Executive Decision Report

Proposed Strategic Acquisition of the Haymarket Centre, Leicester City Centre

Decision to be taken by: City Mayor

Decision to be taken on: 17th November 2021

Lead Director: Matthew Wallace / Richard Sword

Useful information

- Ward(s) affected: Castle Ward (City Centre)
- Report author: Matthew Wallace, Director of Estates, City Development and Neighbourhoods
- Author contact details: +44 (0)116 454 0068
- Report version number: v1

1. Summary

1.1. This report seeks approval to expand our portfolio within the Council's Corporate Estate, with the strategic acquisition of the 'Subject Premises' known as the Haymarket Centre for £9.96m including stamp duty.

1.1.1 Upon successful freehold acquisition, the Haymarket Centre would be included into the Council's Corporate Estate portfolio. This would provide strategic and operational control of a key city centre asset, and would mean that the council ceases to be a tenant for key aspects of the centre. There will be city community-based benefits, such as the protection of weekly shopping basket type retail in the city and opportunities for the provision of more city centre based public services).

1.1.2 The Centre will generate financial returns from the rental income from commercial retail and hospitality occupiers.

1.1.3 The Haymarket shopping centre is a unique acquisition opportunity, as the city council is a major occupier who currently contributes 19% of net revenue to the asset, and strategically the shopping centre is interlinked to our wider regeneration priorities for the city, as is demonstrated through the redevelopment of the Haymarket bus station. Furthermore, as the city centre continues to be a focus in order to support the post Covid recovery, this acquisition offers the ability to support small start-up businesses and the Highstreet through flexible lease arrangements.

1.1.4 Upon acquisition the Council would look to operate the Centre through the current Managing Agents, the terms of which will be finalised prior to completion, subject to negotiation.

2. Recommended decision

2.1 The City Mayor is asked to approve:

2.1.1 the acquisition of the Haymarket Centre for £9.96m including Stamp Duty Land Tax. ~~and fees).~~ *[an earlier version of this report included reference to fees in error and this has been removed]*

2.2.2 the addition of £9.96m to the capital programme as an immediate start, funded from £10m of monies set aside at outturn 2020/21 for capital investment purposes.

3. Scrutiny / Stakeholders / Communications

3.1 Due to the nature of disposal by the present owner's, the Council were required to complete the purchase within a 30-day period with a requirement to exchange immediately thereafter, there has not been opportunity to consult as a result. Further it would be prejudicial to the Council interests if this were to be considered publicly prior to decision or before the purchase concluding, given the exclusive nature of the opportunity and the fact the property has not been marketed at this stage.

4 Detailed Report

Background

4.1 The Haymarket Centre is in the geographical centre of the city, covering 3.8 acres of land, and with 192,000 sqft of enclosed retail space. The extent of the land which the proposals relate to is shown on the plan at in Appendix 1 to this report.

4.1.1. The subject property contains a number of commercial tenants on the internal shopping mall, including the anchor tenants Matalan and B&M. It also comprises areas already leased by the Council, principally the area known as Haymarket House (sub-let to Travelodge), the car park, the theatre and Public Health Clinic. In addition, though in separate ownership, visually the centre also combines the retail units of Primark, TK Maxx, and the under development Metro Bank.

4.1.2 Historically the Centre was purchased by the current owners, Kennedy Wilson for £38m in 2013.

Summary of our Current Interest in the Subject Property

4.2 As noted above, the Council has a significant existing interest in the property though current leasing arrangements. The Council occupation covers some 92,000 square feet and equates to 19% of the rental income of the lettable area , as follows:

LCC Use	Approx Sqft	Annual Rent	Term	Expiry
Theatre	29,612 sqft	£1 peppercorn	55 years	27/9/2073
Car Park	12,002 sqft	£368,000	20 years	08/04/2044
Bus Station Toilets	1518 sqft	£1 peppercorn	9 years	28/09/2024
Travelodge Hotel	36,511 sqft	£1 peppercorn £6.5m premium	125.1 years	15.11.2145
Public Health Clinic	11,517 sqft	£99,500	15 years	17/02/2033
Shop Mobility Unit	1008 sqft	£1 peppercorn	9 years	28/09/2024

4.2.1 The Council therefore has a significant interest at present in the ownership, operation and management of the Haymarket due to being a key leaseholder and having already undertaken significant work to enhance the offer of the property to the city centre in the refurbishment of the theatre and car park and the opening of the Travelodge. The existing interests being combined with the ownership of the freehold would provide the advantage of being able to control the asset to reduce overheads incurred (and forming part of the Service Charges payable by the Council). In addition, at present when the Council requires variations or consents etc significant costs are incurred under the lease in terms of meeting the costs of the Landlord.

