DECISION NO:	*For Member Services use only*

Concurrence No:	066411

Action under delegated authority of Chief Executive	
Action under delegated authority of Director of Finance and Cabinet Member for Finance	
Action taken by Chief Executive in consultation with Cabinet Member(s)	**x**

Subject: Acquisition of the Pavilions Shopping Centre, Waltham Cross.

Signature and designation of officer(s) taking action:

17/09/2020
Chief Executive Date

17/09/2020
Director of Finance Date
Head of Finance Date

Name of Cabinet Member(s) Consulted:

I have been consulted and concur with the proposals set out below:

Councillor Lewis Cocking
Leader

Signature: Date: 24/09/2020

24/09/2020

Councillor Paul Mason
Cabinet Member for Finance and Business Services

Signature: Date:

Name of any member who has declared a conflict of interest in relation to this decision:

THIS DOCUMENT WILL BE PUBLISHED ON THE COUNCIL'S WEBSITE

The report overleaf sets out the decision to be taken, the reasons for the decision, and the details of alternative options, if any, considered and rejected. Officer decisions are available for public inspection, both at the Borough Offices and on the Council's website. Officer decisions are kept for a period of six years at the Borough Offices and for six months on the website after the decision is made. Background papers are available for four years.

RECOMMENDED that: the Council enters into the contract to acquire the Pavilions Shopping Centre, Waltham Cross and completes the transaction within ten working days and retains the existing managing agents in the short term.

Purpose

To seek approval for the acquisition of the Pavilions Shopping Centre, Waltham Cross. To set out the terms for that acquisition and to provide an update on the due diligence carried out by the Council and its advisors.

The Project

On 7 July the Council's Investment Panel agreed to a best and final offer bid of £13.75 million to acquire the Pavilions Shopping Centre in Waltham Cross. This bid was subsequently accepted by the bidder and Heads of Terms (HoTs) for the acquisition were agreed on 10 July with access granted to the data room holding some documents on 16 July. The HoTs allowed ten working days for entering into and exchanging the contract from receipt of a complete legal pack. The vendor was unable to provide the majority of the documents until the beginning of September which has caused significant delays in the process, and there are still some missing items.

The Council and its consultants have been carrying out protracted due diligence on the proposed acquisition which has included all legal matters, an updated building condition survey (including mechanical and electrical plant), the likely costs over the next ten years, the property's valuation and the value of the rent arrears. The results of this due diligence has meant that the Council has renegotiated the acquisition price with the vendors which has now been agreed at £12.7 million. This revised price also reflects the site's development potential.

The price also reflects the strategic positioning of the shopping centre in the Waltham Cross Town Centre and the impact that being able to include the centre within the Council's overall regeneration plans for the town centre will have. It is similar to the impact had in Hoddesdon Town Centre after the Council acquired Fawkon Walk, but the Pavilions is the focal point of the town centre and a significant draw for local shoppers. The effect could, therefore be catalytic and presents significant opportunities in the overall masterplanning for the town centre.

Financial, Legal and Risk Management Implications

The cost of borrowing and returns are shown in the table below based on funding the acquisition at £12.7 million. For prudency in the current Covid situation the rental has been adjusted to 70% of the contracted rate to reflect the current rental collection rates and the yields are based on this collection rate.

Principal sum (acquisition price)	£12.7 million
Total	**£13.53 million**

Duration of loan in years	1	2	3	4	5
Annual Interest Repayment	£135,300	£166,933	£176,972	£203,518	£226,343
Assumed interest rate %	1	1.2338	1.308	1.5042	1.6729
Brokerage Fees (payment for arranging the loan)	£13,530	£13,530	£13,530	£13,530	£13,530
Total Annual Cost	**£148,830**	**£180,463**	**£190,502**	**£217,048**	**£239,873**
Gross rental Income	**£1,526,832**	**£1,526,832**	**£1,526,832**	**£1,526,832**	**£1,526,832**
Covid collection rate adjustment to 70%	**£1,068,782**	**£1,068,782**	**£1,068,782**	**£1,068,782**	**£1,068,782**
Shortfall (Landlords contributions to service charge)	**£174,495**	**£174,495**	**£174,495**	**£174,495**	**£174,495**
Net Rental Income year 1	£894,287	£894,287	£894,287	£894,287	£894,287
ROI% based on net rental at 70%	**7.04%**	**7.04%**	**7.04%**	**7.04%**	**7.04%**

From the above the possible reduction in income from rental would need to be in excess of 55% before a loss were to be made.

