

Investing in our Commercial Asset Portfolio: Opportunity to Purchase Provincial House, High Street, Haverhill

Report No:	EXEMPTION REMOVED CAB/WS/19/030 (The removal of the exemption also relates to the Appendices A-F attached to this report)	
Report to and dates:	Cabinet	10 September 2019
	Council	19 September 2019
Cabinet Member:	Councillor Susan Glossop Portfolio Holder for Growth Tel: 01284 728377 Email: susan.glossop@westsuffolk.gov.uk	
Lead officer:	Julie Baird Assistant Director (Growth) Tel: 01284 757613 Email: Julie.baird@westsuffolk.gov.uk	
Key Decision: <i>(Check the appropriate box and delete all those that do not apply.)</i>	<i>Is this a Key Decision and, if so, under which definition?</i> Yes, it is a Key Decision - <input type="checkbox"/> No, it is not a Key Decision - <input checked="" type="checkbox"/>	

Decisions Plan: The decision made as a result of this report will usually be published within 48 hours. This decision is not subject to call-in, as the decision is being recommended onto Council. This item is included on the Decision Plan.

Wards impacted: Haverhill Central

Recommendation: It is recommended that, Cabinet:

- (1) Approves the purchase of the freehold interest of Provincial House, 30-38 High Street, Haverhill for £3,500,000 (three million and five hundred thousand pounds), excluding VAT, fees and Stamp Duty Land Tax, to be funded from the Investing in Growth fund; and;**
- (2) Establish a capital budget of £3,699,500 (three million, six hundred and ninety-nine thousand, five hundred pounds) to be made available to facilitate the purchase, including fees and Stamp Duty Land Tax, to be funded from the Investing in Growth fund;**
- (3) Establish a capital budget of £145,000 to fund the cost of landlord works, as detailed in 5.4 of this report, funded from the lease surrender premium.**
- (4) Establish a revenue budget of £230,000, for the period of 3 years, to cover the holding costs of the vacant elements of the building, as detailed in 5.9 below, to be funded from the lease surrender premium.**
- (5) Fund the RIBA stage one feasibility costs of £20,000 as detailed in 6.3 of this report, from the Strategic Priorities and Medium Term Financial Strategy Reserve.**
- (6) That should the purchase be made, the Council's Section 151 Officer will make the necessary changes to the Council's prudential indicators as a result of Recommendations (2 and 3) above.**



1. Summary of Proposal

- 1.1 The Council has the opportunity to acquire a four storey mixed use building known as Provincial House, 30-38 High Street, Haverhill. This offers the opportunity to protect jobs with a major employer in the town; provide an addition to our commercial asset portfolio to generate revenue income; and provide a strategic opportunity linked to the delivery of the Haverhill Masterplan.
- 1.2 Given its local and strategic importance, an option agreement to purchase was negotiated (with Portfolio Holders support) to purchase the property, subject to due diligence and a Council decision. This options agreement allows for the Council to acquire the property by 31 October 2019 at a price of £3,500,000, or £3,100,000 if the anchor tenant, Axa Insurance, exercises its 1 June 2020 break option. However the opportunity for the break notice to be triggered has now passed (1st September).

2. Business Case

- 2.1 The proposal is as follows:

	Summary	Further Details
Proposed purchase site and details	The site comprises a multi-use building located in Haverhill High Street, with retail units at ground floor level and three floors of open plan office space above.	Location plan – appendix A Photos – appendix B Property details in section 4 below.
Strategic Case	<ul style="list-style-type: none">• Enabler to retain a major employer, Axa, in the town.• Prominent building which provides place-shaping influence in the town centre.• Potential OPE Hub site.• Potential to create small office space for local businesses.• Commercial elements support the commercial property portfolio – ongoing revenue return• Generate activity in the town centre to increase footfall and retail demand.	See section 3 below
Financial Case	<ul style="list-style-type: none">• Return after borrowing 1.46%• RICS Red Book valuation of £3.7m (£3.145m if AXA terminate their lease on 1 June 2020).• Budget request £3.699m	See section 5 below.

