

## CABINET

20 September 2022

<b>Title:</b> Proposed Purchase of Maritime House Office Building, Linton Road, Barking	
<b>Report of the Cabinet Member for Finance, Growth and Core Services</b>	
<b>Open report with Exempt Appendices 1, 3, 4 and 5</b> (relevant legislation: paragraph 3 of Part I of Schedule 12A of the Local Government Act 1972)	<b>For Decision</b>
<b>Wards Affected:</b> Abbey	<b>Key Decision:</b> Yes
<b>Report Author:</b> Jonathan Langham, Head of Commercial Development, Be First	<b>Contact Details:</b> Tel: 07812 965342 E-mail: <a href="mailto:jonathan.langham@befirst.london">jonathan.langham@befirst.london</a>
<b>Accountable Director:</b> Ed Skeates, Director of Development, Be First	
<b>Accountable Strategic Leadership Director:</b> Philip Gregory, Strategic Director, Finance & Investment	
<b>Summary</b>  An off-market opportunity to purchase the freehold investment of Maritime House has been presented to Be First and the Council. The purchase would ensure that one of the borough's best office buildings would be retained for office use as well as providing a redevelopment opportunity in the medium / longer term.  The clear medium-term redevelopment potential is consistent with the mandate of the Public Works Loan Board solely for purchases in-borough with regeneration outcomes.  The site is immediately adjacent to Roycraft House, which is also owned by the Council and let to Make it London for a period of 10 years. Accordingly, if Maritime House was purchased and operated as an office investment for a 10-year period the Council would be able to formulate comprehensive redevelopment proposals for both sites in the intervening period to ensure that a quality development was provided in future years.	
<b>Recommendation(s)</b>  Cabinet is recommended to:  (i) Approve the purchase of the Maritime House site, Linton Road, Barking, as shown edged red in the plan at Appendix 2 of the report, in accordance with the draft Heads of Terms set out in Appendix 3 to the report;  (ii) Authorise the Strategic Director, Finance & Investment, in consultation with the Chief Legal Officer, to enter into all necessary legal documents to finalise the transaction in accordance with the draft Heads of Terms.	

## **Reason(s)**

To assist the Council to achieve its priorities of “inclusive growth” and “well-run organisation” by protecting valuable office accommodation and providing an opportunity to promote a mixed-use redevelopment in the longer term.

### **1. Introduction and Background**

- 1.1 Maritime house is a 10-storey office block constructed in the 1970s providing approximately 53,000 sq. ft (NIA). It benefits from on-site car parking which is barrier controlled. The building has an appearance of its age, however internally it has been maintained to a good standard with a recent refurbishment of the reception area.
- 1.2 Given the scarcity of office accommodation in the borough which has, in part, been accelerated by permitted development rights to convert offices to residential use, the building has, in recent years, had a good level of occupancy and there has been growth in rental levels. The building is almost exclusively occupied by public sector organisations with strong covenant strengths, which include:
  - London Ambulance Service NHS trust
  - Department Work and Pensions (via a Head Lease from Instant Offices)
  - Be First Regeneration Limited
- 1.3 The building has been owned by the CEG group for a number of years by means of a long leasehold interest. CEG have recently secured the reversionary freehold interest, so the site is sold as an income generating freehold investment. Appendix 4 sets out the building’s current tenancy schedule and Appendix 5 is a valuation undertaken by Wilks Head on behalf of the Council - these documents are in the exempt section of the agenda as they contain commercially confidential information (relevant legislation: paragraph 3 of Part I of Schedule 12A of the Local Government Act 1972) and the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

### **2. Current Position and Proposal**

- 2.1 The building’s owners had engaged DTRE to market the property but have confirmed it will provide the Council with an exclusive position until the Cabinet meeting in September to complete on a purchase. Terms have been agreed to purchase the freehold interest in accordance with the terms set out in Appendix 3, which is also in the exempt section of the agenda as it contains commercially confidential information.
- 2.2 Most of the existing leases expire in 2028 providing approximately six years of fixed income. However, a number of leases are subject to tenant break clauses providing an average lease term until break of 3.9 years. The DWP lease has a break in 2024 and Victim Support are holding over with a likely term extension to April 2023. In the current office market, it is rare to have lease terms longer than five years. Therefore, the relative shortness of the term is not a fundamental concern.