The new purchase price of £12.7 million when analysed against the revised tenancy schedule which shows a net operating income (NOI) of £1.351 million gives a net initial yield, excluding costs, of 10.64%, with no deductions for non collection during the covid period.

The Council's due diligence on the building condition has shown a likely increase in the costs for immediate and medium term repairs as shown in the table below:

Element	**First year**	**Years 2 to 5**	**Years 6 to 10**	**Total**
Landlord (unrecoverable)	£123,438	£1,186,476	£1,140,213	**£2,450,127**
Tenant (recoverable)	£403,028	£1,487,175	£526,389	**£2,416,592**
Total	**£526,466**	**£2,673,651**	**£1,666,102**	**£4,866,719**
Previously advised	£435,100	£1,869,000	£1,532,865	**£3,836,965**
Increase	**£91,366**	**£804,651**	**£133,237**	**£1,029,754**

The overall increase is all estimated to fall onto the landlord as irrecoverable costs, these can be mitigated through the tendering process and if a future redevelopment of the site takes place then some of the works will be unnecessary and therefore not all costs will to be incurred.

It would appear that there has been a significant lack of investment into the asset over several years. One reason for this was the redevelopment aspirations for part of the site which would obviate the need for some of the repairs now required, especially to the car park and the concrete frame, these costs mainly fall in the years two to five.

A number of urgent actions are recommended by the reports to do with overall asset management, compliance with statutory regulations and Health and Safety issues and these should be addressed immediately upon acquisition to ensure the continued integrity of the asset, especially if redevelopment plans are not to be forthcoming for more than two to three years as would seem likely. These are the costs allowed for in year one in the above table.
The property was constructed in 1972 and many of the components in the mechanical and electrical installations are reaching the expected end of useful life and will require replacement over the next ten years. Also there are concerns over the state of repair of the concrete superstructure and specialist reports into condition and requirements of repair is urgently required.

The Council's solicitor has produced a comprehensive pack analysing all the existing leases and contracts with no abnormal features within any of these having been identified.

The actual rent roll for the centre is £1.526m. It is considered prudent to make allowances for non collection of rental during the Covid panademnic and based on collection rates in the last 3 months a reduction in the rent roll to 70% has been made reducing it to £1.069 million .However, there are two vacant units where the landlord therefore has to make contributions to the shortfall in service and insurance charges, additionally the landlord also has to make contributions for the parts of the centre occupied by the management team for insurance and service charge and the rent roll is therefore reduced to £ 0.894 million.The collectable rent roll therefore provides a yield of 7.04% this is in excess of the 6% benchmark the Council sets when considering commercial property acquisitions.

If the Council were to be acquiring the property purely for investment purposes without both the development potential and also the strategic position within the town centre to assist in the promotion of the regeneration of the town centre, then it is likely higher yields would be sought. However when taking all factors into consideration this presents an opportunity unlikely to be repeated.

The arrears and Covid 19 arrangements have also been examined in detail with the Council's Agents and the existing Managing Agents for the centre, Colliers. A comprehensive analysis is provided at appendix B and a summary is in the table below. The table shows a number of historic arrears which should be written off as there is no hope of recovery, the Council will not take on responsibility to recover these arrears. The Council with its agents have been monitoring the arrears picture since April 2020 when the first effects of Covid were felt. Since the initial impact on the June quarter day rentals, growth in arrears has been at around 5% per month and collection percentages have risen to around 75% which is good compared to figures ascertainable elsewhere in the market.