Risks	<ul style="list-style-type: none"> • The prospect of letting vacant office space in its current layout is poor. This could result in lost revenue and increased holding costs. • Risk of a lack of interest from the public sector for an OPE Hub in this location. 	See section 7 below.
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3. Strategic Case

- 3.1 Provincial House is located in a prominent position on Haverhill High Street. As shown on the location plan in **Appendix A**, the building is positioned immediately adjacent to a Council-owned car park which provides parking for occupiers and customers and is positioned strategically across the High Street from the Council-owned retail units at Jubilee Walk.
- 3.2 As landlord of the building, the Council would seek to facilitate the retention of the anchor tenant, Axa Insurance Plc a major employer in the town with approximately 250 staff on the site. Axa have the option to terminate their lease in June 2020, but Officers have provisionally negotiated terms with Axa for a new lease, which is subject to Council approval of the acquisition. If the Council does not acquire the property, Axa may still choose to vacate when their current lease expires in 2022. This presents a significant risk to the vitality of Haverhill town centre. The importance of retaining a mix of uses including offices is widely recognised as an important factor in the continued economic growth of our towns and in supporting other existing businesses. Conversely ownership of the building could provide the Council with place-shaping influence on the High Street, helping to support the Town Centre Masterplan aspiration of achieving growth in the town. The Haverhill Vision 2031 sets out an aspiration to “encourage uses above shop premises, including residential, to maximise the use of space”. Provincial House offers the potential for re-developing the upper floors to maximise the use of the building which is currently underutilised by Axa. This could help improve the commercial activity in the town.
- 3.3 The commercial office space would complement the Council’s existing commercial property portfolio, providing modern office accommodation with parking. There are also advantages from a place making perspective in the Council owning/controlling a number of key properties within the high street which have a direction relationship with the outcomes it is seeking to achieve in the masterplan. In particularly in being attractive in attracting other investment/investors.
- 3.4 The building has the potential to provide space for public sector services in the Town under the One Public Estate (OPE) programme which is addressed in more detail in section 6.2 of this report.
- 3.5 The investment overall would be in line with all four principles of our Investing in Growth Strategy: (i) investing in our place and people; (ii) behaving more commercially for a blended return; (iii) collaborating to

maximise benefit; and (iv) making our process and policies work for our communities.

4. Proposed Purchase and further details

- 4.1 A location plan is attached as **Appendix A** and photos of the building are included at **Appendix B**.
- 4.2 The ground floor consists of 5 units, three of which are occupied by well-known national operators, including Greggs; Savers and Corals. One unit is currently vacant and the remaining unit forms the entrance vestibule and meeting rooms used by Axa. The current tenancy schedule is shown as **Appendix C**.
- 4.3 The existing retail units will be retained to provide a revenue stream, while part of the ground floor meeting rooms could be converted to provide an additional retail unit. The upper floors comprise of three floors of open plan office space, currently leased to Axa Insurance Plc.
- 4.4 The building could be incorporated into the Council's commercial portfolio to support local businesses and public services while generating an income to help support the delivery of Council services. In the longer term, ownership of this building offers the potential to maximise the utilisation of the building for public sector, third sector or business uses to increase activity in the town centre.
- 4.5 Legal due diligence has been completed and the Council has the benefit of a detailed building survey which was prepared by external firm, Whitworth Co Partnership.
- 4.6 Member approval is sought for the purchase of the building for the purchase price of £3,500,000 based on Axa remaining. Further details are set out in the Financial Case in Section 5 below.