- 2.3 Be First has recently served notice on its 9th and 10th floor lease and will vacate on 11 December 2022, at which point this space will be vacant. The terms agreed with Make it London for the occupation of their fifth floor means that Be First can reduce its overall occupational costs over a 5 and 10-year period.
- 2.4 Whilst there is likely to be a void in the re-letting of the 9th and 10th floor at Maritime House, the Valuation set out in Appendix 5 supports the proposed purchase price. Provision will be made for MRP assuming the building has a potential lifespan of 30 years. This will reduce the cash flow income but will also, over time reduce the level of debt on the asset. This will enhance options for redevelopment in future years as the 'book value' of the asset based on the level of outstanding debt will have been reduced. In accordance with the convention adopted elsewhere on the purchase of property investments, the margin between the net income received and the loan cost is attributed to the Be First dividend target.
- 2.5 A number of the floors have been let since 2019 and achieved new headline rents. For example, the Be First letting in 2017 achieved a rent of £19 psf. Lettings in 2019 and 2021 have achieved £27psf. The valuation at Appendix 5 confirms the forecast rental projections relative to the proposed purchase price.

### **Planning Considerations and future redevelopment outlook**

- 2.6 The site will be held in its current employment/office use for at least another 10 years. The site has future redevelopment potential for either a residential or mixed-use scheme.
- 2.7 Given its location next to other Council owned assets (Roycraft House and London Road Car Park) there is the possibility of bringing forward the site in isolation or as a comprehensive redevelopment.
- 2.8 The site is located within Barking Town Centre and the River Roding Transformation Area. The Local Plan seeks development proposals to provide comprehensive mixed-use development of retail, cultural and community uses alongside office and residential development.
- 2.9 The Local Plan protects office floor space in accordance with Policy E1: Offices of the London Plan. This defines Barking Town Centre as Category C: Protect small office capacity, where these centres show demand for existing office functions, generally within smaller units. Given current planning policy while a mixed-use scheme including some small office provision would be preferable, if evidence regarding the lack of demand for office space is provided a primarily residential scheme could also be justified.

### **3. Options Appraisal**

- 3.1 The following options are available to the Council:
- 3.2 **Option 1: Do nothing** - The site owners are about to actively market the building as a short-term income opportunity with medium-term development potential. The marketing details include a schematic for a residential scheme of approximately 210 units with no replacement office accommodation. Therefore, if the council do not purchase the site there is a strong likelihood that the office floor space will be lost

soon after the current leases expire (2028), and the building will be demolished and replaced with a residential tower block.

- 3.3 Whilst the loss of office accommodation is a material planning consideration that must be addressed with market evidence supporting a lack of demand this situation can easily be manufactured by presenting existing and incoming tenants with unattractive terms. There is now little office accommodation in Barking and the loss of this building is likely to result in a further reduction in pedestrian footfall in the town centre associated with office workers using town centre facilities at lunchtime and throughout the day.
- 3.4 The cost impacts of revised EPC standards for office lettings will be a disincentive for investors to retain office buildings if they can be converted or redeveloped for residential use. There are cost/ benefit exemptions that might mitigate the needs to undertake costly alterations. Given recent structural shifts in the office market driven by the recent Covid pandemic it is likely that the demand for office accommodation will decline over time. However, left to the private sector it is unlikely that new office accommodation will be re-provided which will over time erode the economic diversity of Barking town centre. Therefore, it is considered that an intervention to purchase is justified.
- 3.5 **Option 2: Be First remain in occupation at Maritime House** - The opportunity to purchase the freehold of Maritime House came forward after the proposal to occupy Roycraft House had already been approved by the Be First board. Consequently, notice has been served to terminate the Be First lease as of 11th of December. If the Council purchases the freehold this position could be reversed, and the rent paid by Be First to the landlord (LBBB assuming a purchase is forthcoming) could be repatriated to the Council as revenue.
- 3.6 However, occupation of Roycraft presents a lower cost opportunity for Be First and under pins the Make It business case for a workspace facility. Therefore, it would be better to secure an alternative occupier of the vacant floor space at Maritime House at a potentially increased rent to further improve the income return on Maritime House. Accordingly, it is recommended that Be First continue with its planned occupation of Roycraft House and that the vacant accommodation on the ninth and 10th floor is relet to a third party at a commercial rent.
- 3.7 **Option 3: Purchase Maritime House (Recommended)** - This is the recommended approach to provide the Council with a positive income return which is attributed to the Be First dividend target after an allowance for MRP. A purchase will ensure that valuable office accommodation is protected in the short to medium term and that the Council can comprehensively plan for the redevelopment of both Roycraft House and Maritime House in the longer term to provide a mixed-use neighbourhood that will generate sustainable patterns of development and sustain other facilities in the town centre. Ownership will also give LBBB control over relocating other council occupiers as part of any wider accommodation review.
- 3.8 **Option 4: Encourage a third-party to purchase the site and secure similar regeneration objectives** - Based upon the marketing details prepared by DTRE it is evident that the site is most suited for redevelopment purely for residential uses therefore any likely private sector purchaser will pursue the short-term demolition of the building and its replacement with a residential tower block. Unless a third party