	Total debts at present	**Historic debt to be written off**	**Total collectable debt**
Rental	£278,102	£37,390	£240,712
Service Charge	£261,312	£151,442	£109,870

Insurance	£18,443	£13,644	£4,799
Other (including unallocated credits)	(£44,100)		(£44,100)
VAT	£99,401	£47,209	£52,192
Total	**£613, 158**	**£249,685**	**£363,473**

The contract provides that the Council takes over recovery of all arrears but with no obligation to refund historic payments to the vendor, unless recovered within three months of the sale, nor is there to be any addition to the price to reflect this. This means that the Council will be at liberty to enter into any arrangements with tenants over their arrears including, if thought appropriate, the writing off of historic arrears to enable traders, where relevant, to start with a clean sheet from when the Council takes responsibility. However in the first instance attempts to recover all arrears will be proceeded with, but with care as the Council would of course wish for tenants to remain in situ rather than being forced to close because of the built up arrears.

Full title documentation has been received and the title is to be cleaned of outstanding historic notices as requested by the Council prior to completion, the property is to be sold with full title guarantee.

The existing Managing Agents, Colliers, are to be retained by the Council with an initial contract until 24 December 2021 which coincides with the end of the service charge account year. All the managing agents' costs are covered by the service charge arrangements including the wages and personnel costs of the centre manager and his small team, who are employed by the managing agents. A tender exercise will be carried out at this time next year to appoint new managing agents or indeed retain the existing agents.

Where there is a shortfall in service charge arrangements or rental collections (such as vacant units) that shortfall will be a landlord's liability and funded from rental collections. As present such a shortfall is estimated at £0.175 million per annum and accounted for in the reduction from the contracted rental income of £1.526 million to £1.351 million.

There are currently two vacant units and one tenant, Bon Marche, is under administration but still trading. It is considered that the income will suffer over the next 12 months due to the impact of Covid 19 but where arrangements have not yet been entered into it would be the Council's intention to ensure discussions are had with all tenants to ascertain their trading position once the acquisition for the site has been completed.

Colliers has been talking to all tenants over the past few weeks and provided the Head of Property Services with a dialogue against each tenant and their trading capability. This has not thrown up any material differences to the situation as understood prior to the bid being made. Additionally New Look has issued a new Creditor Voluntary Arrangement (CVA) which is due to take effect on 15 September, and provides that rent will be based on a turnover percentage of 4%. At present it is not possible to estimate the effect that this will have on the income.

Some tenants have entered into Covid 19 rental arrangements which will be honoured, these are in the form of rent deferrals or in some acute hardship cases, a reduction in rental for one quarter (the June quarter) the effect of this, and the rental arrears is considered, to have a minimal effect on the NOI at present.

The percentage rate of rent collection through the Covid period is now at around 75% which compares well to other collection figures as low as 20% being reported in the market. Some tenants are looking to renegotiate on agreements and make rental based on turnover but any such requests will be treated on its own merits.

At present Savills are retained by the vendors to market all vacant units and carry out rent reviews and lease renewals. It would not be the Council's intention to retain Savills but to either carry out this function in-house or tender out to locally based agents including the currently retained managing agents.

Overall the legal due diligence has not revealed any problems that the Council was unaware of at the time of making the bid. The arrears situation gives the Council complete control moving forward with no comeback to the vendor. There are some missing documents but the Council is to receive undertakings from the vendor's solicitors over certified copies being produced.

The vendor had wanted to insert an overriding lease into the deal to ensure that they could collect overage that remains unpaid in respect of the lease to EN8 Homes. However this requirement has now been dropped following pressure from the Council and a mechanism establish to ensure the vendor receives any payment due without the need for the lease and the complications this would bring.

The Managing Agents have been very helpful with matters over the past three weeks and retaining them is considered the most appropriate way forward to ensure continuity as they have the intimate knowledge of separate deals entered into with all tenants and would be in the Councils best interests to retain them.

Car Park Income

The car park charges differ from the rest of the Council's car parks within Waltham Cross and an exercise has been carried out, based on the usage information provided by the centre managers, to see what the difference in car park income could have been over the year up to March 2020 if charging had been on the same basis. The following table shows the changes in income and the effect of the yield in comparison to the actual figures received.

