ISLINGTON
For a more equal future

Decision of:	Corporate Director, Community Wealth Building
Decision date:	25 July 2024
Publication:	Open
Council Priority:	Community Wealth Building
Wards:	Bunhill
Responsible Officer:	Assistant Director, Corporate Asset Management
Report No.	I029286

Subject: Old Street Lease Surrender

Reason for urgency:

The Council owns two office blocks on Old Street that have been let on commercial terms for many years, providing managed office space to sub-tenants. The principal leaseholder for 45 and 69 Old Street has notified the Council that it intends to surrender its leases. The leaseholder has agreed to surrender the leases in an orderly way including a surrender payment and supporting the transfer of existing sub-tenants to help the council retain a proportion of the rental income. If the Council does not accept the surrender of the leases, the principal leaseholder has stated it will place the company which holds the leases into administration. If the company goes into administration, the rent paid by the sub-tenants will be paid to the Administrator and, as the company that holds the leases has no assets, the Council will have to enter a potentially protracted legal process as an unsecured creditor to receive any of the income and will not be able to recover any costs incurred. It is therefore recommended that the Council agree to accept the surrender of the leases and the proposed successor arrangements.

1. Recommendations

1.1. To authorise accepting the lease surrenders for both 45 and 69 Old Street and finalising the arrangements with the lessee regarding all payments and the sub-lease holders.

2. Report summary

2.1. This report seeks urgent approval to accept the surrender of leases for 45 and 69 Old Street in return for a one-off payment and the transfer of existing sub-tenants, as the most effective solution to minimise financial losses for the Council.

2.2. Accepting the surrender of the leases in a managed way will also prevent disruption to the sub-tenants' businesses in the longer term, avoiding the loss of businesses and employment in the local area.

2.3. 45 Old Street is currently unoccupied and would present a void risk to the Council upon surrender, 69 Old St is fully occupied and it is proposed that the sub-tenants transfer to the Council's management upon surrender.

3. Details of the proposal

3.1. Following negotiations with the leaseholder, the terms proposed for a managed surrender of the lease are for the leaseholder to pay a premium equivalent 4.5 months from March to surrender its lease obligations.

3.2. The leaseholder has made it clear that its intention is to terminate all lease arrangements before the end of July 2024 and will dissolve the subsidiary company holding the leases if agreement cannot be reached.

3.3. The leaseholder has committed to do everything possible to ensure that all sub-tenants in the 20 serviced offices remain in occupation so that the Council can benefit from the income generated. The gross receivable income from the 69 Old Street operation is estimated at £420,000 pa (after deductions for the proposed managing agent and all building costs), generating a modest improvement on the £390,000 pa payable to the Council under the current lease. Although the building is currently fully occupied, this income estimate assumes a 25% tenant attrition rate.

3.4. It is proposed to manage the 69 Old Street directly with the assistance of a partner which specialises in management of serviced offices on behalf of landlords. A separate contract will be entered into with the partner. The arrangement will be that the company receive the rent from the license holders, which will then be passed onto the council less a fee of approximately £8.3k per calendar month. A competitive tender exercise has been undertaken in anticipation of the lease surrender and COVALT has been established as the preferred provider.

3.5. The 45 Old Street building is vacant. The existing lease arrangement for 45 Old Street is at a rent of is £550,887 per year. The market rent is currently valued at approximately £400k per year and advice from letting agents suggests, if the council wishes to achieve market rent, that it may take 12-24 months to secure a tenant, possibly with additional rent concessions. The void cost (including empty rates and service charge expenditure) is estimated to be £225k per annum.

3.6. On surrender, a number of actions will be undertaken in parallel to seek to mitigate the void risk from 45 Old St:

- active marketing including the potential for discounted rent in return for early occupation
- meanwhile solutions including options to split the building into multiple hereditaments
- void cost minimisation including empty building business rate exemption and cost-effective solutions to secure the building whilst vacant
- subject to viability and planning considerations, assessing potential for a longer term change of use to residential, linked to a potential new build scheme on the neighbouring Stafford Cripps Estate or potentially conversion to temporary accommodation.

4. Other options considered and the reasons for recommending this proposal

4.1. The only alternative to accepting the surrender of the leases is to do nothing. If the council does not accept the managed surrender of the leases, the company will go into administration. This will mean that 45 Old Street will be empty, and the rent paid by the sub-tenants in 69 Old Street will be paid to the Administrator. As the company being liquidated has no assets, the Council will have to enter a potentially protracted legal process as an unsecured creditor to receive any of the income and will not be able to recover any costs incurred.

4.2. In recent years, London's office market has experienced saturation due to a surplus of available office space across the city. Vacancy rates have risen, leading to increased competition among landlords to attract tenants. Under these circumstances, many landlords have to offer additional incentives to fill vacant spaces and it is prudent to prevent a property falling empty if it is avoidable.

