

Item No.	Classification: Open	Date: 9th March 2015	Meeting Name: Overview and Scrutiny Committee
Report title:		Rent Policy in the Tenanted Non-residential Estate – Baseline Briefing Note	
Ward(s) or groups affected:		All	
From:		Director of Regeneration, Stephen Platts	

RECOMMENDATIONS

1. That the existing rent policy currently in operation and summarised in Table 1 at paragraph 15 below shall be noted.
2. That the policy, issues and opportunities arising will be reviewed as part of a co-ordinated, planned programme of strategic asset reviews over the coming 2015/16 year, namely:
 - Strategy for Affordable Business & Creative Space Provision
 - Corporate Asset Management Plan update;
 - Commercial Properties Review;
 - Asset Management Planning for Voluntary & Community Assets
3. That an ongoing programme of regularising all occupations of Council premises shall continue, to ensure transparency and consistency across all property holdings and tenants / tenant groups.

BACKGROUND INFORMATION

4. The tenanted non-residential estate can be broadly divided into three components; the retail, business and voluntary & community sector portfolios.

Retail Portfolio

5. The 48 parades and 449 lock-up shops making up the tenanted retail estate generate an income of £4.33 million per annum. A more detailed breakdown is set out in Appendix 1. Just over a third of this is collected from the 100 shops in the three largest clusters; East Street, Southwark Park Road and Jamaica Road. The capital value is £41.4 million.
6. The remaining shops are generally situated in smaller parades averaging 9 units each. Frequently they are located on or around housing estates and the services they provide are specifically locality orientated. Several of the parades are in transition pending redevelopment.
7. In property investment terms the best of the shops can be regarded as low grade, characterised by non-central locations, limited income generating and

rent growth potential, non-corporate tenants and a higher level of risk in relation to possible tenant default. Even so, at present the majority are fully let, with the rent roll standing at 92% of the full Estimated Rental Value of the portfolio (the difference is due to some vacant units and historic rents until review/renewal), subject to a churn of vacancies and new lettings at about 5% per annum.

8. In terms of new lettings in the region of 50% are to new businesses and all (irrespective of new or established business) are on market terms, including rent that the market would typically be prepared to offer.

Business Premises

9. Industrial units, workshops and studios; a diminishing element of the estate following policy shifts and a programme of sale and alternative use (including the Council's own use). A summary of the main estates held is provided in Appendix 2.
10. Marked reductions in accommodation of this type across London means demand is high. For the same reasons the capacity to provide or facilitate affordable business, creative and performance space is a recognised issue and we are reviewing this in detail with a view to providing a full briefing in the coming quarter which will consider opportunities to expand the estate to support small businesses and creative industries.
11. The Voluntary and Community Sector Estate is a more diverse group of properties and some particular issues in relation to these assets are considered below (see para. 19. below).

KEY ISSUES FOR CONSIDERATION

Policy implications

Rent Policy & Holistic Estate Management

12. The Council's rent policy for the portfolio's described above is defined in, corporately adopted policy documents which are complimentary to each other, summarised in *Table 1*, overleaf.
13. In commercial terms the rent policy is effective and efficiently managed. The portfolio exhibits a low proportion of void properties, gradual increases are obtained at lease renewal, rent review and in new lettings, and arrears are contained at approximately 5% of the rent roll for the portfolio.
14. Above all a pragmatic approach is taken to the management of the estate, drawing in a series of inter-related aspects which will be explored in the 2015/16 Commercial Properties Review:
 - Diversity of compatible uses to achieve sustainable, vibrant shopping parades;
 - Exclusion of undesirable uses irrespective of their rental potential including payday lenders and betting shops;
 - Investment in assets e.g. shopping parade improvement programmes, where there is an economic / community case to do so;

- Achieving (statutory) compliance in the context of the Landlord and Tenant relationship.