Differences in charging regime

The Pavilion parking charges are:

£1.50 for up to 3 hours
£2.00 for up to 5 hours
£3.00 for up to 7 hours
£6.00 for more than seven hours

The tariffs in the Council's car parks are:

£1.00 for up to 1 hour
£1.90 for up to 2 hours
£2.70 for up to 3 hours
£3.70 for up to 4 hours
£5.00 for over 4 hours

The overall effect on the net operating income is less than a 1% decrease if the Council' parking charges were to be adopted, and changing the regime would have little or no effect on yields. However there may be adverse reaction from the tenants of the scheme to changes in the payment regime which discourage long term dwell and therefore spend in the shopping centre and the town centre overall and any changes would need to be carefully considered.

The car park income is currently ring fenced for repairs to the car park as the service charge regime specifically excludes the car park from service charge arrangements.

Overall Risk management.

The centre has a well-developed risk management regime for ensuring compliance with all Covid -19 regulations which will be monitored along with all changes in legislation published.

A comprehensive management and risk policy is to be developed for the centre in co-operation with the Managing Agents and others. Procurement exercises to be put in place for the urgent reports and inspections as recommended by the surveys already carried out to be implements and a repairs fund is required to be set up in the short term with a capital bid to be placed for the next round to ensure that the Centre is maintained to the highest standard so as to encourage both retailers and the general public that the centre is a safe and secure place to do business**.**

Discussions with a number of specialist shopping and town centre asset managers will be undertaken so that the Council can take on board advice in moving forward with the asset so as to use it to enhance the overall viability and marketability of Waltham Cross Town Centre for the benefit of all business owners and residents of the area.

The risk of non collection of rental, service charge and insurance during this Covid period is a concern but reports from the agents indicate a 70% collection rate without any undue pressure being placed on tenants for arrears and payments. The centre is setup for local people to come too and generate the required attendance rates and spend to ensure that units within the centre can remain open. The four major tenants, being Sainsburys, WH Smith, Boots and Peacocks have all continued trading and payments throughout the last 6 months and there is no reason to assume these traders will fall away. All initial efforts in the management will be directed to ensure the stability of the income stream and working with tenants in this regard.

Consideration may be given to a rebranding exercise in due course.

Alternative Options Considered and Rejected

The only alternative at this point is for the Council to withdraw its offer and not complete the acquisition.

Contribution to the Council's Objectives and Environmental Sustainability Priorities

A THRIVING ECONOMY OFFERING BUSINESS GROWTH AND JOBS

2. Enable sustainable growth in local employment for residents by encouraging the creation of high-skilled, high-value jobs on identified sites.

3. Pursue the implementation of the housing and infrastructure needed to support a thriving economy.
4. Foster development of town centres as vibrant locations for business and leisure.

SUSTAINABLE LIVING IN AN ATTRACTIVE ENVIRONMENT

12. Promote community safety and reduce fear of crime.

AN EFFECTIVE COUNCIL EFFICIENT AND RESPONSIVE TO THE NEEDS OF RESIDENTS

15. Maintain a stable financial position.
16. Build strong partnerships to deliver more for the Borough.

Conclusion

Overall the legal due diligence has not revealed any problems that the Council were unaware of at the time of making the bid, the arrears situation gives the Council complete control moving forward with little or no comeback to the vendor.

The Managing Agents have been very helpful with matters over the past three weeks and retaining them is considered the most appropriate way forward to ensure continuity of approach and engagement with the tenants.

The Building Condition has given most cause for concern and the prospect of additional costs which may in turn be difficult to regain from the Service Charge arrangements, negotiations with the vendor have proved unsuccessful in achieving any price reduction and the level of capital expenditure expected in the next five years is in line with the expectations in the original investment report.

The valuation has concluded that the price to be paid is an accurate reflection of the market price.

A comprehensive management plan to be devised with the co-operation of the managing agents is to be devised and procurement of consultants for various studies and reports to be put in chain once acquisition has been secured.

Overall It is recommended that the acquisition proceeds at the value of £12.7 million and that exchange of contracts followed by a 10 day completion period is entered into.

Contact Officer:	Kevin Clark	Ext:5541	Date 15 September 2020

Action reported to the Cabinet on: