Agenda Item No: 8

MILTON ROAD LIBRARY, ASCHAM ROAD, CAMBRIDGE, CB4 2BD – VARIATION TO LEASE

To:	Commercial and Investment Committee
Meeting Date:	18th December 2020
From:	Tony Cooper, Assistant Director of Property
Electoral division(s):	Arbury
Forward Plan ref:	N/a *Key decision:* No

Purpose: The Committee is being asked to consider a variation to the current lease for the Milton Road Library premises.

Recommendation: Approve the completion of the Deed of Variation based on option 3 *(as set out in paragraph 2.3)* with completion of the Deed of Variation being subject to the receipt of the premium payment from the landlord developer.

Officer contact:
Name: Tony Cooper
Post: Assistant Director of Property
Email: tony.cooper@cambridgeshire.gov.uk
Tel: 07711 260350

Member contacts:
Names: Councillors Goldsack and Boden
Post: Chair/Vice-Chair
Email: Mark.Goldsack@cambridgeshire.gov.uk | cboden@fenland.gov.uk
Tel: 07831 168899 | 07860 783969

1. BACKGROUND

1.1 The Milton Road Library (the library) is in Cambridge at the western end of Milton Road, at the junction with Ascham Road. The library and community rooms extend to 245m^2 (2,437 sq ft) of ground floor modern purpose-built accommodation.

1.2 The library is occupied as tenant by Cambridgeshire County Council (the Council) under a commercial lease agreement from This Land Development Ltd (the landlord developer) who are the freehold owners of the building which also includes residential units on the upper floors. The original library site was sold by the Council to the developer in May 2018 and as part of the sale, it was agreed that the developer would construct a new library as part of their development and in return the Council would agree to lease back the ground floor accommodation on commercial terms in order to re-provide the existing library accommodation.

1.3 Once the new building had been completed, the developer completed the library lease with the Council. This lease agreement was completed in September 2019. The lease is dated 27th September 2019 and is for a term of 25 years and was backdated to commence on the 24th May 2019 and will end on the 23rd May 2044. The Council pays an annual market rent of £51,000 per annum under the lease which is reviewed on a 5 year upwards only basis in accordance with the higher of either the market rent at the time of the rent review or the increase in the Retail Price Index (RPI All Items) over the 5 year period, whichever is the greater. The next rent review is due on 24th May 2024 and at this point and at every future 5 yearly rent review over the remaining term of the lease, the rent cannot decrease below the current passing rent at the date of each rent review. In addition to the rent, the Council is also responsible for paying business rates under the lease, an insurance rent and a service charge set at 43% of the total service charge expenditure for the building. The Council cannot sub-let the library accommodation under the lease or assign it to a third party without the landlord's consent. However, the lease does contain 5 yearly tenant break clauses (often referred to as break options or break provisions) which gives the Council the ability to end the lease early on serving at least 12 months' written notice in advance of each break date. The particular break dates specified in the lease are on the 24th May 2024, 24th May 2029, 24th May 2034 and 24th May 2039.

1.4 The Council have a pre-emption right to buy back the Milton Road building from This Land if their intention is to sell their interest which is their current intention. The C&I Committee subgroup met on the 6th February 2020 and declined this offer under the Council's pre-emption rights.

1.5 The break clauses in the Milton Road library lease are the main focus of this paper as the landlord developer approached the Council on the 21st January 2020 to see whether the Council would be willing to complete a Deed of Variation to remove all of these break clauses from the Council's lease agreement as they were intending to sell their freehold interest in the building now that the development has been completed.

1.6 It is useful to put this approach by the landlord developer in a commercial context. It is not an unusual practice for an owner to attempt to re-negotiate existing lease terms or agree a new extended lease with a tenant prior to selling their interest particularly where the lease is shortly due to expire. This is often colloquially referred to as a "lease re-gear". The tenant is not obliged or compelled to vary the terms of their lease given that they have a legal interest in the property and the outcome is therefore a matter of negotiation between the two parties. The reason that landlords and owners of property are keen to increase rental levels, extend leases and remove break clauses is that commercial properties are valued based on the rental income stream that they produce. In addition, the greater the security of income and the greater likelihood that the income will increase in the future, the lower the yield (or higher the multiplier) that is applied to the particular income stream which results in an increase in the market value of the property.

1.7 In the UK, the average commercial lease term across all sectors is currently 6 years in duration. Leases of 25 years, such as this were commonplace in the 1990s and 2000s but are now relatively rare and it is unusual for occupiers to enter leases for commercial premises which are significantly in excess of 10 years. In this particular case, the landlord developer has requested the Council as tenant under the lease agrees to remove all break clauses which would result in an unexpired lease term remaining of 18.5 years for a growing inflation linked rental liability which cannot be reduced and which is underpinned by the strength of a Local Government covenant. This combination represents a significant uplift in value (sale price) to the landlord developer whilst at the same time reducing the future flexibility of the Council to end the lease early and vacate the property in the future should this be necessary, particularly as it will result in a growing rental liability for the Council until 2044 during which time current library practices and requirements are likely to change significantly.