5. Financial Case

- 5.1 The investment value of Provincial House is closely linked to the tenure of the anchor tenant, Axa Insurance Plc. The existing lease held by Axa represents 69% of the current rental income. Due to the open plan nature of the office space occupied by Axa, if Axa vacate the premises, as indicated by our market research with local agents, it would be difficult to attract a similar single occupier with those space requirements.
- 5.2 The Axa lease expires on 31 May 2022, but Axa has a break option which allows them to terminate their lease on 1 June 2020 subject to 9 months' notice (1 Sept 2019). Originally Axa were committed to triggering this break and leaving Haverhill. Predominantly they were concerned about the future use of the building and the uncertainty this created, as well as a desire, at Head Office level, to consolidate their UK operations.
- 5.3



However during discussions with the Head of the UK operation, they recognised the business benefits of an established and strong workforce at Haverhill and expressed a desire to remain if they could downsize into the first floor leaving the two upper floors vacant. This reflects that they now only use one floor for their operations, despite leasing the whole office space. They have indicated that their needs reflect changing ways of working and through better utilisation of space they have indicated they may also look to increase employment numbers.

Surveyors in Property Services have provisionally agreed terms with Axa for the surrender of their existing leases for the offices and parking and the granting of a new 10 year lease, with a 5 year tenant-only break option at a rent of £140,680 per annum exclusive of VAT subject to the payment of a surrender premium of £845,000 to cover lost rent and other liabilities associated with their tenancy. Half of the premium will be paid on surrender of their current leases and the other half will be paid on completion of the new lease.

- 5.4 The proposed new lease with Axa is conditional on the Council, as the new landlord, installing new air conditioning to the first floor at an estimated cost of £145,000. The proposal is that this cost is funded from the lease surrender premium, with the remainder to cover the holding costs from the 2nd and 3rd floors.
- 5.5 This new lease represents a rent of £10 per sq ft for the offices which constitutes a significant uplift from the passing rent of £7.42 per sq ft, albeit for a much reduced 36% of their original space. Under the new arrangement Axa will lease 30 parking spaces (previously 60) at a rent of £15,600 per annum. This is in addition to the rent of £140,680 for the office space and represents an increase in income from the car parking which, under an historic agreement, is currently £0.
- 5.6 Notwithstanding the potential office voids and the low probability of letting the top two floors in the short term, the existing retail income together with the income from the proposed new Axa lease for the first floor are expected to generate an initial return on investment of 7.75% before borrowing (1.46% after borrowing) which is in line with the aspirations of the investing in growth agenda fund.
- 5.7 The following table shows the financial implications of purchasing the building based on the budget requested. On the basis of the progress made on negotiating heads of terms and level of certainty provided by senior staff at Axa, we have worked on the assumption that Axa sign a new 10 year lease on the terms detailed above.



	YEAR 1 - 3 BASE CASE	YEAR 4 onwards	
		BEST CASE*1	WORST CASE*2
Capital Implications of Provincial House, Haverhill	£	£	£
Purchase Cost of building	3,500,000	3,500,000	3,500,000
Stamp Duty (SDLT)	164,500	164,500	164,500
Purchase costs at 1.0% of Capital Value	35,000	35,000	35,000
Refurb costs for 2nd and 3rd floors (basic)	-	53,300	53,300
Total Capital Cost	3,699,500	3,752,800	3,752,800
Revenue Implications of Provincial House, Haverhill	£	£	£
Rental Income	(271,130)	(501,770)	(187,430)
Car Parking (separate agreement)	(15,600)	(31,200)	(15,600)
Building Maintenance Contribution (1.1% of capital cost)	38,500	38,500	38,500
Holding costs (business rates, SC)*3	-	-	122,100
(Surplus) / deficit per annum before borrowing	(248,230)	(494,470)	(42,430)
Borrowing - Interest	101,736	103,202	103,202
Borrowing - Minimum Revenue Provision	92,488	93,820	93,820
(Surplus)/deficit per annum after borrowing*4	(54,006)	(297,448)	154,592
Return on total investment (before borrowing and costs)	7.75%	14.20%	5.41%
Return on total investment (after borrowing and costs)	1.46%	7.93%	-4.12%

Assumptions:

*1 Assumes vacant retail unit and office space on 2nd and 3rd floors let following minimum costs to bring up to lettable standard. Assumes income from revised ground floor unit.

