

# Croydon Council

<b>DELEGATED DECISION REPORT TO:</b>	<b>Cllr Callton Young, Cabinet Member for Resources and Financial Governance</b>
<b>SUBJECT:</b>	<b>Alteration to lease terms for existing Agreements at Concord and Sycamore House, London Road, Croydon</b>
<b>LEAD OFFICER:</b>	<b>Sarah Hayward Interim Executive Director Place Steve Iles Director Public Realm</b>
<b>CABINET MEMBER:</b>	<b>Councillor Carlton Young, Cabinet Member for Finance and Resources Cllr Stuart King Deputy Leader and Cabinet Member for Croydon Renewal</b>
<b>Ward</b>	<b>West Thornton</b>
<b>COUNCIL PRIORITIES 2020-2024</b>	
Corporate Plan - the proposals presented in this report will:	
<ul style="list-style-type: none"> <li>• Maximise the use of the Council's assets to deliver new homes, including affordable, private for sale and private rented stock</li> </ul>	
<b>FINANCIAL SUMMARY:</b>	
The proposed amendments to the lease will deliver a one off capital receipt of at least £1m. The benefits and risks of the various options are set out within the detail of this paper	
<b>FORWARD PLAN KEY DECISION REFERENCE NO.: 3921RFG</b>	
The notice of the decision will specify that the decision may not be implemented until after 13.00 hours on the 6th working day following the day on which the decision was taken unless referred to the Scrutiny and Overview Committee.	

The Leader of the Council has delegated to the Cabinet Member for Resources and Financial Governance the power to make the decisions set out in the recommendations below

## 1. RECOMMENDATIONS

Cabinet Member for Resources and Financial Governance in consultation with the Leader agrees the following:

- 1.1 Approve the variation of the existing lease terms for the long leases for Concord and Sycamore House on the basis set out in section 3.2 of this report

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| 1.2 | Note the potential opportunity to secure a further capital receipt through the extension of the lease terms. |
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## **2. EXECUTIVE SUMMARY**

- 2.1 Concord and Sycamore House are two former office buildings that were converted into residential accommodation in 2015 under the permitted development scheme. The Council initially took 10 year leases for each site but these were then re-gearred in 2017 and separate long leases for both Concord and Sycamore House were agreed. These were for an effective term of 40 years in return for a reduced annual rental and taking on full repairing responsibilities. On expiry of the leases the Council have the right to purchase the freehold interest for £1.
- 2.2 The current leases are drawn on standard full repairing and insuring terms with the landlord insuring and tenant reimbursing the cost.
- 2.3 The current freeholder, Cheyne Asset Management are proposing to sell the assets and the prospective purchasers are looking to amend the terms of the leases with the Council in return for a one off cash payment. They have proposed an initial option as set out below with the further potential to extend the lease term for a further one of capital payment.

## **3. BACKGROUND**

- 3.1 The Council entered into 40 year leases for both of these buildings in July 2017. Under these agreements, the Council is responsible for all repairs and maintenance and for re-imbusement of the insurance costs. The rent paid is below a market rent but is indexed linked with annual CPI increases. Under the terms of the lease the Council is not permitted to assign the lease but can sublet individual units and can charge a social or market rental.
- 3.2 There is no break clause in either lease except in the case where the property is destroyed or damaged by an insurable event and cannot be reinstated or is unlikely to be reinstated within 3 years. At this point the tenant may terminate the lease.
- 3.3 Under the terms of the existing lease the Council are already fully responsible for all repairs and maintenance to the building and will continue to be so for another 37 years. As was demonstrated by the recent extensive works required to comply with fire regulations, the lease does not give the Council the ability to stop paying rent if the building or parts of the building become incapable of occupation due to repairs issues.
- 3.4 The prospective purchasers, JAG Capital Investment Managers are looking to purchase the leases as part of their long term pension investment portfolio. They are therefore looking to secure a guaranteed long term income stream and have approached the Council to amend the terms of the leases. They have proposed 3 basic options:

#### **3.4.1 Option 1 – Continued 37 Year Lease and an upfront payment**

This option would entail the lease running for the remaining 37 years, with the lease being varied to make the tenant responsible for insuring the premises and guaranteeing to pay the rent for the term of the lease no matter what. (ie remove the option to terminate the lease following destruction by an insurable risk). This would result in a one-off upfront payment of £1M to the Council. In addition the purchasers are prepared to allow a right to redevelop the building during the term of the lease. This is not currently an option within the existing lease and therefore if the building was to develop a major structural failure the Council would be required to carry out the necessary repairs rather than have the right to redevelop which, given the age and nature of the building could be a more viable option.