Table 1: Existing Rent Policy

DOCUMENT	STATUS	RENT POLICY ELEMENTS
Asset Management Plan (“AMP”)	The Council’s overarching plan for the prudent stewardship of its property assets, geared to the achievement key corporate outcomes. Last approved in 2010, an update is planned for 2015/16 to ensure the core objectives of the Council Plan are fully reflected. The AMP aligns closely with the Medium Term Resource Strategy.	<ul style="list-style-type: none"> • Manage tenanted premises to maximise revenue income with regard to new lettings, rent review, lease renewal and minimising arrears of rent.
Strategy for the Management of VCS Premises	Sits beneath the AMP, adding an additional level of detail in relation to Council owned premises occupied by VCS tenants. Geared at supporting the VCS within the framework of financial responsibilities and diminishing resources.	<ul style="list-style-type: none"> • A transparent, equitable approach regarding access to and the cost of premises, including regularisation of lease agreements • Alternative modes of occupation where appropriate - asset transfer through management arrangements, long leases in consideration of levering in funding, shared accommodation and encouraging VCS tenants to look beyond traditional modes of occupation.
Asset Transfer Protocol	In some cases the preferred approach will be to release buildings, or a significant degree of control over them to bring forward other benefits. The protocol is a practical tool for considering alternatives to traditional lettings, where this will help to achieve assets outcomes that the Council acting alone may be unable to achieve. An essential component is that the property based solution arrived at delivers an element of additionality.	<ul style="list-style-type: none"> • Alternative modes of occupation e.g. management arrangements and transfer of long lease interests with rents offset, where appropriate, in proportion to the tenant’s financially measurable commitment to a property in asset management terms.

15. In the meantime it can be said that compared to private sector provision, the Council’s offer is relatively cheap, and flexible lease terms over and above (but including) rent free periods that might normally be offered “in the market”

are available with a view to reconciling and accommodating these various objectives. Examples (see also para. 21):

- Phased rents, increasing step by step in predictable amounts;
- Alternatively the substitution of index linked (CPI, RPI, etc.) for traditional rent review mechanisms – removing the uncertainty and potential fees entailed in the process;
- Rents payable monthly rather than quarterly;
- Lease restructure

Transparency & Consistency

16. Property agreements by their nature entail long term commitments. Consequently tenants in occupation today may do so under a contract drawn up 15 or more years ago, at a rent that has been fixed under different market conditions and subject to periodic review.
17. In each case the detail of the contracts reflect a specific deal negotiated between the parties. The process is nevertheless a transparent one. Properties are let on market terms including rents observable from transactional evidence, and lease terms determined by best practice and Landlord & Tenant law prevailing at the time the lease is entered into.
18. Almost inevitably tenants in the same parade, for example, may find themselves occupying similar premises on different terms, causing the perception of unequal treatment. Lease variations may be agreed where it is prudent to do so in estate management terms, having regard to wider resource obligations and financial duties. Even so, it is not the case that rent fluctuations when they occur are automatically reflected throughout the entire portfolio or parts of it. This would be administratively unviable and impact on net incomes received in terms of additional transaction costs. Whilst tenants might welcome the benefits of a falling market, it is unlikely that the same could be said in times of rising rental levels. Acknowledging these factors, change generally takes place incrementally at rent review, lease renewal or in new lettings.

The Voluntary & Community Sector Estate

19. The VCS estate consists of a wide range of property types, locations, states of repair and tenants. As a result the terms on which these assets are occupied also tend to be quite diverse and rents and lease terms are not readily comparable. Terms are individually negotiated for each. In some cases, without any visible or hidden subsidy the rent settled on the asset will be low because this is all the property will support in the market.
20. The over-riding principal remains that market rent is charged. Where the Council wishes to support the occupying organisation this is achieved through grant aid, rather than renting at an undervalue. A key advantage of the approach has been that support is applied only for as long as the funding department or a relevant external agency deems it appropriate to do so, and the tenant receiving this support continues to deliver the community benefits warranting it.

21. Leases and Landlord and Tenant law are somewhat less agile in this respect. One consequence of this is that some tenants have remained in premises under historic agreements at low or negligible rents; long after the Council might otherwise wish to support them. This operates to eliminate opportunities for income, to exclude prospective tenants who may have more to contribute or better compliment corporate objectives, and to instill the perceptions, here justified, of unequal treatment discussed previously. Where there is a contractual opportunity to do so, or no current agreement exists, we are actively renegotiating and regularising these occupations.