5. Key impacts and risks of the proposal

5.1. Accepting the managed surrender of the leases exposes the council to several risks:

5.2. 45 Old Street will fall empty, and it may be some time before a tenant is found and the nature of the lease the letting agents have suggested will be necessary and the time they estimate it will take to find a tenant, mean it may be some years before the council benefits from material income from the property.

5.3. Retaining the sub-tenants at 69 Old Street will help to offset the costs of 45 Old Street being empty, but there is no guarantee that the license holders will continue to remain at the premises. However, the leasehold has committed to doing all it can to ensure the license holders are retained and that loss of employment in the local area and income to the council is minimised.

5.4. If the council does not accept the managed surrender of the leases, the council will not be able to mitigate the impacts of the company going into liquidation. This will mean that an Administrator will be appointed, 45 Old Street will fall empty without the council receiving any income from 69 Old Street to mitigate the costs. The rent paid by the license holders in 69 Old Street will be received by the Administrator and the council will have to enter a potentially protracted and expenses legal process to seek receipt of the income and to make new arrangements with the license holders.

6. Contribution to the Islington Together 2030 Plan

6.1. Accepting the surrender of the leases in a managed way will prevent disruption to the sub-tenants' businesses in the longer term, avoiding the loss of businesses and employment in the local area and will reduce the council's exposure to potentially significant financial losses.

7. Consultation and community engagement

Negotiations have been taking place with the current leaseholder to ensure the leases are surrendered in a managed way.

8. Implications

8.1. **Financial Implications**

8.2. The Council currently receives £0.941m per annum in rental income for 45 Old Street (£0.551m) and 69 Old Street (£0.390m). The leaseholder gave notice that it was going to vacate the premises by 30 June 2024, but has agreed to pay the equivalent to 4.5 month's rent for the for the current financial year (to 16 August 2024). This means the Council will receive £0.353m in this financial year out of the annual rental stream for these properties of £0.941m, a shortfall of £0.588m.

8.3. The leaseholder has given notice at both buildings because the Old Street market has not fully recovered since the COVID-19 pandemic; there is more good quality stock in the area than there is demand for; capital investment requirements in the buildings are high; and one large client occupying 45 Old Street vacating the premises making their model no longer viable. The leases for both buildings are held in a stand-alone Special Purpose Vehicle that is in financial distress and is at risk of being wound up at any time.

<u>69 Old Street</u>

8.4. The leaseholder has sublet 69 Old Street to 20 subtenants as serviced office accommodation. The Council is negotiating with the leaseholder so that these subtenants will remain in-situ and become tenants of the Council. Under this arrangement the Council would benefit from a continued rental income stream. It is proposed that the property is managed by an external agent, COVALT, at a cost of £0.150m for 18 months (£8.3k per month) while a new appointment process is put in place to procure a management agent for the longer term. The Council is responsible for business rates (estimated at £0.275m per annum) and utilities, maintenance, and insurance costs (estimated at £0.075m per annum) but would seek to pass these on to the subtenants through a service charge. This process would be managed by the managing agent.

8.5. According to the leaseholder capital investment is required in the air conditioning system which is at the end of its life and a general refurbishment of the building is required to ensure it is in an appropriate condition. This was estimated to cost between £0.5m and £1m by the leaseholder. The Council does not have a budget for this so funding would need to be found in the capital programme to meet it if these works are required.

8.6. There are several risks with these arrangements:

8.7. One or more subtenants may decide to vacate the premises reducing the rent stream for this premises (11 contracts end in this financial year), and the ability to pass on building costs (business rates, utilities, maintenance and insurance costs) in full through the service charge.

8.8. The management fee is a fixed cost of £8.3k per month regardless of the number of tenants in place, therefore if all the tenants left the building, the Council would still be liable for this fee.

8.9. There is not a financial incentive for the management agent to retain subtenants or replace those that may choose to vacate the building.

8.10. If subtenants leave the building and a replacement tenant is not found the Council would be liable building costs in relation to that part of the building.

8.11. This impact of this arrangement on the assumption that all the subtenants remain in place is a net cost of £0.052m in 2024/25 and £0.070m from 2025/26 onwards as shown in the table below, assuming all building related costs can be passed on and all 20 subtenants remain in place. The loss will increase if subtenants leave and are not replaced (11 contracts are due to end in this financial year). Some residual building running costs may still fall on the Council even if all the subtenants remain in place as the building is not fully occupied (there are currently 2 vacant office spaces).