4.2.2 The Council has already invested in the surrounding area such as the new Haymarket bus station, the new road link to St Margaret's bus station and the pedestrianisation of the surrounding roads. There could be opportunities for further regeneration in the area, by relocating other services to the centre and through development of the asset itself.

Asset plans and strategic potential of the subject premises

4.3 The retail strategy seeks to maintain a city centre retail presence, whilst at estate level, support local enterprise and provision through flexible leases and incentives. This acquisition therefore supports the strategy in that it strengthens the council's city centre retail holding, ensuring the continuance of this very central and popular location.

4.3.1 This transaction will add to and enhance the corporate estate.

Management of the Centre upon acquisition:

4.3.2 The centre is currently managed by an agent, Savills, on behalf of the current owner (Kennedy Wilson) and the owner act as the asset manager determining strategic direction of the asset. As part of the due diligence it has become clear he Managing Agent holds the vast majority of the data, experience and information about the centre.

4.3.3 The Council does not currently have capacity to manage such an asset and the loss of the knowledge of the managing agents on acquisition would make continuity of the centre more demanding and difficult.

4.3.4 It is therefore proposed, subject to negations, that Savills are appointed as the Council's Managing Agents for a 2 year period to allow for assessment of the management arrangements and learning, in order that alternative arrangements can be made for the end of that 2 year period whilst ensuring continuity of service to the tenants.

4.3.5 It is also proposed that an Asset Manager be appointed for a year to establish the strategy for the asset going forward, drive down vacancies, reduce rent arears and improve service charge recovery. The retail and shopping centre expertise required to undertake this role doesn't exist within the Councils existing team, therefore we would seek external subject matter experts to provide this service. The cost for this will be £125k for the year.

4.3.6 As a going concern it is acknowledged that the Centre will require continuous investment to continue to make it an attractive destination for customers as well as businesses operating from the centre.

Rental Income and Existing tenancy arrangements:

4.4 The shopping centre has 52 tenancy lease agreements. As to be expected on a transaction of this nature, there are various observations highlighted through the due diligence that we have raised as queries with the vendors team. A summary of those lease agreements along with analysis comments and key risks across all 52 tenancy leases has been included within Appendix 4.

Existing Rent arrears and Outstanding Service Charge payments:

4.4.1 The Heads of Terms are written that the rent and service charge arrears transfer across with the transaction. Any monies recovered post transaction should be passed back to the vendor. The detail of this point is being discussed further to establish whether any arears obtained post completion should remain with the Council to support ongoing and future investment into the Shopping Centre rather than returned.

Rent arrears

4.4.1 The headline rent arears identify that £332k of rent is owed. If the credit on the Council's own advance rent payments is refunded, then £673k of rent is owed. The vendor has deals in play to get this figure down before completion. If some does transfer however, this could be positive, as we may recover some and should be able to use some as leverage to get better ongoing deals with some existing tenants.

4.4.2 The obvious concern is that too many tenants have been allowed to avoid paying rent again, with a good management regime in place this can be quickly turned around.

Service charge arrears

4.4.3 Service Charge arrears are currently £251K. With the right management plan in place The Council will be able to collect a significant amount of that figure. The Council will engage fully with the SPA and to make sure the Vendor tops up any service charge holes that we know are not recoverable i.e. tenants in admin, tenants vacated etc.

4.4.4 A full service charge analysis can be viewed in Appendix 4.

5. Technical Due Diligence

5.1 Access to documents concerning the property has been obtained through the exclusivity period to allow for the Council and its advisors to undertake due diligence, proper financial forecasting and risk assessment and identification in relation to the asset. This has included detailed analysis of the current tenants, their term, the rental income and term positions on each and a detailed analysis of the service charge arrangements. An independent valuation and further site visits have also been undertaken to assist in the due diligence process.

