

To: City Executive Board
Date: 15th September 2017
Report of: Fiona Piercy, Interim Assistant Chief Executive –
 Regeneration & Economy
Title of Report: Investment in Existing Property Portfolio

Summary and recommendations	
Purpose of report:	To provide an update on the progress of a number of identified opportunities to maintain or improve the income stream from the Council's property investment portfolio. To seek approval for an increased budget requirement of £4,635,000 in addition to the existing approved budget of £10,300,000 to include the undertaking of additional projects.
Key decision:	Yes
Executive Board Member:	Councillor Edward Turner
Corporate Priority:	Vibrant and sustainable economy An Efficient and Effective Council
Policy Framework:	Asset Management Plan
Recommendation(s): That the City Executive Board resolves to:	
<ol style="list-style-type: none"> 1. Note the progress on the various schemes that had been identified and had budget approval to the value of £10,300,000. 2. Recommend to Council an increase of £4,635,000 to the allocated budget of £10,300,000 to deliver the development opportunities at 1-5 George Street, Standingford House, Cave Street and add the new project of refurbishing 2 flats at 11 New Road and houses at 9 and 10 Ship Street. 3. Authorise entering into exclusive negotiations to seek financially viable agreements to lease with two identified commercial tenants at 1-5 George Street in line with the Not For Publication Appendix 7, subject to Council budgetary approval. 4. Enter into the above agreements for lease at rental levels above the threshold of £125,000 per annum in line with the constitution. 5. Delegate to the Interim Assistant Chief Executive – Regeneration and Economy, in consultation with the Head of Finance, the authority to 	

alter the terms of the agreements to lease on the basis that they continue to represent best value during negotiations.

Appendices

Appendix 1	Plan of George Street
Appendix 2	Plan of Standingford House
Appendice 3a, b, c	Artist Impressions
Appendices 4a,b	Plan of Ship Street & New Road
Appendix 5	Revenue cashflow NOT FOR PUBLICATION
Appendix 6	Development cashflow
Appendix 7	List of tenants NOT FOR PUBLICATION
Appendix 8	Financial Implications NOT FOR PUBLICATION
Appendix 9	Risk Register NOT FOR PUBLICATION

Introduction

1. Four projects were identified by the City Council as requiring capital expenditure to increase and improve the income stream from the existing assets within the property investment portfolio. These properties were –
 - 1) 38-40 George Street (Odeon)
 - 2) Old School, Gloucester Green
 - 3) 1-5 George Street
 - 4) Standingford House, Cave Street
2. High level feasibility studies were undertaken on each and subsequently a budget of £10.3m for the projects was included within the City Council's Budget Report in December 2015.
3. No further work has been carried out on 38-40 George Street as this opportunity is currently not deliverable.
4. £685,000 has already been committed to the successful purchase of Old School, Gloucester Green.
5. On further detailed analysis the scope of the opportunities at 1-5 George Street and Standingford House has increased and as a result the projected revenue and density of the projects has improved significantly. To support this increased revenue the anticipated development cost for the two schemes has risen to £14m (£9.75m + £4.25m respectively).
6. In addition to the above, 2 flats at 11 New Road and houses at 9 and 10 Ship Street have been identified as requiring capital expenditure to allow the rental value to be maintained and maximised.
7. Further information on the individual properties is set out below.

38-40 George Street (Odeon Cinema)

8. This 1930's building is currently let until 2024 to Odeon Cinemas, with a Tenant only break clause in September 2019. The risk relating to this break clause is recognised and high level viability works have taken place. Odeon has recently been taken over by AFG and is not yet clear on its intentions. Discussions will continue, to ensure that Odeon 's intentions are known at the earliest opportunity No further exploratory work will be undertaken on this project until clarity is given as to the intentions of Odeon. Therefore this development opportunity will be re-visited in 2018.