*2 Assumes the two vacant retail units (following the end of their lease terms), the ground floor office and the top two floors do not relet. Assumes existing retail tenants remain to the end of their leases. Assumes

*3 Holding costs for Years 1 - 3 assumed covered by Axa surrender premium

*4 Borrowing on a maturity basis, over 40 years at 2.75% interest

- Axa sign up to new 10 year lease for 1st floor area only

- 5.8 The figures in the table above include the full cost of prudential borrowing, however, actual borrowing would only take place when the Council's treasury management activities identify such a need. For example, this could be when the Council's cash flow management activities anticipate that an external cash injection is required to maintain the appropriate level of cash balances for the council to operate and fulfil its budget and service delivery requirements.

- 5.9 Given that Axa are expected to vacate the second and third floors, we have budgeted for holding costs of approximately £230,000 primarily to cover the cost of business rates, utilities and non-recoverable service charges associated with the vacant parts of the building. We have allowed that this will be covered by the surplus of the Axa surrender premium (£705,000) for at least the first three years. Based on market study and investigations, it seems unlikely that a tenant will be found for the vacant office space in the short term and we have assumed a three year period for this space to remain vacant. However the Council, alongside exploring the redevelopment options (section 6.0) could market the property to further test market advice received to date. This would include utilising our advantages such as owning adjacent parking, and economic development activity to help increase potential to fill voids.
- 5.10 The worst-case scenario assumes that by year 4 any tenants with lease expiries will chose not to renew. This risk will be managed though proactive estate management and early engagement with those tenants.
- 5.11 The Council has obtained an RICS "Red Book" valuation report of the property. The reported opinion of Market Value is £3.7m assuming Axa remain in occupation, albeit under their existing lease term. We have undertaken an in-house valuation which provides an indicative Market Value of £3.781m, assuming the new Axa lease is completed. This higher figure reflects that the rental income from Axa is secured for a longer period, and the potential is there to generate further rental income from the upper floors. Either scenario reflects favourably against the negotiated purchase price of £3.5m.
- 5.12 A table detailing the results of Dunn & Bradstreet credit checks for each tenant has been attached in **Appendix D**. The table provides information regarding the financial standing of each tenant and demonstrates that all tenants are long established companies with strong covenants and a low risk of failure.
- 5.13 Officers have reviewed the current office market in Haverhill and found no evidence of demand for large open plan offices. Existing office stock in the town caters for the small businesses with the majority of office space being under 1,000 sq ft. Commercial agents operating in the area have warned of the potential difficulty of letting office space of the size offered at Provincial House, hence why we will need to also consider alternative options for the space.
- 5.14 Although the national retail market is experiencing a reduction in demand, Haverhill town centre continues to maintain healthy occupancy levels. With 10 vacant shops at present, the 5.2% vacancy rate compares well with the 10.4% national average.
- 5.15 Unit 4 on the ground floor is currently vacant but the vendor is offering a one year rent guarantee for the shop, which will provide the Council with some revenue comfort while a tenant is sought.
- 5.16

Discussions with the vendors commenced in March and the option was agreed in order to allow the Council the opportunity to undertake due diligence and initial feasibility whilst the property would remain off-market. The cost of the option was negotiated at £10,000 (down from the originally proposed £100,000) and this amount will be taken off the purchase price. If the option is not taken up, the Council will not be able to recoup the £10,000 consideration paid for the option.

6. Re-development potential

6.1 Building condition

6.1.1 A detailed condition survey of the building was recently prepared by external building surveyors, Whitworth Co' Partnership. The survey provides a detailed assessment of the current condition of the fabric of the building and the mechanical and electrical systems along with cost estimates for any recommended repairs.

6.1.2 Whitworth's overall assessment concludes that the building is sound. They had no major concerns regarding the condition of the building but highlighted minor defects which can be remedied with a reasonable level of investment.