Beyond Rent Policy - the Wider Offering

22. Our work looking at affordable business premises tells us, if predictably, that local businesses and voluntary enterprises want to concentrate on their core activities, get support when they need it (especially SME's prone to skills gaps across workforce and management) and in the process keep costs low. Instead of cheap rents the emphasis becomes value for money plus support, including:
- flexible lease terms – break clauses, renting from month to month, etc. (the Council has long operated flexible lease terms – see also para.15);
 - complimentary accommodation and shared facilities
 - business services and support
 - IT support
23. Not surprisingly the accommodation providers who have been most successful in catering for the needs of emerging businesses and community enterprises have been those able to offer, and more importantly manage, additional services such as pooled business support.

Resource implications

24. Along with a broad group (telecoms aerials, advertising hoardings, a shopping centre, etc.) of miscellaneous investment holdings, budgeted annual incomes from the tenanted non-residential estate have increased over the last few years to stand at approximately £13.6 million today:

Year	2010/11	2011/12	2012/13	2013/14	2014/15
Rent in Charge	£11.3	£11.8	£13.5	£13.4m	£13.6 m

25. Any proposals to alter rent policy will need to be examined in the context of a wider review of the portfolio to ensure that opportunities do not frustrate other objectives, including the generation of significant incomes to allocate in pursuit of corporate goals. It is worth noting that the majority of the incomes received from current lettings is for the benefit of the HRA and any financial impacts would need to be assessed and agreed (Pullens Estate also falls within the HRA).
26. Inevitably rents are just one component of the total occupation costs an occupier will need to manage. Service charges, premises operating costs and National Non Domestic Business Rates (NNDR) all need to be factored in to the equation. It may be appropriate to consider whether intervention in the

last of these in particular is viable proposition for the Council as a means of supporting local businesses.

Other Issues

27. The workstreams identified in Recommendation 2 above will be accompanied by full consultation, community impact assessment, and advice from other officers including Director of Legal Services, Strategic Director of Finance and Corporate Services and other directors as appropriate.
28. Thorough consideration will be given to the statutory framework against which rent policy is implemented (s.123 Local Government Act 1972, State Aid rules etc.), together with all financial, budget and staffing issues.

BACKGROUND DOCUMENTS

Background Papers	Held At	Contact
Corporate Asset Management Plan http://moderngov.southwark.gov.uk/ieListDocuments.aspx?CId=302&MId=3335&Ver=4 (ITEM 14)	Regeneration Department (Property), 160 Tooley street	Matthew Jackson 0207 525 1332
Strategy for the Management of VCS Premises http://moderngov.southwark.gov.uk/ieListDocuments.aspx?CId=118&MId=1481&Ver=4 (ITEM 13)		
Asset Transfer Protocol IDM February 2012		

APPENDICES

No.	Title
Appendix 1	LBS Main Retail Premises
Appendix 2	LBS Industrial Portfolio

AUDIT TRAIL

Lead Officer	Stephen Platts, Director of Regeneration	
Report Author	Matthew Jackson, Head of Property Asset Strategy	
Version	Final	
Dated	2nd March 2015	
Key Decision?	No	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER		
Officer Title	Comments Sought	Comments Included
Director of Legal Services	No	No
Strategic Director of Finance and Corporate Services	No	No
List other officers here	-	-
Cabinet Member	No	/No
Date final report sent to Constitutional Team/Community Council/Scrutiny Team	2nd March 2015	