The variation will also grant the Council the ability to opt for a further 8 year lease extension by serving a Notice on the Landlord on or before the 31 October in return for an additional capital receipt of c£8m

Following completion of the lease variations the Council would have two potential options that will be purely at the discretion of the Council as to which one, if any, are taken:

#### **3.4.2 Option 2a – Extend to 45 Years with and an upfront payment**

This option would entail the lease being extended by 8 years, with no reduction in the annual lease payment. This would result in a one-off upfront payment of c£8M to the Council (in addition to the £1m under option 1).

#### **3.4.3 Option 2b - Extend to 45 Years with a reduction in the annual lease payment and an upfront payment**

This option would entail the lease being extended by 8 years, with a reduction in the starting annual lease payment of circa £85.6K. This would result in a one-off upfront payment of c£4M to the Council (in addition to the £1m under option 1).

The two stage approach has been put forward due to the timing of the deal to allow for the Council to follow the correct governance and for further due diligence by way of structural surveys.

## **4. DETAIL**

4.1 The proposals outlined above all have the same basic lease amendments:

1. The lease will be amended so that the Council are responsible for insuring the buildings – the insurance team have confirmed that this will be possible and given that the Council will have the benefit of using its block policy, may deliver some savings or at least certainty. This years recharged insurance premiums showed an increase of c 62% increasing from £54,000 to £88,000 and under current guidance the tenant is unable to force the landlord to take out insurance with the cheapest company
2. The major change that is proposed is for the introduction of a “Hell or High Water” clause. This basically means that the Council would have to

guarantee paying the rent for the entire term of the lease. At the moment the Council have the ability to break the lease if the building is damaged or destroyed by an insured risk and it is incapable or likely to be incapable of being re-instated within 3 years. There are no other break options. This clause gives the pension fund a guaranteed income over the whole term.

3. The introduction of a tenant only redevelopment clause. There is currently no right for the tenant to redevelop the buildings over the term of the lease. Therefore if the buildings developed substantial disrepair issues, the Council would not have an automatic right to rebuild and may therefore have to undertake uneconomic repairs. Whilst rent would still be payable for the period of the redevelopment at the agreed passing rent, this would at least allow the Council to redevelop and the rent would remain as per the old lease rents. This will reduce future risk by increasing flexibility

4.2 Whilst points 1 and 3 are seen as positive changes that provide more flexibility and control in the long term, point 2 does increase the Councils potential risk. Therefore as part of the negotiations, the terms of the proposal will include indemnity insurance to cover the potential risk. The proposal is to take out a policy with Aegis, an A+ rated company with the premium being covered by the purchaser. The summary of the policy terms are set out below:

**Proposed Contingent Insurance policy:**

Insured	Contingent Loss of Rent The Mayor and Burgesses of the London Borough of Croydon
Property(ies)	1. Concord House, 454 London Rd, Croydon CR0 9BH 2. Sycamore House, 799 London Rd, Thornton Heath CR7 6FD
Lease	A HOHW lease dated [tbc] and made between (1) the Landlord and (2) the Tenant
Inception Date	<b>tbc</b>
Period of Insurance	From the Inception Date and continuing {either for a period of [37] years, or until xx/xx/xxxx – being the expiry date of the Lease}.
Cover	The Insurer will, subject to the Excess, indemnify the Insured during the Period of Insurance for Loss of net Rent payable under the Lease sustained directly as a result of 1. total damage or destruction to the Property; and 2. the Property is unable to be reinstated during the Period of Insurance; and 3. the Insured is required to continue to make payments of Rent under the Lease

Excess

1. Three years from the date of any loss, destruction or damage to the Property; and
2. The Limit of Indemnity for the full Reinstatement Amount under a standard Material Damage insurance policy

Limit of Indemnity

1. Concord House - £847,034.88 per annum at the Inception Date
2. Sycamore House - £429,270.70 per annum at the Inception Date

The LOI will increase each year in accordance with the Rent Review calculation under the Lease subject to a maximum amount of [3]%.