6.1.3 The following is a summary of the estimated costs for essential repairs as reported in the survey.

Works required now	£6,565
Short Term (1-2 years)	£49,490
Medium term (1-5 years)	£51,700
Long term (10-15 years)	£120,050
Total costs	£227,805

6.1.4 An annual provision to cover these costs has been built into the financial appraisal in 5.7 above.

6.1.5 The long term costs relate to the expectation that the flat felt roofs may need to be re-covered within 10 to 15 years. At present Whitworth advise the flat roofs and the copper elements of the roof are in satisfactory condition. Subject to the repair and replacement of some copper sheets, they estimate that the copper roof could last another 40 to 50 years.

6.2 One Public Estate

6.2.1 As part of the Open Public Estate (OPE) programme the partner organisations which make up the West Suffolk Property Board received a grant to commission a 'Public Asset Study' to identify opportunities to transform the public estate in Haverhill to achieve operational efficiencies and generate economic growth.



- 6.2.3 The 2018 study sought to highlight opportunities to reconfigure the public estate in Haverhill by assessing the current accommodation requirements of public partners and identifying opportunities for co-location. It identified the potential for two or more 'hubs'. Alongside a 'blue light' hub and the extension of facilities at the leisure centre (already partly implemented), the report identified the scope for a 'community services' hub. In the case of the latter, the report did not prescribe a specific location for the potential hub. Instead, it highlighted existing options on land already owned by the public sector *and* the possibility of the partners acquiring a new site. Some of the original grant money is available for further feasibility work once a preferred option is identified.
- 6.2.4 Delivery of the OPE programme in Haverhill is being led by the ONE Haverhill partnership, linked to the delivery of the town centre masterplan. Although these OPE discussions for Haverhill are at an early stage, the potential availability of space in Provincial House provides the ONE Haverhill partnership with additional options for locating key community services and public services alongside business space to help energise the High Street. For instance, facilities for advice and skills which are well suited to office accommodation.
- 6.2.5 The location of a public service hub on the High Street could therefore support the aims of the OPE programme and potentially help drive the wider place-shaping agenda for the town in line with the Town Centre Masterplan.

6.3 **Feasibility Study**

- 6.3.1 The Council's Place Delivery and Strategic Property team have produced a high level feasibility study to assess the viability of reconfiguring underutilised parts of Provincial House to accommodate public sector uses and flexible office space accounting for the consolidation of Axa's operations onto the first floor.
- 6.3.2 Zonal drawings, which show the potential for subdividing the vacant office space for public sector uses, are included in **Appendix E**. The drawings are conceptual at this stage, but demonstrate the potential to cater for some public services in the building in line with the initial opportunities identified in the Public Asset Study.
- 6.3.3 The estimates undertaken from this initial design exercise indicates the cost of undertaking the works would be between £2,468,000 and £2,856,000. These numbers would be reviewed as part of the next-stage feasibility and would be considered alongside an assessment of the wider benefits (such as additional rental income, increased footfall and release of other public sector land). A breakdown of the costs is attached as **Appendix F**.
- 6.3.4 As part of the next stage feasibility, further discussions with OPE partners would need to take place as to inform potential requirements and opportunities for wider land release of other sites in public ownership. Other options for the space, outside of public sector use, would also be considered.

6.3.5 In order to be able to undertake some more detailed feasibility work, an initial budget of £20,000 is required. This will enable us to provide more detail in relation to the proposals set out above and other options for the space.

6.4 Energy saving measures

6.4.1 The Council's in-house Energy Advisor has identified the potential for energy savings of approximately £11,620 per annum, with an investment of £73,750 in building improvements. This equates to an approximate return of 15% over 20 years.

6.4.2 The measures include the installation of solar panels on the flat roof, digital controls for air-conditioning, thermostats in server rooms, LED lighting and more efficient wall heaters. These savings could potentially be recovered from tenants in the form of income.

6.4.3 In future the plant room on the ground floor, which currently contains redundant plant, could be used to house an energy centre that could provide heat and power to nearby buildings. The Haverhill Vision 2031 set out an ambition for decentralised energy provision in the town.

