Corporate Director (Law and Governance) and Monitoring Officer, T W Mortimer LLB Solicitor OSC

OVERVIEW AND SCRUTINY

ASHFORD BOROUGH COUNCIL

Notice of a Meeting, to be held in the Civic Centre, Tannery Lane, Ashford, Kent, TN23 1PL on Tuesday, 24th April, 2018 at 7.00 pm.

The Members of the Overview and Scrutiny are:-

Cllrs. Burgess, Chilton, Krause, Bartlett, Martin, Miss Martin, Ovenden, Hicks, MacPherson, Howard, Feacey and Knowles

Agenda

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4. **Commercial Investment by the Council** 1 - 12

The report will present information on the Council's policies for property acquisition; the background, return, risks, due diligence and future plans for International House and Park Mall; and risk assessment for commercial investments made by the Council.

(Report to follow)

Note for each Application:

(a) Private representations (number of consultation letters sent/number of representations received)
(b) The indication of the Parish Council's/Town Council's views
(c) Statutory Consultees and Amenity Societies (abbreviation for consultee/society stated)

Note to Members of the Committee: The cut-off time for the meeting will normally be at the conclusion of the item being considered at 10.30pm. However this is subject to an appropriate motion being passed following the conclusion of that item, as follows:
"To conclude the meeting and defer outstanding items of business to the start of the next scheduled Meeting of the Committee".

ASHFORD

Supports ‘S’, objects ‘R’, no objections/no comments ‘X’, still awaited ‘+’, not applicable/none received ‘-‘

Note on Votes at Planning Committee Meetings:

At the end of the debate on an item, the Chairman will call for a vote. If more than one motion has been proposed and seconded, the motion that was seconded first will be voted on first. When a motion is carried, the Committee has made its determination in relation to that item of business and will move on to the next item on the agenda. If there are any other motions on the item which have not been voted on, those other motions fall away and will not be voted on.

If a motion to approve an application is lost, the application is not refused as a result. The only way for an application to be refused is for a motion for refusal to be carried in a vote. Equally, if a motion to refuse is lost, the application is not permitted. A motion for approval must be carried in order to permit an application.

DS
16 April 2018

Queries concerning this agenda? Please contact Clare Ricketts telephone: 01233 330491 email: clare.ricketts@ashford.gov.uk
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Agenda Item No:

ASHFORD
BOROUGH COUNCIL

Report to Overview and Scrutiny Committee

Council investment in commercial property

International House and Park Mall

The Overview and Scrutiny Committee is asked:

1. Note the content of the report

Date of O&S meeting:	Tuesday 24th April 2018
Chair of O&S Committee:	Cllr Chilton
Relevant Portfolio(s):	Cllr Galpin Corporate Property and Projects Cllr Shorter Finance & IT
Summary:	This report provides a summary of the background of the purchase of both International House and Park Mall and how the Council has managed these facilities.
Exempt from Publication:	**NO**
Background Papers:	Cabinet Report 13th February 2014 Commercial Quarter Overview & Scrutiny 24th March 2015 International House Update Overview & Scrutiny 22nd September 2015 International House Report on Full years trading Cabinet 12th March 2015 Regeneration of Park Mall Council 16Th April 2015 Regeneration of Park Mall Cabinet 8th September Corporate Property Performance Annual Report 2015/16 Cabinet 14th September Corporate Property Performance Annual Report 2016/17
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Agenda Item No.

Report Title: Council investment in commercial property International House and Park Mall

Introduction and Background

1. During scrutiny of the 2018/19, budget members expressed interest in scrutinising the commercial approaches taken by the council with regard to strategic and income-generating property acquisitions.

2. The commercial approaches fell into two distinct strands. Income generated through the acquisition of commercial property funded directly by the council and the return on loans made by the Council to its wholly owned property company.

3. This report looks at the acquisition of and investment into commercial property funded directly by the council and specifically the purchase of International House and Park Mall. The Property Company report is to be presented to this Committee in May.