**APPENDIX 1:
LBS Main Retail Premises**




Investment Category	Parades	Units	Avg Units per Parade	Floor Area (m2)	Passing Rent for Group	Indicative Rents per Unit	Capital Value for Group
Locality/Transitional • Taplow, SE17 • Acorn Parade, SE15 • Seeley Drive, SE24 • Crossthwaite Ave, SE5 • Vestry Rd, SE5 • Sceaux Gardens, SE5 • Dunton Rd, SE1 • Woodwarde Rd SE24 • Maddock Way, SE17 • Commercial Way, SE15 • Mortlock Close, SE15 • Commercial Way, SE17 • Asylum Rd, SE15 • Old Kent Rd, SE15 • Northchurch, SE17	13	100	8	6754	£518,434	£3,000 to £10,000	£4.7 million
Intermediate • Southwark Park Rd, SE16 • Walworth Rd, SE17 • Market Place, SE16 • Old Kent Rd, SE1 • Wyndham Rd, SE5 • Jamaica Rd, SE16 • Harper Rd, SE1 • East St (part), SE17 • Albion St, SE16 • Great Suffolk St, SE1 • West Lane, SE16 • Jamaica Rd, SE16 • Dockhead, SE1 • Abbey St, SE1 • Camberwell Rd, SE5 • Peckham Park Rd, SE15 • Peckham Hill St, SE15 • Long Lane, SE1 • Redcross Way, SE1 • Peckham High St, SE15	21	228	11	16647	£2,029,067	£6,000 to £16,000	£19.7 million
Marginal Investment • Bartholomew St, SE1 • Southwark Park Rd, SE16 • Peckham High Street, SE15 • Camberwell Road, SE5 • Waterloo Road, SE1 • Pilgrimage St, SE1 • London Rd, SE1 • Lower Rd, SE16 • East St, SE17	14	121	9	6838	£1,787,710	£10,000 to £22,500	£17 million
Total	48	449	9	30,238	£4,335,211	-	£41.4 million
Top 3 Parades/Clusters by Size – for info • East St, SE17 • Jamaica Rd, SE16 • Southwark Park Road, SE16	3	99	33	8985	£1,639,160	£12,000 to £22,500	£15.8 million

As Percentages:

Investment Category	Parades	Units	-	-	Passing Rent	-	Capital Value
Locality/Transitional	22%	22%	-	-	12%	-	11%
Intermediate	51%	55%	-	-	47%	-	48%
Investment Grade	27%	23%	-	-	41%	-	41%
Top 3 Parades/Clusters	22%	30%	-	-	38%	-	38%

Note: the figures exclude standalone shops, including those with residential upper parts. There are just over 50 of these, adding another £0.5 million rental income per annum.

**APPENDIX 2:
LBS Industrial Portfolio**

ESTATE	DESCRIPTION	ACCOMMODATION	ASSET MANAGEMENT CONSIDERATIONS
<p>Tower Workshops, Riley Road, SE1 3DG</p> 	<ul style="list-style-type: none"> Former Metal Box factory, originally built in the 1930's and converted to its present use under the Council's jobs and industry programme in 1980's. Owned freehold by the Council and managed in-house. Current uses include light industry, studios, workshops and offices. 	<ul style="list-style-type: none"> Approx 50,000 sq.ft in total, comprised in 55 units ranging in size from 400 to 2,750 sq.ft. Accommodation is fairly basic, some facilities are communal. However, excellently located in an area where supply of traditional business space has dwindled to negligible levels in favour of higher value alternative uses. 	<ul style="list-style-type: none"> Competitive rents c. £10.00 per sq.ft for vacant units Flexible lease terms The total gross rent roll from the estate is currently in the region of £400,000 per annum. Consistently low vacancy rates. Whilst this level and relative security of income makes retention attractive, the future of the asset is kept under review as opportunities are identified.
<p>Pullens Estate (Iliffe Yard / Peacock Yard), Crampton Street, SE17</p> 	<ul style="list-style-type: none"> Two 1920's mews estates, arranged around cobbled courtyards, to the south-west of the Elephant & Castle. 	<ul style="list-style-type: none"> Approx 35,000 sq.ft in total, comprised in 75 units ranging in size from 400 to 1,175 sq.ft. 	<ul style="list-style-type: none"> Extremely popular estate with consistently high occupation rates. The rent roll is a little short of £600,000 per annum. Flexible packages – short or 15 year leases, RPI rents, monthly rents. A long established location for diverse business and creative uses in this part of the borough, with potential to increase activities in the immediate locality.
<p>Dockley Road Industrial Estate, Rouel Road, SE16 3SF</p> 	<ul style="list-style-type: none"> A dated, 1980's-built industrial shed development of 11 units, situated immediately off Spa Road, SE16. 	<ul style="list-style-type: none"> Approx 19,800 m2 in total, comprised in 11 units ranging in size from 1,160 to 2,830 sq.ft. 	<ul style="list-style-type: none"> A leasehold asset, held on a tenancy expiring in 2077. The net rent obtained is c. £23,000 per annum after a head rent has been paid away to the landlord. There is an outstanding rent review. The property falls within the Bermondsey Spa regeneration area and will be retained in the short term only. It is expected that redevelopment will be progressed during 2015/16.