Material Damage Insurance Policy

A standard Material Damage Insurance Policy available to the Insured in the London Insurance Market from an insurer with a rating of at least A-

Reinstatement Amount

The Limit of Indemnity provided for under a Material Damage Insurance Policy in respect of the full value of the reinstatement of the property taking into account increases in the cost of building

Premium

To be agreed but c1%-1.3% of the Limit of Indemnity

- 4.3 Given the covenant strength of the Insurer it is not believed that there will be a long term risk of the company failing and the policy being void.
- 4.4 Whilst this policy cannot guarantee to cover 100% of all potential failures to be able to occupy the premises for the intended purpose, it is difficult to envisage an event that would prevent occupation that is not already a risk under the existing lease (ie major repair issues) or through a change of legislation or government prohibition that would not attract compensation. At present, damage caused by uninsurable risks would not allow the Council to determine the lease.
- 4.5 The Council's Insurance team have confirmed that both the company and the proposals outlined above should minimise any potential risk so far as insurance is able to do so.
- 4.6 With the inclusion of the indemnity insurance, the additional risks of the proposed changes are considered to be minimal and the redevelopment clause and ability for the Council to insure are likely to be beneficial.
- 4.7 If the lease is amended as proposed by Option 1 above then the Council would receive a one off payment of £1m. The purchasers have also agreed to cover the Council's valuation and legal fees should the matter completed. As part of

the variations there will also be a clause allowing the lease to be extended for a further 8 years. This is to be a tenant only option and will be time limited whereby the notice must be served by 31 October 2021 for either option 2a or 2b as outlined above

- 4.8 Option 2a offering a reduced rental is less financially attractive both from an NPV basis and especially if the premium can be used to offset part of the loan from MHCLG. It must be recognised that both of the options to extend the lease term could carry some additional risk given the age and possible maintenance requirements for the building. In order to help quantify any risk a full structural survey and concrete analysis is recommended before undertaking any decision and as part of the negotiations the landlord has agreed to cover up to £25,000 towards the cost of undertaking such surveys. The results of the surveys will allow an informed decision to be undertaken prior to service of the notice.
- 4.9 JAG are looking to purchase the assets and are likely to do so whether the Council agree to any of the above Options or not. If we decline they will take out the indemnity themselves to cover continuity of income but this is seen as less attractive in the market than a guaranteed income from the Council. The extension of the term to 45 years is attractive to JAG as this is a recognised investment period within the market which, again, makes this a more attractive proposition for the company
- 4.10 Given the impending purchase, time is of the essence and JAG are looking for formal cabinet approval to Option 1 prior to the 31<sup>st</sup> July

## **5. CONSULTATION**

- 5.1 No external consultation has been undertaken in connection with the options contained within this report

## **6. PRE-DECISION SCRUTINY**

- 6.1 This proposal has not been presented to Scrutiny

## **7. FINANCIAL & RISK ASSESSMENT CONSIDERATIONS**

### **7.1 Revenue and Capital consequences of report recommendations**

The impact of the three options has been considered on the basis of a NPV model to allow a suitable comparison.

The payments to the Council will be made on completion of the lease agreements

## **Options for Concord House and Sycamore House**

	<b>Option 1</b>	<b>Option 2a</b>	<b>Option 2b</b>
	£'000	£'000	£'000
<b>Cash Inflow</b>			
<b>Upfront payment to LBC</b>	<b>-1,000</b>	<b>-9,000</b>	<b>-5,000</b>
No of years (lease)	37	45	45
<b>Cash Outflow (saving)</b>			
Insurance Premiums (saving p.a.)	-5.909	-5.909	-5.909
Lease Payments (saving p.a.)		-	37
Lease Payments (additional years)	-	8	8
Lease Payments (additional payments p.a.)	-	1,285	1,200
Discounted NPV	<b>-1,128</b>	<b>-6,003</b>	<b>-4,246</b>

Option 1 is the recommended option for the Council as it involves a one-off payment of £1m to the Council for a 37-year period with no change to the annual lease payments. This option is recommended from a cashflow aspect as it results in a positive discounted Net Present Value of £1.128m at the end of the 37 year term.

