revenue provision (MRP)) are likely to exceed the rental payments by an average of £140,000 per annum for the first 5 years. Beyond that point, subject to the robustness of the interest rate and inflation assumptions, the borrowing cost will fall below the assumed rental payments and deliver future savings.

Financial modelling has been undertaken in full and this is contained within Appendix 1 (exempt). A summary of the modelling is shown below in Table 1 that shows the total revenue costs in relation to acquiring the asset compared to continue to lease the accommodation.

Table 1	Continue to lease (total revenue costs)	Acquire freehold (total revenue costs)	Saving
Revenue over 20 years	£22.68 million	£18.09 million	£4.59 million
20-year NPV	£16.31 million	£13.76 million	£2.55 million

The hold period for financial modelling has been estimated at 20 years. The interest rate assessment assumption including MRP has been included within Appendix 1 (exempt).

Over a longer time period (20 years), net present value modelling indicates that acquisition is significantly more financially beneficial than renting. Acquisition also secures an asset for the Council that will have a future value.

Appropriate allowance for the borrowing costs will need to be made within future revenue estimates, Medium Term Financial Strategy, and a virement made from the current rental budget.

Except for the rental payment, the revenue running expenses of the building are not expected to be impacted by the acquisition as these are already met by the Council. There may be a cost avoidance as continued renting could have resulted in the Council facing a future claim for dilapidations. Potential dilapidation costs could be over £500,000.

The freeholder has not elected to levy VAT.

Legal Implications

The Council will undertake legal due diligence checks as part of a property transaction conducted by a local authority.

The Local Government Act 1972 section 120 empowers the Council to acquire by agreement any land inside or outside its area for the purposes of:

- a. its functions under any enactment, or
- b. for the benefit, improvement or development of its area.

The Council may acquire by agreement any land for any purpose for which it authorised by this or any other enactment to acquire land. Notwithstanding that the land is not immediately required for that purpose; and, until it is required for the purpose for which it was acquired, any land acquired under this subsection may be used for the purpose of any of the council's functions.

The Local Government Act 2003 section 12 gives local authorities power to invest. It provides that a local authority may invest:

- a. for any purpose relevant to its functions under any enactment, or
- b. for the purposes of the prudent management of its financial affairs.

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Background Papers Used in Preparing This Report**Not applicable**

DETAILED ANALYSIS

1. Proposals and Analysis of Options

- 1.1 The Council currently leases 145/155 King Street from Canada Life, an investment and pensions company, under a 20 year lease that expires in 2027. It is a fully repairing and insuring lease, meaning the Council is responsible for all of the maintenance internally to the building.
- 1.2 The current rent is £926,000 pa, and an upwards only rent review is due in May 2022, which may result in the rent increasing – advisors estimate that the revised rent will be between £1m pa and £1.15m pa. (10-15% increase).
- 1.3 An opportunity has arisen to acquire the freehold interest. The financial profiling shows the Council will save on rental costs when off-set against borrowing costs. The current freeholder, Canada Life, notified the Council it was to sell its freehold interest in early autumn 2019. The Council and Canada Life had discussions to understand their timelines for selling the freehold asset.
- 1.4 The Council outlined its strategy that it may acquire the freehold interest, subject to a negotiated price that offers value for money. Canada Life postponed the disposal of the freehold on the open market with full marketing prepared for a sale in September 2019. This allowed the Council a short period where it could consider the financial and operational reasons whether an acquisition would be worthwhile. There have been negotiations between Canada Life and the Council. A provisionally agreed price has been agreed set out in the exempt appendix 2.
- 1.5 The Council must make significant future financial savings. The acquisition will enable significant savings to be made over the longer term and this has been profiled in exempt appendix 1. The Council's Ruthlessly Financially Efficient remit supports the acquisition of this property as it reduces the Council's exposure to rental expenditure and makes longer-term financial savings after capital repayments are considered to fund the acquisition. Acquisition also secures an asset for the Council that will have a future financial value.
- 1.6 Subject to Cabinet approval, the acquisition would be undertaken in mid-January 2020. The freeholder has received Board approval to proceed.
- 1.7 There are additional reasons apart from the profiled savings and investment opportunity to acquire this property as it presents a strategic opportunity for the Council.
 - The Council's Civic Campus will be completed in 2022/23, playing a crucial place making role in transforming the western part of King

Street. If the Council acquires the freehold interest, this could allow the Council to use its freehold assets to support further place making

- If Canada Life disposes to a third party, a future freehold owner may seek to re-develop the property in 2027 when our lease ends. H&F would need to find a replacement for all its customer facing services and social services hub within 8 years. The Council's search for decant offices in 2018 was challenging, and this could create service continuity challenges. If the Council owns the freehold of 145/155 King Street, it has greater control to plan its asset use and potential modernisation.
- Securing freehold ownership of 145-155 King Street presents a development opportunity and place making opportunity for the Council. This could involve a new retail/office development or potentially a mixed development with new homes on the upper floors.
- At the moment, a re-development option has a lower residual value than the current office investment valuation, reflecting the additional costs of constructing new build against the current strong office valuation.