International House

4. The council approved the purchase of International House together with the adjacent properties on Dover Place and the Dover Place car park in February 2014. The purchase of International House was part of the council's wider ambition of creating and establishing a Commercial quarter.

5. The purchase of International House and the Crouch's Garage site has enabled the council to facilitate the comprehensive redevelopment of this area. As can be seen, the first part of this redevelopment is well underway with the building of the new office block on Dover Place car park completing in May 2018 and with the appointment of an architect to bring forward incubator units on the Island site within the commercial quarter site.

6. The council also saw the purchase of International House, as strategic investment. The purchase of the building enabled the council to secure an additional income stream and thereby increase our financial resilience over time rather than be reliant upon Central Government funding which has been steadily reducing.

7. As has been reported annually to the council in the Corporate Property Performance Annual Reports to Cabinet in September 2015/16 and again to Cabinet 2016/17, International House continues to provide a high level of return against the cost of purchasing the property. Returns for International House are summarised later in this report.

Park Mall

8. The council approved the acquisition of the long leasehold interest in Park Mall, which had 243 years remaining at the time of purchase together with the freehold acquisition of 98 High Street (currently occupied by O2).

9. The contract contains an overage provision that states, if the Council sells the freehold property for more than the purchase price within 3 years of completion, then the Council will pay to the seller 50% of the increase in the purchase price, once fees have been deducted from the purchase. This will come to an end of next month.

10. The decision to purchase Park Mall was on the basis to intervene in the town centre where the private sector had failed. The Council's intervention supports the council's longer-term regeneration plans for the town centre and not for a financial return.

11. At the time of purchase, Park Mall was in steady decline with a vast number of the units being vacant. It was felt by many, that in its then form and under its previous owner, it would not be revived. However, the Council was confident that with intensive management, and a local focus, the centre could be reinvigorated into a successful and sustainable retail-led shopping centre.

12. At the time of purchase, members accepted that in the short term and possibly longer than that the purchase would be cost neutral for the council.

13. At the time of purchase, it was recognised that the centre is ageing and ultimately in the medium term will need to be redeveloped. It was accepted that in the short term the council had, a full agenda seeking to deliver the big 8 projects and that it would take between 3 to 5 years until this position was changed and there was the capacity to begin the process of planning for the longer-term future of the site.

14. The purchase of Park Mall has also allowed the council to take a longer-term view on the redevelopment of the site that is constrained by the Council owning the leasehold rather than the freehold interest. By taking a holistic approach to any future redevelopment, it could be shaped to complement other initiatives the council intendeds to undertake to revitalise and reshape the town centre.

Property Operation and Management

15. At the time of purchase of the facilities and property management of the buildings was outsourced externally. International House was being managed by GVA and Park Mall being managed by Jones Lang LaSalle. The commercial agency function for the properties was managed by Atrium Surveyors and Cushman Wakefield respectively.

16. Following the purchase of Park Mall the council appointed Craddick Retail to act as commercial agents for the property whilst retaining Atrium Surveyors to act as commercial agent for International House. The commercial agency function for International House is planned for retendering in June 2018.

17. In 2016 officers with the support of the Portfolio holder, undertook a review of the property and facilities management for International House and Park Mall and concluded that at that time it was unable to bring management of the properties in-house, as the council did not have the necessary resource or skills to manage the buildings. Accordingly, in 2017 the council went out to competitive tender for the provision of property and facilities management services. The result of the tender was that, GVA retained the property and facility management function for International House whilst Stiles Harrold Williams took over management of Park Mall.

Current Occupancy Levels

18. The occupancy levels for both office and retail properties varies over time and can be impacted on by lease expiry dates, local and national market conditions as well as other external economic factors such as the impact of Brexit and the confidence of international financial markets.

19. Whilst the British economy has been undergoing a slow recovery since the financial crash of 2008, recently we have seen the failure of a number of large well-known businesses such as BHS, Toys 'R' Us and Carillion undermining the levels of confidence in the economy.

International House

20. At the time of purchase of International House, community groups who each secured tenancies at peppercorn rates occupied the first floor of 5,000 sqft. Officers worked with the community groups to relocate them to alternative locations thus freeing off valuable lettable space, which is let at a market rent.

21. In addition, a number of further initiatives were initiated to improve the facilities within the building together with the surrounding area in doing so retained a number of the existing tenants who had previously shown an interest in considering alternative facilities once their lease had come to an end.

22. Due to the nature of the tenancies which were in place at the time of the acquisition and in the subsequent years (2016/17 and 2017/18) saw a number of leases expire, equating to approximately 39,250 square foot (of a total of approximately 79,245 square foot).

23. The most significant lease, which ends in 2018, is that for Block B (occupied by the DWP) for approximately 17,000 square feet. Commercial terms for a new lease have been agreed and it is anticipated that a new long-term lease for this part of the building will be signed imminently, in doing so this further

protects the Council from income volatility on this block for a ten year period.

24. Of the remaining vacant space, approximately 22,250 square ft., commercial terms and/or leases have been agreed/signed for approximately 16,500 square foot, which leaves approximately 6,000 square foot vacant. The majority of this is accounted for by the 11th floor, which became vacant in November 2017. This floor is currently being actively marketed with a number of potential tenants having expressed an interest.

Park Mall

25. It is against this backdrop that the purchase and subsequent success at Park Mall should be considered. At the time of the purchase of Park Mall, it was made clear that the primary goal of the purchase was to try to reinvigorate the centre and enable the council to achieve the regeneration of that part of the town centre.

26. Park Mall was in decline with only four national multiple retailers represented in the centre. The majority of units were either vacant or occupied by the charity sector or retailers with poor quality covenants.

27. With the council's entrepreneurial approach being applied together with overwhelming commitment by the Portfolio Holder for the town centre and support by officers the Council has been able to turn around a failing centre.

28. Following the purchase of Park Mall the council set about attracting new retailers and businesses to the centre. At the time of writing, this report there is now only two vacant units with a lease on one of the vacant units expected to be signed imminently and discussions taking place with a number of potential retailers for the other. In addition, the number of charity shops has reduced to one and that covenants on the tenants for a number of the remaining units have been improved.

Return on Investment

29. The returns on investment have been reported to members annually since the purchase in 2014 of International House (Corporate Property Performance Annual Reports 2015/16 and 2016/17 and the report entitled International House Report on Full Years Trading 2014/15). Figures for the 2017/18 period are not yet available. Copies of the results are provided in **Appendix 1**.

30. As can be seen for International House the yield received has been in-line with or higher than predicted. For Park Mall, it was expected that to begin with, it would operate at a slight loss and that it would take 3 to 5 years before Park Mall was able to operate with a revenue position that was broadly neutral.

31. However due to the final purchase price for Park Mall being lower than originally anticipated plus the work the council has proactively achieved in reducing the number of vacant units and increase the strength of the

covenants within the shopping centre, Park Mall has reached a position where it is making a small profit for the council.

Review of Risk Registers

32. At the time the council approved the purchases of both International House and Park Mall risk registers were included within the reports. Copies of these and a review of the risks and commentary on them are provided in **Appendix 2**.

Future Plans for International House & Park Mall

33. International House was purchased as both an investment as well as part of the longer term council plan to develop the Ashford Commercial Quarter. With the continuing demand for office space in Ashford, there are currently no plans to dispose of the property as it is providing a financial return to the council as shown in **Appendix 2**. The resurfacing of the International House car park is planned for this month with further improvements planned for later this year.

34. For Park Mall, the council has made significant strides in turning the fortunes of the centre around and helping the centre to attract people to the town centre. At this time, the council intends to focus on developing the appeal of the centre and attracting retail providers that will bring additional footfall to the centre and to the town centre in general.

35. In the longer term, the purchase of Park Mall will aid the council in its plans to redevelop this area of the town centre; emerging thoughts are being considered for the scope and the timing of the redevelopment proposals, which to be commercially viable and would need to programmed, cognisant of the Council's leasehold interest. Therefore, the future redevelopment of the site will form one of the key projects for the new administration and the next corporate plan.

Conclusion

36. The purchase of International House and Park Mall by the council has led to both significant financial benefits to the council in relation to International House and a significant improvement in both the occupancy and footfall in Park Mall.

37. These purchases and improvements, in conjunction with other council activity such as the Elwick Place development, are helping the council achieve its aim of making Ashford a destination for both employers and the public in general.

38. A new corporate property management strategy was presented at April's Cabinet; this strategy will provide the structure in how the Council considers property purchase opportunities for the future.

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Appendix 1 – Return on Investments

	International House 2014/15	International House 2015/16	International House 2016/17		Park Mall 2015/16	Park Mal 2016/17
Total Income	£1,047,800	£1,223,198	£1,699,827		£416,640	£525,374
Total Expenditure*	£255,650	£309,709	£706,509		£414,391	£516,612
Surplus/Deficit	£792,151	£913,489	£993,318		£3,249	£8,762
Purchase Price	£7,900,000	£7,900,000	£7,900,000		£823,500	£823,500
Return	10%	11.6%	12.6%		0.4%	1.1%
Predicted return	11%	11.2%	11.4%			

* Expenditure does not include capital charges/financing charges or internal recharges for staff costs etc.

Appendix 2 – Risk Registers – Park Mall

Park Mall acquisition Strategic Risk Analysis

Original issue 18/02/2015
last Update 18/03/2018

Risk Description	Impact	Severity of impact 1 low 5 high	Probability 1 low 5 high	Outcome / Risk weighting	Mitigation	Assigned to	Mitigation Progress	New Likeli' hood	New Rating
Redevelopment costs underestimated	Project runs over budget or development proves not viable and project fails	5	3	15	Thorough site investigations, due dilgence and development apprisal prior to site acquisition	Pmckenner	Proposals have not commenced	3	15
Change in Council direction/priorities	Loss of member support for project - project closed	5	2	10	Obtain Cabinet approval prior to May 2015	Pmckenner	Members remain committed in managing the existing facility and will decide on the priorties for the Town Centre shortly	2	10
Timeframe slip (beyond rent guaranteed period)	Project runs over budget	4	3	12	Sufficent allocation of resources with efficient and effective project management	Management Team	Corporate Delivery Plan has been established, where resource planning is in place	3	12
Insufficent resources allocated to project	Project delivery delayed	4	2	8	Ensure sufficent allocation of resources at project start and continual assessment throughout project life cycle	Management Team	As above	2	8
Changing Council personnell during life of project	Project loses momentum	2	5	10	Working chanels of communication and no single points of failure	Pmckenner	Corporate Delivery Plan to establish Project Sponsor and Team	5	10
Leasehold/landlord libility underestimated	Project costs estimate and/or demand on resources exceeded	3	3	9	Legal/title investigation and condition survey	Pmckenner	Proposals have not commenced	3	9
Unforseen land assembly complications	Project cost increases and/or delay	4	3	12	Legal/title investigation and measured land survey	Pmckenner	Proposals have not commenced	3	12
Change to Central Government policy	Dependent on change	5	2	10	Keeping informed of change	Policy Team	Updated regularly	2	10
Harm to Council's reputation	Loss of public support buy-in	3	3	9	Working channels of communication	Dean Spurell	Socail media channels , website for centre, loveashford and ashfordfor	2	8
Change in market conditions	Impact on project budget/viability	3	3	9	Make provision for market sensitivity in appraisal	Pmckenner	Proposals have not commenced	3	9
Increase in retail unit voids	Increased project costs (S/C, rent, NCR)	4	3	12	marketing strategy and effective management of units	Economic Development/ Pmckenner	Ongoing with agent and the strong committement of officers to turn around a failing centre	3	9
Title constraints (consents, overage provision) in relation to site development	Project cost increases	4	2	8	Legal/title investigation	Pmckenner/Legal services	Proposals have not commenced	2	8
Resourcses required for property management underestimated	Project costs increase	4	3	12	Realistic resource budgeting at outset which is continually reviewed	Phil Bond /Paul Stanton	Compeditive tendering for FM function. Long term mainteance costs to be balanced against contuing to manage the facility	3	12
Planning Persmission/Policy	Non compliant Planning Permision and Policy	5	2	10	Early planning involvement and continual review	Pmckenner	Proposals have not commenced	2	10