with social value aspirations can be identified it is unlikely that a mixed-use scheme will be delivered by the private sector. Even if planning requirements require evidence of a lack of demand for office accommodation it is anticipated that this evidence could be prepared relatively easily (give the likely cost of complying with revised EPC standards and the ongoing maintenance of the building) and undermine any aspiration to retain a significant element of office accommodation in any redevelopment scheme.

#### **4. Consultation**

- 4.1 The proposals in this report were discussed with the relevant Cabinet Member on 16 August 2022 and have also been considered by the membership of the Investment Panel.

#### **5. Commissioning implications**

Implications completed by: Shanaaz Carroll, Interim Head of Commissioning and Place

- 5.1 The proposed purchase is adjacent to Roycraft House and the London Road car park that are both owned by the Council and will form a redevelopment site in the medium term, when the Roycraft lease to Make it London, a workspace provider, expires in 2032. Maritime House is the best quality office accommodation in Barking and the proposed purchase will ensure that the office accommodation is retained until comprehensive redevelopment proposals have been developed.
- 5.2 If the site is not purchased there is a risk that the site will be developed for predominately residential uses that will displace the current commercial uses that have a strong synergy with other nearby town centre uses enhancing the vitality of the town centre. Therefore, the purchase will provide the Council with better control over the future re-development of this key site to ensure that eventual uses maximise their proximity to other town centre uses and public transport facilities.
- 5.3 Therefore, the proposal is considered to be supportive of the wider Inclusive Growth strategy.

#### **6. Financial and Investment Implications**

Implications completed by: David Dickinson, Investment Fund Manager

- 6.1 The detailed financial implications are included in Appendix 1 of this report, which is in the exempt section of the agenda as it contains commercially confidential information (relevant legislation: paragraph 3 of Part I of Schedule 12A of the Local Government Act 1972) and the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

#### **7 Legal Implications**

Implications completed by: Dr Paul Feild, Principal Governance & Standards Solicitor

- 7.1 This report proposes as the preferred option the acquisition of Maritime House at Linton Road Barking. The site is not yet on the open market so the sale will be by

private treaty. The actual acquisition will be under conditions set by the heads of terms as in Appendix 3. There is currently in existence a long leasehold and the freehold interest. The landlord interest will be as a going concern which is beneficial for VAT purposes. The Council will acquire both interests and merge them, but its ability to use the building will be subject to the existing leases to the current commercial tenants which it will take over as landlord.

7.2 **Vires** - The Council has the power to acquire land for its functions by virtue of Section 120 Local Government Act 1972. To promote the delivery of the potential development opportunity it can utilise the general power of competence in section 1 of the Localism Act 2011 which provides sufficient power for the Council to participate in the transaction and enter into the various proposed agreements, further support is available under Section 111 of the said 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.

7.3 **Investment Aspects** - In exercising the power of general competence and in making any investment decisions (to the extent that any aspect of this transaction is considered to involve investment decisions), the Council must have regard to the functions for the purpose of which it is exercising the power, must act reasonably and also have regard to the following:

- Compliance with the Statutory Guidance on Local Government Investments (the Statutory Guidance).
- Fulfilling its fiduciary duty to taxpayers.
- Obtaining best consideration for any disposal.
- Compliance with Section 24 of the Local Government Act 1988 in relation to giving financial assistance to any person (which either benefits from a general consent or requires express consent by the Secretary of State)
- Compliance with any other relevant considerations such as state aid and procurement.

The implications are that there is a responsibility on the Council to actively management and review its investment strategy and the underlying assets themselves. This is because the Council is under a Best Value duty under the Local Government Act 1999 to pursue continuous improvement and ensure value for money.

7.4 **Subsidy and State Aid** - As local government is an emanation of the State, the Council must comply with treaties, laws and regulations regarding state assistance as now set out in the Subsidy Control Act 2022. This means that local authorities cannot subsidise commercial undertakings or confer upon them an unfair economic advantage unless within defined exceptions. This report does not identify any specific aspect of the proposed acquisition that is other than an arm's length commercial transaction between the Council and Vendor, thus this arrangement satisfies the requirement it is on market terms.