Whilst the other options result in a higher NPV but the term is over a 45-year period and the upfront cash payment to the Council now for a shorter lease term is more favourable to the Council in the current financial climate.

Approved by: Geetha Blood, Interim Head of Finance on behalf of S151 officer

## **8. LEGAL CONSIDERATIONS**

- 8.1 The Interim Director of Law and Governance & Interim Deputy Monitoring Officer comments that the recommendations set out in this report are within the powers of the Council.
- 8.2 Of particular relevance is;
- 8.2.1 The general power of competence under section 1 of the Localism Act 2011 which provides that a local authority has power to do anything that individuals generally may do;

- 8.2.2 Section 111 of the Local Government Act 1972 which enables the Council to do anything which is calculated to facilitate, or is conducive to or incidental to, the discharge of any of its functions, whether or not involving expenditure, borrowing or lending money, or the acquisition or disposal of any rights or property;
- 8.2.3 For the purposes of the proposals to extend the existing leases referred to in this report, Section 120 of the Local Government Act 1972 gives the Council power to acquire by agreement any land/property:
- (i) for the purposes of any of its functions under that Act or any other Act; or
  - (ii) for the purposes of the benefit, improvement or development of the Council's area; or
  - (iii) for any purpose for which the Council is authorised by that Act or any other Act to acquire land;
- 8.2.4 Section 12 of the Local Government Act 2003 and the Council's powers to invest for any purpose relevant to its statutory functions or for the purposes of prudent management of its financial affairs.
- 8.3 In considering the proposals set out in this report, the Council has a general duty of best value under Section 3 of the Local Government Act 1999 to secure continuous improvement in the exercise of the functions of the authority having regard to economy, efficiency and effectiveness and therefore covers performance of all of the powers and duties of the authority.
- 8.4 The parties to a lease are at liberty to vary the terms of a lease and can vary most terms without triggering a surrender and regrant, but a variation that increases either the length of the term or the physical extent of the premises will take effect as a surrender and regrant.

Approved by: Doutimi Aseh, Interim Director of Law and Governance and Interim Deputy Monitoring Officer.

## **9. HUMAN RESOURCES IMPACT**

- 9.1 There are no direct impacts for LBC workforce with the exception of officer time to manage this process which has been factored in.

Approved by: Sue Moorman, Director of Human Resources

## **9. EQUALITIES IMPACT**

- 9.1 This is purely a modification to the lease terms and will not have any impact on any of the groups that share protected characteristics.

Approved by: Yvonne Okiyo, Equalities Manager

## **10. FREEDOM OF INFORMATION AND DATA PROTECTION CONSIDERATIONS**

- 10.1 Information requested under the Freedom of Information Act 2000 about the negotiations and purchase, which is the subject of this report, held internally or supplied by external organisations will be accessible subject to legal advice as to its commercial confidentiality (or other applicable exemption) and whether or not it is in the public interest to do so.

## **11. ENVIRONMENTAL IMPACT**

- 11.1 The changes to the lease terms will have no environmental impacts
- 11.2 The Council has a commitment to address environmental sustainability as an integral part of all activity. The Green Commitment and Environmental Procurement Policy are key relevant policies.

## **12. CRIME AND DISORDER REDUCTION IMPACT**

- 12.1 There will be no additional impacts on Crime and disorder.

## **13. REASONS FOR RECOMMENDATIONS/PROPOSED DECISION**

- 13.1 The amendment to the lease terms for options will secure a one off capital receipt. There is some potential increase in risk but this is considered minimal given the other amendments that have been negotiated and the insurance that will be put in place.

## **14. OPTIONS CONSIDERED AND REJECTED**

- 14.1 The Council do not have to enter into any of the options proposed but if they are rejected the opportunity to negotiate similar terms and the associated financial payments are likely to be lost or at best significantly reduced

## **15. DATA PROTECTION IMPLICATIONS**

- 15.1 **WILL THE SUBJECT OF THE REPORT INVOLVE THE PROCESSING OF 'PERSONAL DATA'?**

NO

- 15.2 **HAS A DATA PROTECTION IMPACT ASSESSMENT (DPIA) BEEN COMPLETED?**

NO

Approved by: Steve Wingrave Head of Asset Management and Estates

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**CONTACT OFFICER:**

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and Estates ext 61512

**BACKGROUND DOCUMENTS:**

None