Graphical Explanantion

High Risk

Probability

5	5	5	10	15	20	25
4	4	4	8	12	16	20
3	3	3	6	9	12	15
2	2	2	4	6	8	10
1	1	1	2	3	4	5

Likelyhood

Low Risk

1 1 2 3 4 5

Severity

Appendix 2 – Risk Register – International House

Risks Assessment

The Cabinet adopted a property acquisition policy that outlined the risk assessment criteria that would be applied when making an acquisition. These risks are as follows:-

Acquisition risk – negotiations for the purchase of this property are at an advanced stage with the valuation agreed and therefore the risks in this area are considered minimal.

Property market changes – the property is not being actively marketed by the owners and negotiations are at an advanced stage so there is a low risk of the property market changing and affecting this property.

Cost risk – Due to the advanced stage to discussions this is a low risk of incurring abortive costs; however, some costs have already been incurred and would be lost should the purchase not continue.

Lack of suitable sites- Not applicable for this purchase as the asset has been identified.

Property market risk- This investment is not looking to speculate on an increasing asset value and the cash flows of the assets will be used to reduce the debt linked to this purchase and therefore a reduction in the property value should not cause a significant risk.

Void risk- the financial modelling has assumed a 5% level of voids and bad debts however; a protracted period of voids is a risk to this investment. The Council is going to continue the existing management arrangement, which has experience in the management, and marketing of the property. It is suggested that the provision for voids and bad debts is put aside in a reserve to cover for a fall in income levels. The primary risk in this area is the eventuality that tenants exercise break clauses within their leases and suitable alternative tenants cannot be found. The length of existing tenancies is staggered and there is a reasonable duration remaining on existing tenancies, which mitigates this risk. Given the towns focus on growth and the reasonable prospect for recovery, this is not seen to be a short-term risk. Long-term voids will have an impact on the overall revenue budget with no income to offset the costs of owning a property. To mitigate this eventually the Council may need to consider whether the property could be sold or redeveloped.

Refinancing risk- the Council exposure to increasing debt will need to be considered as part of its Treasury Management function and will be reviewed annually**.** Therefore when assessing investment opportunities we will use the PWLB 25 year interest rate. This acquisition represents the second property purchase under the property acquisition policy. Whilst these properties have incurred some debt, the Council is comfortable with the level of general fund debt on its balance

sheet with debt forecast to be circa £11m and general fund assets forecast to be £65m.

Review of Risk Registers: International House

Acquisition risk – The purchase of International House was completed successfully.

Property Market Changes – Demand for office space has remained good within Ashford.

Cost Risk – The purchase of the building was successful so there were no abortive costs.

Lack of Suitable Sites - Not applicable.

Property Market Risk – There has not been a reduction in commercial property prices.

Void Risks – As has been mentioned previously there have been a number of leases ending since International House was purchased. The majority of which have had new leases negotiated and agreed. The most significant void has been the 10th floor however, terms have now been agreed for its lease and it is hoped that the contract for the lease will be signed in the next 4-6 weeks. Financial modelling has assumed a 5% level of voids and bad debts, which has mitigated decreased revenues due to voids.

Refinancing Risk – Financing of the purchase of International House has been considered as part of the council's overall Treasury Management function.