7.5 **Human Rights** – As the proposal as described does not seek the use of compulsory purchase powers or displacement of any residents there does not appear to be

critical risks associated with a Human Rights Act challenge, nevertheless, matters should be kept under review in case such considerations should arise.

## 8. Other Implications

### 8.1 Risk Management

8.2 The key risks relating to the project are as follows:

**Property Management and Service charge recovery** - The principal reason for Be First servicing notice to vacate Maritime House is the high cost of the service charge amounting to approximately £10 psf. The combination of rent and service charge means that Maritime House is a relatively expensive form of accommodation. Due diligence is being undertaken but it is understood that all the existing tenancies are subject to a service charge demand that recovers all of the landlord's costs of running the building. It is understood that only Be First negotiated a cap on the service charge contribution meaning that the landlord had to fund the unrecovered cost of the service charge which amounted to approximately £8,000 per annum.

It is unlikely that the service charge costs of Maritime House can be lowered given the age of the plant and machinery within the building. Therefore, care will be needed in providing attractive lease terms to ensure full-service charge recovery at the same time as achieving commercial rental levels. Given the paucity of good quality office accommodation in Barking and a continued level of demand from the public sector it is likely that income levels and service charge recovery will be sustained.

A firm of building surveys has been appointed to review the fabric of the building and provide a commentary on key maintenance issues to ensure that a sufficient service charge budget is maintained. Proper control on the service charge budget will ensure occupational costs remain reasonable and the buildings occupancy levels can be maintained.

**The impact of minimum energy performance standards** - All commercial lettings over 50 Sqm for a term of two years currently need an EPC rating greater than level E by 2023. In 2027 it is proposed (the Government White Paper) that the EPC standard will be increased to level C and to a B in 2030. This is likely to result in a significant proportion of the stock of office accommodation in Barking, and the UK as a whole, becoming obsolete. This will further reduce supply and increase rents. As such whilst there is likely to be a cost impact in upgrading office accommodation to achieve an improved EPC rating this will be balanced by increased rents being achieved on the remaining stock. Currently three are three floors (3rd, 4th and 6th) that have a C or E rating. The rest of the building has a B rating. An allowance has been made for improvement works and will be reviewed in the light of more detailed surveys.

In order to better assess the impact of the shift in minimum EPC rating a condition survey is underway to determine the costs of achieving a C and B rating to ensure that a sufficient budget can be set aside for these works. This is likely to relate to more energy-efficient lighting and the upgrade of air conditioning systems to remove gas heating.

**Increased levels of vacancy and falling income** - It is difficult to predict levels of occupier demand in the short to medium period. However, the evidence from Maritime House suggests it continues to be a popular location commanding increased rental levels. The impact of changes in minimum EPC ratings is a clear risk that can be mitigated by determining likely costs for remedial works and ensuring that the accommodation continues to be cost effective for its occupiers. This might require a review of the provision of heating and cooling solutions.

There is a paucity of good quality accommodation in Barking, and it continues to be a cost-effective substitute to adjacent centres such as Stratford. The 9th and 10 floor will become vacant in December 2022, the 3rd floor in April 23 and potentially DWP might break in 2024. In this worst-case scenario this would amount to 50% of the floorspace being vacant. However, rental evidence suggest that this would provide an opportunity to increase rents at each lease event that are phased over a 3-year period that will further improve the income return. Initial discussions are already underway with an office leasing agent to market test the demand for the 9th and 10th floor.

**Increased costs impacting on longer term development potential** - Based upon current lease terms and opportunities for a comprehensive redevelopment this is likely to take place beyond a 10-year time horizon. Therefore, it is difficult to project anticipated costs. However, the council will have the opportunity to postpone redevelopment by elongating the buildings use as an office investment. The council has previously been successful in accessing grant funding to pursue economic and social objectives. An element of the refurbishment works on Roycraft House were included in the current levelling up bid for Barking town centre. Accordingly, there will be opportunities in the forthcoming period to review the schemes longer term viability.

**Public background papers used in the preparation of the report:** None

**List of appendices:**

**Appendix 1:** Financial and Investment Implications (exempt document)

**Appendix 2:** Site Plans

**Appendix 3:** Heads of Terms (exempt document)

**Appendix 4:** Sales Details (exempt document)

**Appendix 5:** Wilks Head Valuation (exempt document)