

Report to: Cabinet

Date of Meeting: 4 April 2016

Report Title: Aquila House - Purchase

Report By: Peter Grace
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Purpose of Report

To seek approval to purchase Aquila House

Recommendation

1. To purchase Aquila House

Reasons for Recommendations

The Council is already committed to taking a lease of 15 years (with a break clause at 10 years). The purchase of the freehold provides the Council with the opportunity to make annual revenue savings given the low borrowing rates currently available. The Council would avoid any uplift in rent at each 5 year rent review period and would avoid many of the dilapidation costs that would be applicable at the end of the lease - given that the Council will be required to reinstate the building to original condition and floorplans. The addition of the shops to the Council's property portfolio provides the opportunity for an enhancing the revenue income stream in line with Council objectives.

Introduction

1. The property comprises a substantial office block located on Hastings seafront and arranged over ground, upper ground, first, second, third, fourth and fifth floors. The ground floor comprises 4 lock-up retail units occupied on individual leases and a further triple fronted retail unit which is used in connection with the offices above (5,764 Sq ft in total). The remainder of the building is given over to offices arranged over upper ground, first, second, third, fourth and fifth floors (29,654 Sq ft in total).
2. The main part of the premises occupied by the Council and also now sublet is at a rent of £236,000 per annum. The four individual retail units generate a significant rental stream (directly to the owners) as disclosed in the associated Part 2 report.
3. Terms have been agreed in principle to purchase the freehold of Aquila House. The Council's legal team are undertaking the purchase.
4. An external valuation has been obtained from Dyer and Hobbis which is lower than the agreed sale price. The difference between the valuation and sale price is significant, and does have implications should the Council purchase the building (see financial implications).
5. The valuation and market price by the seller (Ashbourne) is derived from what is viewed as the secure income stream from the Council for a minimum of 10 years and potentially 15 years and beyond – and provides a yield of 6%. This is a very attractive proposition for property investors and indeed since agreeing to sell to HBC they have advised us that they have received a higher offer. After considerable deliberation they have agreed to hold the price to the Council given the long relationship we have had with them and the considerable disruption and inconvenience we have had with the refurbishment works.
6. The market price also includes some “hope value” based upon the likelihood of increased market rentals in the south east and the knock on effect to rentals in Hastings – which they consider inevitable in the medium to long term and given the cost of new building.

Financial Implications

7. The rental that the Council will shortly pay along with the rental stream from the shops would be higher than the Council could borrow the money to purchase the freehold outright. By doing so the Council could achieve an annual savings. This saving would increase as upward only rent reviews (every five years) would be avoided and service charges can be minimised.
8. In practice the actual savings will be dependent upon whether the Council borrows for all or some of the purchase price or uses a proportion of capital receipts or some of its reserves. The decision will be dependent upon the level of capital

receipts received and expected in 2016/17. The estimated interest rate used for this evaluation is 3.2% at 8 April 2016 – proposed date of exchange and completion.

9. The difference between the valuations can be expected to lead to a large write in the Council's accounts and the Council needs to be very aware that this will be a consequence of Council purchasing the asset. The loss in paper value is because the Council is seen as a very good and secure covenant, whereas if the Council is purely selling the building there is not currently a large market for a building of this size for a single occupier – hence the lower valuation by Dyer and Hobbis. The reduction in value would reduce the value of the Council's balance sheet.
10. The reason for making this acquisition, despite the potential large write off that could follow, is that it will save the Council significant amounts of money in the long term. The Council will also benefit by having an asset that it could potentially sell or redevelop should it ever need, or choose, to do so. It will also avoid dilapidation costs at the end of the lease.
11. There is a real opportunity to make savings on the service and maintenance costs and time required by staff to work with owners and off site contractors and agents. This will be a key area to review as part of the budget and PIER (Priority Income and Efficiency Review) process.
12. As an investment decision the yield is equivalent to 6.28%.

Risk Management

13. Financial Risks - The Council will avoid future rental increases. An income stream from the shops is attractive, albeit rentals could of course go down in future. The Council will avoid the costs of reinstating the building at the end of the lease – which could be considerable given the internal alterations to the building now made.
14. The borrowing limits set out in the Treasury Management Strategy, agreed by full Council in February 2016, will not be breached. The Capital spend will also be significantly higher as a result of this purchase.
15. There are four shops involved two of which have leases in excess of 6 years remaining..
16. The Council will look to protect its asset by regular planned maintenance and proper insurance.

Organisational Consequences

17. The ownership of the building brings with it the responsibilities for boilers, lifts, utilities and services, along with maintenance of the fabric of the building and dealing with damages and breakdowns. There will need to be a review of the current responsibilities, skills and knowledge within Business Support, Estates, and the Surveyors team to ensure the shops, the building and operations within it can be managed most effectively.

Conclusion

18. The Financial case is favourable; annual revenue savings against the existing rental payments can be achieved. The Council avoids future increases in rental costs at each of the 5 yearly rent reviews. The Council avoids the dilapidation costs at the end of the lease period and stripping back the floorplans and reinstating to the start of lease condition. The Council gains the income stream from the shops (albeit there will be void periods from time to time).
19. In addition the Council will be able to manage the building without the need for gaining the often time consuming landlord consent for any proposed changes (and lettings) as well as meeting landlord costs. The Council will also be in a position to manage the service and maintenance costs of the building and the support contracts far more effectively and will be looking to make savings in this area.
20. This is a very short window of opportunity to consider and complete the purchase of the building should the Council so choose and hence the urgent report.

Policy Implications

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness	No
Crime and Fear of Crime (Section 17)	No
Risk Management	Yes
Environmental Issues	No
Economic/Financial Implications	Yes
Human Rights Act	No
Organisational Consequences	Yes
Local People's Views	No
Anti-Poverty	No

Additional Information

None.

Officer to Contact

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