Old School, Gloucester Green

9. This property was purchased for £685,000 in 2016 and the project is now closed.

1-5 George Street

10. 1-5 George Street comprises 5,232 sq ft of retail and office accommodation (partly vacant) and 5/5a George Street comprises 3,580 sq ft let to Ask Restaurants. A plan is attached at Appendix 1. All existing leases expire on, or before, 24 December 2017. In the absence of reinvestment, the current accommodation is dated and likely to prove difficult to let resulting in an erratic and diminishing rent roll. Of the current income of £212,600 per annum, £85,900 could be at serious risk and unlikely to be sustainable.
11. Initially, it was proposed to undertake a modest refurbishment for retail on part of the ground and basement floors, with residential above. High level viability suggested a capital cost of approximately £3,600,000 to secure a rent of £262,000 per annum. The return was increased by a capital receipt from the sale of the residential upper parts. However there were some design difficulties in access arrangements for residential above the refurbished accommodation.
12. Subsequent and more detailed viability suggested that better outcomes both from a design and financial perspective could be achieved by pursuing a much denser development of the site rather than refurbishment. In addition it was identified that the site lent itself more to office accommodation than residential (particularly if the aim is to maximise revenue rather capital receipt on sale). This has been confirmed by our property advisors.
13. A full design team has subsequently been appointed and the project has progressed to concept design stage (RIBA Stage 2).
14. The latest proposal is for a full demolition and rebuild of the existing buildings to provide approximately 6,000 sq ft of restaurant accommodation on the ground and basement levels with approximately 16,500 sq ft of Grade A office accommodation on the upper parts. There is a lack of quality office accommodation in the City Centre, so this scheme format has considerable benefits in providing central office accommodation for businesses wanting to remain in a central location and potentially for attracting new businesses into the area.

15. The completed development should have an income stream of some £630,000 per annum and a total new construction cost of £9,700,000 (therefore an increase in the capital budget of £6,100,000).
16. It is anticipated that the end capital value of the project will be in the region of £11,500,000.
17. Based on the above the scheme would deliver a profit after costs of approximately £1.5m representing a 15+% profit on cost. The provision of Grade A office accommodation in the heart of the City is a major consideration.

Risk Mitigation - Potential Agreements to Lease (pre-let)

18. Identifying and securing a pre-let at this stage of the development process mitigates significant marketing and letting risk on completion of the construction process. Authority is sought to enter into exclusive negotiations with two tenants that could occupy the whole building on completion. Both proposed parties have sufficient covenant strength to support the valuation assumptions. In order to satisfy the requirements of s.123 Local Government Act 1972, the rental levels suggested will be ratified by a third party independent valuation to ensure best value is achieved. It is noteworthy that 2 lettings for the whole building would significantly decrease the management burden of the property compared to a multi let scenario and will potentially increase value due to known covenant strength.
19. This approach also supports a George Street restaurant occupier and a current town centre business which protects the city centre from potentially losing a significant private sector employer. The ability to work with these identified occupiers through the design process could bring cost savings and de-risks the development process.
20. The proposed tenants for the pre-lets are contained in the NOT FOR PUBLICATION Appendix 7

Threshold Level Authority

21. In compliance with the Council's constitution and given that the rental levels are above the officer authorisation threshold approval is therefore required from CEB to enter into the agreements to lease. It is further requested that the Interim Assistant Chief Executive – Regeneration and Economy has authority delegated, in conjunction with the Head of Finance, to approve changes in rental level (providing it still meets s.123 requirements) and to authorise the detailed terms and conditions of the agreements.

Standingford House and Building H Cave Street

22. Standingford House (previously known as the Enterprise Centre) is a multi-let office/workshop building converted from a 1950's industrial property. The existing accommodation is of poor quality and the building fabric is approaching the end of its economic life. Building H is adjacent and is a former car repair workshop which is now vacant and also in poor condition. This is a single storey structure which provides inefficient site density. The site is overlooked by residential properties and is not attractive. A plan is attached at Appendix 2.
23. The original proposal in December 2015 comprised the construction of an annexe to Standingford House on Building H site. These works were estimated at

approximately c.£1.1m to increase the rent by £110,000 per annum from the existing £100,000 per annum. The proposal was also predicated on gaining vacant possession of Building H, this has now been secured.