2. Options Appraisal

2.1 Option 1 – *To continue leasing the premises.*

2.2 The Council to renew the lease in 2027 for another 20 years. The Council may need to work with a freeholder to invest in some modernising of the heating/ventilation as well as modernising communal areas and toilet facilities. The Council would also be liable for dilapidations at the end of the lease if it moved out. The Financial Implications sections outline the profiled rent over 20 years, and this does include potential dilapidations costs.

2.3 Option 2 – *To acquire freehold by private negotiation with the current freeholder in 2019*

2.4 This option will make financial savings as outlined in the Financial Implications section. The Council could share its property with its partners/contractors and help shape its capital investment and planned maintenance programme too. The Council would have time to consider options for re-developing to provide a greater scale of building on a larger footprint.

2.5 Option 3 – *To assign the current lease (all floors or floor by floor) at a future date and after the new Civic Campus is operational.*

2.6 The Council may find it difficult to find new commercial sub-tenants for a limited period up to 2027. There could be void periods if the Council moved out and new tenants had not been legally signed up. This would mean H&F continued to be liable for rental payments. The Council would need to find new office accommodation for its Children's Services and Social Care staff. The Council would also be liable for dilapidations at the end of the lease in 2027.

2.7 **Option 2** is recommended. This report has been prepared on this basis. The Council's external property advisor has conducted negotiations with the freeholder and has agreed heads of terms in Appendix 2 (exempt)

2.8A Red Book RICS valuation has been undertaken by a property agent that outlines the investment value of the asset reflecting H&F as a leaseholder. The investment value has been assessed in consideration of other office investment sales, yield information and office rents. The report included wider commentary on the property market, general economic market in London and the office market in Hammersmith.

2.9 The acquisition of the property would ensure H&F saves on rental payments for as long as it continues to occupy the premises. Financial profiling and implications are summarised in the sections below and detailed in exempt Appendix 1. The modelling has been undertaken over 20 years.

2. Reasons for Decision

3.1 An opportunity has arisen to acquire the freehold interest of a key asset within H&F asset base, where currently it is a lessee. The financial profiling shows the Council will save on rental costs when off-set against borrowing costs. A decision is required in order to acquire the asset and meet the council's ruthlessly financially efficient strategy.

4. Equality Implications

4.1 There are no direct equality implications for groups with protected characteristics at this stage, under the Equality Act 2010, by the approval of these proposals.

Implications completed by: Fawad Bhatti, Policy & Strategy Officer, Public Services, tel. 07500 103617.

5. Risk Management Implications

Risk	Issue	Mitigation
Council seeks to sell 145-155 King Street in the short term	If the Council vacated the property and wanted to re-develop the asset its current future value is less than the current investment value	The Council is acquiring the asset as a long- term investment. It is unlikely to sell this asset but seek to secure other commercial tenants.
Continued uncertainty of Brexit impacting property market before the Council completes the sale	There have been office investment sales in Hammersmith within the last 2 months and these transactions continue to	If there was deterioration in the economy this would impact on the valuation of the property. The

	highlight strong office rents	Council's property specialists would provide advice up to the final legal completion in January 2020.
The landlord of 145/155 King Street decides to market the property formally	The Council would need to formally bid and compete against property funds and institutions. This may result in the Council's offer not being accepted against other parties' bids. The Council would remain as a leaseholder	The Council has worked with Canada Life so there is a short timeline to allow an acquisition at a negotiated price, as advised by a property specialist.

5.1 If the property was acquired the freehold asset would be insured by the Council. At present, the current landlord insures the property and H&F is liable for this cost via a service charge. If the Council acquired the property, the Council's insurers will engage with the corporate facilities management team, so they are fully aware of the insurers policy requirements.

Implications verified by: David Hughes, Director of Audit, Fraud, Risk and Insurance, 07817 507 695

List of Appendices:

- Appendix 1 – Financial modelling on acquisition (exempt)
- Appendix 2 – Heads of terms (exempt)