1.8 Whilst it is good commercial practice for property owners to look to carry out lease extensions and lease re-gears to maximise the value of their properties. Conversely, it is also standard commercial practice that a tenant faced with such a request (particularly if they have professional representation) would seek to “sell their break” to the landlord/owner as the practice is often referred to in the marketplace in return for either a premium payment or in the form of a rent free period equivalent to the value of the rights they are surrendering.

2. MAIN ISSUES

2.1 Option 1 – Do Nothing

The Council could refuse to negotiate and require that this new lease which has only recently been completed by the developer landlord in October 2019 remains unchanged. The developer landlord would still be able to sell their interest subject to the Council’s existing lease. This would allow the Council to retain ongoing flexibility regarding the ability to end the lease early if this was required nearer the future break dates, however it would forego the receipt of a premium payment for relinquishing the break clauses within the lease.

2.2 Option 2 – Agree to remove the 1st break option due in May 2024 from the lease and complete a Deed of Variation on this basis.

This option would result in a term certain until May 2029 (over 8 years certain) which would improve the investment value for the vendor but still provide the Council with the future flexibility to end the lease early if this was required nearer the future break dates. The

Council as tenant would still expect to receive either a rent-free period, a reduced rent or a premium payment in exchange for agreeing to the removal of the May 2024 break option.

This proposal was considered during the initial discussions but the developer landlord would ultimately not agree to the approach that they had originally tabled and they wanted to ensure that all break clauses were removed from the lease which would result in the Council being committed to the property and the rising rental liability until 2044. The landlord developer was not willing to consider any alternatives options. As outlined in option 1, the Council as tenant is within its rights to simply continue with the lease as originally agreed and it is not obliged to reach an agreement with its landlord to amend the lease. The landlord developer could still sell their freehold interest subject to the existing Council lease.

2.3 Option 3 – Agree to remove all break clauses from the lease and complete a Deed of Variation on this basis.

As the landlord developer was insistent that all break clauses should be removed from the lease, the appropriate means of assessing the value of the premium payable to the tenant was to assess the increase in value to the landlord of the tenant agreeing to the lease variation and then agree a fair share of the uplift in value (synergistic value) being an amount equivalent to a 50% share in the uplift in such circumstances. The uplift in value to the vendor from removing all break clauses under the lease until 2044 (24 years certain) was assessed at £200,000. Therefore, in negotiations the Council as tenant put forward its proposal for a payment of £100,000 (the premium payment, by means of a capital receipt) in return for completing a deed of variation to remove all tenant break options within the lease. The landlord developer accepted this proposal in an email dated 29th October 2020.

Option 2 is not viable as the landlord developer is not willing to consider this option. Option 3 provides the benefit of a £100,000 capital receipt and safeguards the future of the library provision at this site, but at the expense of the loss of future flexibility to the Council under the lease. However, the Council anticipates the long-term provision of the library at this particular location will be required, therefore the loss of flexibility is not expected to be problematic and the provision of the library service from the premises will be unaffected by the proposed amendments to the existing lease. If in the unlikely future scenario that the library provision is not required to be delivered from the premises before the lease term ends in 2044, then the Council would still have the option of repurposing the use of this asset or could alternatively seek consent from the landlord to enter into a sub-lease with an alternative user.

It is therefore recommended that the Committee approves the completion of the Deed of Variation based on option 3 with completion of the Deed of Variation being subject to the receipt of the premium payment from the landlord developer.

3. ALIGNMENT WITH CORPORATE PRIORITIES

3.1 A good quality of life for everyone

There are no significant implications for this priority.

3.2 Thriving places for people to live

There are no significant implications for this priority.

3.3 The best start for Cambridgeshire's children

There are no significant implications for this priority.

3.4 Net zero carbon emissions for Cambridgeshire by 2050

There are no significant implications for this priority.

4. SIGNIFICANT IMPLICATIONS

4.1 Resource Implications

There are no significant implications within this category.

4.2 Procurement/Contractual/Council Contract Procedure Rules Implications

There are no significant implications within this category.

4.3 Statutory, Legal and Risk Implications

There are no significant implications within this category.

4.4 Equality and Diversity Implications

There are no significant implications within this category.

4.5 Engagement and Communications Implications

There are no significant implications within this category.

4.6 Localism and Local Member Involvement

There are no significant implications within this category.

4.7 Public Health Implications

Access to Library Services is associated with improved educational outcomes. Higher levels of education are associated with better health outcomes. Libraries also provide information about lifestyles that improve health and wellbeing.

Have the resource implications been cleared by Finance? Yes
Name of Financial Officer: Ellie Tod

Have the procurement/contractual/ Council Contract Procedure Rules implications been cleared by the LGSS Head of Procurement? Yes
Name of Officer: Gus de Silva

Has the impact on statutory, legal and risk implications been cleared by the Council's Monitoring Officer or LGSS Law? TBC
Name of Legal Officer: Fiona McMillan

Have the equality and diversity implications been cleared by your Service Contact? TBC
Name of Officer: Beatrice Brown

Have any engagement and communication implications been cleared by Communications? Yes
Name of Officer: Christine Birchall

Have any localism and Local Member involvement issues been cleared by your Service Contact? TBC

Have any Public Health implications been cleared by Public Health Yes
Name of Officer: Kate Parker & Val Thomas