Valuation – Freehold and Market Rent

5.2 To demonstrate the value, the Council has obtained an independent Valuation in compliance with all industry standards, from Cushman and Wakefield. In Cushman and Wakefield's opinion the purchase price proposed is supported. The market rent and the market value of the freehold interest in the subject property, as at the valuation date and subject to their assumptions in the report, are:

5.2.1 The market rent valuation is £2,366,673

5.2.2 The market value of the freehold interest is £9,500,000

5.2.3 The Independent Red Book Valuation can be found in Appendix 2.

Building Structure

5.3 The centre is a concrete framed structure with in-situ cast slabs and largely brickwork elevations, with areas of vertical glazing and cladding panels. The centre was originally constructed in the early 1970's and has been subject to various alterations and refurbishments over the years. There have been no specific structural surveys completed as part of the due diligence, but the main structure has been described as sound and secure in the 2020 condition survey that was carried out.

5.3.1 Mechanically it has many original features which are beyond their design life and present a risk to the Council, albeit no more so than other aged stock of its estate. Investment needs and funding will be considered in the Council's usual capital programme and maintenance programme setting, as with existing assets.

Maintenance Observations

5.4 Through the technical due diligence surveys, we have identified the above backlog of maintenance on the shopping centre. This type of maintenance and repair is to be as anticipated with an asset of this nature and age. The indicative costs of these are attached in more detail within Appendix 3, with appropriate risk ratings and are profiled over a number of years. The asset will be incorporated within the corporate estate maintenance programme and a budget allocated accordingly on a cyclical basis, concentrating on the non-compliances straight away, followed by the immediate investment / PMM.

6. Legal Implications

6.1 **TUPE**

6.1.1 There are, as is understood from the data made available to the Council no employees directly employed by the current owner of the Haymarket Centre.

6.1.2 As in the report the facilities management is carried out by Savills, who directly employ a number of staff who work solely on the centre management. That contract with the current owner is specially drafted to terminate on sale of the asset by the current owner and cannot be novated to the Council.

6.1.3 Provided that the Council contracts with Savills as proposed in the body of the report then no TUPE will arise as there will be continuity of service from Savills and the staff will remain in their employment. This will need to be carefully monitored and if the contract does not look as though it will be entered into legal advice will need to be sought as TUPE will then most likely to operate to transfer the staff to the Council in the absence of a new operator undertaking the management function of the centre.

6.2. **Property and Title observations**

6.2.1 Liability for the property will not pass to the Council until completion. Whilst there may be a period between exchange and completion there will be no risk in the property for the Council. Insurance is being arranged for completion.

6.2.2 The title report from the Council’s external solicitors concludes that the title is a good marketable title. This is subject to points of note from the title investigations, the key ones of which are summarised below:

a. The title is subject to a number of restrictive covenants, most notably restricting the use to retail with associated office accommodation or residential above. It also restricts the sale and/or production of alcohol. In addition, there are ones relating to the height of the buildings fronting Braunstone Gate. The report concludes that the actual current use is likely to be in breach of some of these and it is recommended an indemnity policy is obtained.
b. There are various rights of way over the Property that have been granted to adjacent land parcels. Though not an issue at present these should be noted in terms of future development of the site.
c. There are multiple telecommunication wayleaves, common to a property of this nature. They are however difficult to terminate, will restrict future development depending on what is proposed, and will result in the need for proper management to ensure the terms of the agreements are complied with. It should also be noted that the law in this area is complex and often in favour of the telecommunications companies, rending such agreements fairly significant in terms of their impact on a property.
d. The title registers to the Property do not indicate the ownership of or responsibility for boundary fences or walls. This means we do not know at this stage who has financial responsibility. It could be us as owner, it could be a third party or it may not be determined and, therefore they will be party boundaries (if either our deeds or the adjoining owners deeds do not mention it) and issues arise in dealings with these boundaries and can vary depending on the nature of the boundary (e.g. wall, hedge, fence).
e. Due to requirements under the various leases we should arrange to have in place insurance for the full reinstatement value of the centre on completion. If we do not we will be in breach as landlord.

6.3 Contractual and commercial matters

6.3.1 Advice has been given in relation to the appointment of a Managing Agent, as this will take place without a procurement exercise, but it is considered permissible within the Public Contract Regulations 2015 on the basis of urgency.

6.3.2 There are requirements within the contract for sale which will require the Council to effect novation of relevant commercial agreements following completion within a set timeframe. On review there are however few relevant agreements owing the fact that the majority are held by the managing agent and not the owner and that others terminate on sale. Those limited agreements that are relevant are being dealt with by enquiries to ensure they novate or are terminated.

Emma Jackman, Head of Law (Commercial, Property & Planning)

7. Financial Implication

This report proposes to add £9.96m to the capital programme (as an immediate start) to enable purchase of the Haymarket Centre and associated Stamp Duty Land Tax, professional fees, etc. This will be funded from the £10m of monies set aside at outturn 2020/21 for capital investment purposes. No borrowing is being incurred and there will be no on-going financing costs.

Whilst the purchase will generate significant rental income to the Council, this is not the primary purpose of the purchase, as described in the report.

The due diligence referred to in the report has included the necessary financial reviews. In particular, the centre will generate on-going income from commercial rents, the Council will cease to pay rents on areas currently leased (see 4.2 above), operating costs will be incurred (for example the managing agents and day to day maintenance and staffing); and more major and planned maintenance will of course be needed from time to time. The report identifies that some works will be required in the shorter term.

Certain operating costs are charged to the service charge account, with subsequent recharges to tenants. The Council will continue to be liable for the service charges relating to the areas it occupies.

As noted, a programme of planned maintenance and renewal will be developed. The centre will also require periodic investment to ensure it is able to continue to attract shoppers and businesses, supporting on-going rental income and footfall and the vibrancy and success of the city centre. The funding for such works will be considered as part of future capital programme setting processes, and will take into account the rental income being generated.

Colin Sharpe, Deputy Director of Finance

8. Climate Change and Carbon Reduction implications

8.1 According to UK government figures the commercial sector was responsible for 10.1% of carbon emissions in Leicester in 2019. Following the city council's declaration of a Climate Emergency in 2019, and it's aim to achieve carbon neutrality, addressing these emissions is a vital. The greatest opportunity to make progress in this area is through those buildings under the council's direct control and influence, including where buildings are acquired by the council.

8.1.1 If the proposal to acquire the Haymarket Centre were to go ahead, then opportunities to improve the energy efficiency of the overall building and the individual units should be considered and acted upon, wherever practical, as part of the transition to net zero by 2030. This would include measures outlined above such as improving insulation, fitting lower-carbon heating and hot water systems, installing low-energy lighting and equipment and fitting renewables, such as solar PV panels. This work could be guided by the individual Recommendation Reports accompanying the EPCs, with a particular focus on those units with the lowest EPC ratings. However, it should be pointed out that whilst these improvement measures will improve the overall EPC ratings and reduce carbon emissions, they are not designed to achieve zero carbon.

8.1.2 In order for the project to achieve net zero it would require separate survey work to be carried out by independent consultants to advise on appropriate solutions for the site as a whole, and the necessary funding identified.

9 Equalities Implications

Not Applicable for this transaction

10 Background information and other papers:

- Local Government Act 1972
- Revenue Outturn Report July 2021
- Section 123 of the Local Government Act 1972.
- Corporate Estate Annual report and Strategy 2020/21

11. Summary of appendices:

11.1 Appendix 2 to 4 are exempt from publication and are therefore marked "Not for Publication".

Appendix 1: Site red line plan

Appendix 2: Independent Red Book Valuation Report

Appendix 3: Technical Due Diligence Summary report

Appendix 4: Summary of due diligence, Identified risks

12. Is this a private report (If so, please indicate the reasons and state why it is not in the public interest to be dealt with publicly)?

12.1 The general covering report is not exempt but specific details given about the property in Appendices 2-4 are exempt. This is because they give specific information about the property, tenants and the owner(s). This is exempt information as defined in Paragraphs 1 (information relating to an individual) and 3 (information relating to the financial or business affairs of a particular person, including the authority holding that information) of Schedule 12A of the Local Government Act 1972, as amended. Appendices 2-4 are, therefore, marked "Not for Publication".

13. Is this a "key decision"?

Yes

14. If a key decision, please explain reason

The report involves capital expenditure in excess of £1m which has not been specifically approved by Council, as per Article 6 of the Constitution.

APPENDIX 1

Site red line plan

Site Plan

APPENDIX 2

Independent Red Book Valuation Report

Exempt from Publication

APPENDIX 3

Technical Due Diligence Summary report

Exempt from Publication

APPENDIX 4

Summary of due diligence, Identified risks

Exempt from Publication