Impact of proposed arrangement if all subtenants remain	**2024/25 £m**	**2025/26 onwards £m**
Loss of rental income (7.5 months in 24/25, 12 months 25/26 onwards)	0.244	0.390
Forecast rent from 20 subtenants (7.5 months in 24/25, 12 months 25/26 onwards)	(0.263)	(0.420)
Management fee (fixed cost) (8.5 months in 24/25, 12 months in 25/26 onwards)	0.071	0.100
Net cost	**0.052**	**0.070**

8.12. If all the subtenants decide to vacate the building the Council would be liable for the following costs – this is a worst-case scenario:

Costs to the Council of proposed arrangement if all subtenants leave and cannot be replaced (worst case scenario)	**2024/25 £m**	**2025/26 onwards £m**
Loss of rental income (7.5 months in 24/25, 12 months 25/26 onwards)	0.244	0.390
Management fee (fixed cost) (8.5 months in 24/25, 12 months in 25/26 onwards)	0.071	0.100
Business rates (4.5 months in 24/25 incl. 3-month exemption, 12 months 25/26 onwards)	0.103	0.275
Security, maintenance and insurance (7.5 months in 24/25, 12 months 25/26 onwards)	0.047	0.075

Net cost	**0.465**	**0.840**

8.13. The proposed arrangement does however avoid void costs for the Council if all subtenants remain. The Council would be liable for business rates of £0.275m per annum if the building was vacant as well as costs in relation to insuring and securing the building (estimated at £0.075m per year). This would be on top of the lost rental income of £0.390m per year. Unoccupied properties are eligible for an initial one-off 3-month business rate exemption period.

<u>45 Old Street</u>

8.14. 45 Old Street will be vacant from the point that the leaseholder surrenders the lease. The Council will incur void costs until the property can be re-let. These are estimated at £0.15m for business rates and £0.075m for other void costs such as securing the building. Unoccupied properties are eligible for an initial one-off 3-month business rate exemption period.

8.15. It is expected that it could take at least 2-years to secure a tenant if at all. Once a tent is secured, there would likely be a rent-free period. The leaseholder has stated that the building requires an air conditioning system replacement, an internal refurbishment and re-configuration of space and have estimate that this would cost at least £1m. The Council does not have a budget for this so funding would need to be found in the capital programme to meet it if these works are required.

8.16. The Council will incur significant losses on this building for which there is no budget. These are estimated to be (excluding the £1m capital investment requirement):

	2024/25 £m	**2025/26 onwards £m**
Loss of rental income (7.5 months in 24/25, 12 months 25/26 onwards)	0.344	0.551
Business rates (4.5 months in 24/25 incl. 3-month exemption, 12 months 25/26 onwards)	0.056	0.150

Other void costs (7.5 months in 24/25, 12 months 25/26 onwards)	0.047	0.075
Net cost	**0.447**	**0.776**

8.17. **Legal Implications**

8.18. The Council has power to enter into a deed of surrender under section 1 of the Localism Act which provides a general power of competence. Section 1 gives Local Authorities the legal power to do anything that an individual can do that is not specifically prohibited. For example, the power to do something for the benefit of the Authority, its area, or persons / residents present in its area. This includes agreeing terms for the surrender of a lease and as part of those negotiations can accept that dilapidations will not be payable.

8.19. The Council is under a fiduciary duty to act prudently, responsibly, commercially and in their view of what constitutes the best interests of the general local taxpayer. This means that the decision must be rational, authorised by law and must take into account all relevant considerations.

8.20. This report states that the arrangements proposed reflect the current market conditions and the leaseholder's potential insolvency. Therefore, in agreeing the terms of the proposed surrender, the Council must be satisfied that, having regard to the financial implications and recommendations in this report, its decision complies with this duty.

8.21. In order to complete the surrender of the two leases, the Council will need to enter into a deed of surrender in relation to both leases. Completion of the deeds will end the Landlord and Tenant relationship and the obligations that arise therefrom. All entries at the Land Registry will need to be removed.

8.3. **Climate Change and Environmental Implications**

8.3.1. There are no environmental implications arising from this decision.

8.4. **Equalities Impact Assessment**

The council must, in the exercise of its functions, have due regard to the need to eliminate discrimination, harassment and victimisation, and to advance equality of opportunity, and foster good relations, between those who share a relevant protected characteristic and those who do not share it (section 149 Equality Act 2010). The council has a duty to have due regard to the need to remove or minimise disadvantages, take steps to meet needs, in particular steps to take account of disabled persons' disabilities, and encourage people to participate in public life. The council must have due regard to the need to tackle prejudice and promote understanding.

8.4.1. An Equalities Impact Assessment screening tool was completed on 29 May 2024 and found that there were no equality implications in respect of this proposal.

9. Timetable for implementation

9.3. The surrender of the leases will be finalised immediately following the decision by the Corporate Director of Community Wealth Building and this decision is therefore not available for call-in.

Appendices: None

Background papers: None

Report authorised by:

Interim Assistant Director Corporate Asset Management

Date: 22 July 2024

10. Record of the decision

I have today decided to take the decision set out in section 1 of this report for the reasons set out above. My agreement is indicated by the checkbox below.

Decision authorised by:

Corporate Director, Community Wealth Building ☒

Date: 25 July 2024

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