6.4.4 Technologies such as biomass or gas combined heat and power systems and boilers could be installed which would generate an income of £10,000 to £30,000 per annum achieving a return of at least 10% on the investment.

7. Risks

7.1 Legal Considerations

7.1.1 The usual legal due diligence, including searches, to support a potential acquisition has been completed and no major concerns have been raised.

7.1.2 The Council's Legal Service have examined the title papers, copy leases granted and the search results obtained by Legal. The main issue highlighted relates to the Axa lease, in particular, whether or not they will exercise their break option. The Council's positive negotiations with AXA regarding the potential for entering into a new lease with the Council on exercise of the Option should help to retain Axa as a tenant.

7.1.3 Other potential issues, set out below, have been mitigated against as far as possible:

- As stated at 5.13 above, Unit 4 is vacant but the seller's offer of a one year guarantee should mitigate any loss of rent in the short term;
- under the terms of the existing lease for the car park, the Council is obliged to insure and maintain the car park land and access areas but AXA indemnifies the Council under its lease terms against any third party claims regarding use of the car park land and the service road during working hours unless caused by the neglect of the Council. These terms will be re-gearred as part of the lease surrender;

- the Ladbrokes lease runs for 5 years, but an annual tenant break clause creates some uncertainty over the income;
- a potential chancel repair liability has been identified but this is mitigated by the seller agreeing to supply an indemnity policy which will be upgraded to the level of the purchase price being paid by the Council.

7.2 Resource considerations

7.2.1 If purchased, the property will be managed using existing resources within the Council's in-house Estates team.

7.2.2 Although Axa has offered to provide reception services while it is mutually beneficial, staff time will be required to set up new service charge budgets and procure services for the maintenance of common areas.

7.2.3 The cost of maintaining common areas could be recovered from tenants depending of occupation levels, but the ongoing property management requirements will need to be factored in to Property Services staffing resources.

7.3 Other Risks

Risk	Mitigation
Risk of retail tenancy voids as a result of the ongoing nationwide decline in demand for retail.	This acquisition is proposed with a view to maximising the utilisation of the building to generate more footfall on the high street thus improving retail trade. The vendor is offering a one year rent guarantee for the vacant unit which provides revenue comfort and allows time to find another tenant.
Tenant liquidations could affect revenue streams.	The three existing retail tenants and Axa are large companies which represent strong covenants with a low risks of failure. See the table in Appendix D which details tenant covenants. Mixed use developments spread the risk of tenant failure. If the retail market collapse, the offices could continue to produce an income. The existence of four separate tenancies will further help to spread the risk. In addition, the future development of the building could increase the number of occupiers thus spreading the risk further.



<p>Unforeseen defects could be discovered after the purchase which could prove costly to remedy.</p>	<p>The Council's in-house Building Surveyors have inspected the property and a full building survey has been prepared by an external firm. Both report no major concerns in relation to the fabric of the building.</p>
<p>The proposal for Axa to downsize to the first floor could result in the top two floors of office space remaining vacant in the medium to long term exposing the Council to holding costs and lost revenue.</p>	<p>A high level feasibility study of the potential re-development potential of the vacant space has been prepared in-house. This provides costs alternative uses, particularly considering public sector uses. Even allowing for the vacant office space, the short term income produces an adequate return on investment to meet the requirements of the Investing in Growth Fund.</p>

8. Alternative Options

- 8.1 At any point during the life of the investment the building could be sold. In the long term, value could be added by obtaining outline planning consent for alternatives uses.

9. Consultation and engagement

- 9.1 This is set out within the report as above

10. Implications arising from the proposal

- 10.1 **Financial** - Covered in the main report.
- 10.2 **HR / Staffing** – there are no TUPE or HR issues relating to this purchase.

11. Appendices

- 11.1 **Appendix A** – Location Plan
Appendix B – Photographs
Appendix C – Tenancy schedule
Appendix D – Tenant covenants
Appendix E – Feasibility drawings
Appendix F – Feasibility costings