24. Subsequently, changing legislation on the energy performance of commercial buildings meant that Standingford House would become unlettable from 2018 due to its poor energy efficiency. The original scheme would not have tackled this issue. This has provided an opportunity to reconsider the overall proposal to create an integrated building which utilises the site much more efficiently and provides increased development, this approach being endorsed by the occupiers and the local planning authority.
25. The current proposal is for a significant refurbishment of Standingford House which will comply with new legislation and future proof the income stream. The site of Building H will provide an integrated extension over two storeys. Artist impressions are attached at Appendix 3.
26. The alternatives considered included a full redevelopment of the whole site which was less financially attractive. Residential use was also considered and discounted on planning policy grounds.
27. The preferred option has the further advantage of providing continuity of occupation for existing tenants.
28. The proposal provides much needed modern small business units in a central location with inherent regeneration benefits. It also future proofs an income stream which had become unsustainable due to legislative changes. The new proposed capital budget for the revised works is £4,250,000 which should provide an income stream of approximately £400,000 per annum.
29. The project is currently at a stage of finalising cost and specification and further engagement is ready to be undertaken. A planning application is being prepared for the development and works are being progressed to demolish building H.

Additional Project - Ship Street & New Road

30. Residential properties at 9 & 10 Ship St and 11 New Road (second floor) have been vacant since the leases were forfeited due to non-payment of rent. A plan is attached at Appendix 4. No income is being created from these assets. They require complete refurbishment before they can be re-let as they are currently uninhabitable and un-lettable. If the properties are refurbished they could be let on standard commercial lease terms for residential use. The City Council is unable to let properties on assured shorthold tenancies which would be the normal private market practice. This is a statutory position which cannot be challenged (Housing Act 1988 Schedule 1). These properties are not suitable to be transferred into the HRA housing stock or for Temporary Accommodation acquisition project (due to the location and configuration). CEB should note that there will be a margin between the income received by the Council under the standard commercial lease and that received by the tenant which will let to residential occupiers under Assured Shorthold Tenancies.
31. This is a new project where circa £300,000 is required to provide an income stream of some £55,000 per annum. Without this investment there will be ongoing and increasing maintenance and vacancy liabilities. The works will ensure a good

standard of residential accommodation in the City Centre which should attract good quality landlords. An alternative would be to dispose of the assets which is not a preferred option at the present time. The New Road property is opposite the entrance to the new Westgate centre and could see value appreciation. The Ship Street property forms part of a larger strategic holding around Ship Street & Broad Street.

32. The project has been progressed with Direct Services and subject to allocation of budget is ready to commence.

Financial implications

33. The financial implications are provided at Appendices 5, 6 & 8 NOT FOR PUBLICATION. In all three revised scenarios there is an above average rate of return for the Council and the increased revenue will provide additional resources to support the Council's Medium Term Financial Plan. Within the Council's current capital programme is an amount of £10.3 million financed from prudential borrowing profiled over the next four years. This report requires provision to be made for an additional £4.635 million which is also assumed to be financed by prudential borrowing taking total estimated spend up to £14.635 million over the next four years. In cash terms additional commercial rental income is estimated at £770,000 per annum. In summary the financial returns are shown in Appendix 8

Legal issues

34. None – See attached Risk Register.

Level of risk

35. Property development by its very nature requires fluidity around budgets through the design and planning process. From the initial concept to delivery there are significant changes to be expected around scheme design, use and density. Challenges to deliverability and therefore risk continue throughout the project and are exacerbated by potential flux in the property market (both occupier and investor) and by changes to the construction market (which is currently buoyant) and which drives cost.
36. Of the 3 opportunities the 1-5 George Street proposal attracts the highest development risk. Both Standingford House and Ship Street/New Road are significantly further forward in the design process and therefore costs are more certain. George Street is at concept design stage and consequently further cost changes are anticipated. In addition this is a complex scheme on a landlocked site in the city centre. This opportunity could revert to a refurbishment option should significant cost over-runs be identified. See attached risk register at Appendix 9 NOT FOR PUBLICATION for detailed risk assessments.

Equalities impact

N/A

Conclusion

37. The latest design and viability work on the projects described in this report has identified opportunities to maximise development returns and secure regeneration benefits along with the need to meet latest environmental standards. The increase in budget will secure improved returns and outcomes improving the quality of our portfolio.

Report author	Nick Twigg
Job title	Major Projects & Development Manager
Service area or department	Regeneration and Major Projects
Telephone	01865 252294
e-mail	ntwigg@oxford.gov.uk

Background Papers: None

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