

Report to: Cabinet



Date of Meeting 30th September 2020

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THE ACQUISITION OF OCEAN BLUE, THE ESPLANADE, EXMOUTH, EX8 2AZ – PROCESS FOLLOWED AND BUSINESS CASE FOR ACQUISITION

Report summary:

The Council completed on the purchase of Ocean Blue on 4th March 2020, delivered in accordance with the adopted Commercial Investment Framework.

The purpose of this report is to update Members on:

- a) The process followed in accordance with the Commercial Investment Framework
- b) The acquisition and business case behind this – bearing in mind that this is a public document, some commercially sensitive information will be omitted

Recommendation:

To note the content of this report

Reason for recommendation:

To provide enhanced awareness of the detail behind this acquisition

Officer:

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Portfolio(s) (check which apply):

- Climate Action
- Corporate Services and COVID-19 Response and Recovery
- Democracy and Transparency
- Economy and Assets
- Coast, Country and Environment
- Finance
- Strategic Planning
- Sustainable Homes and Communities

Financial implications:

As the report is simply to advise Members of the acquisition and process followed, there are no financial implications requiring comment.

Legal implications:

As the report is simply to advise Members of the acquisition and process followed, there are no legal implications requiring comment.

Equalities impact Low Impact

Climate change Low Impact

Risk: Low Risk; Due diligence sought to identify and mitigate risks before acquisition completed. Financial modelling allowed for a cautious approach to future maintenance liabilities.

Links to background information

[Commercial Investment Framework. Cabinet 06.02.19](#)

[Commercial Investment Scrutiny.06.02.2020](#)

[Marketing Details](#)

Link to [Council Plan](#):

Priorities (check which apply)

- Outstanding Place and Environment
- Outstanding Homes and Communities
- Outstanding Economic Growth, Productivity, and Prosperity
- Outstanding Council and Council Services

Report in full

The process followed in accordance with the adopted Commercial Investment Framework

- 1.1 This investment opportunity was marketed in summer 2018 and at a time prior to the Commercial Investment Framework being adopted. The Council's Senior Management Team, Leader, and Portfolio Holders for Asset Management, Finance and Economy supported an offer being made, subject to the usual due diligence and Council approvals. Once the Commercial Investment Framework was adopted in February 2019, the Council then followed the approach set out within.
- 1.2 Links within this report are to the following:
 - a) Cabinet report of 6th February 2019 together with attached Commercial Investment Framework. Confidential appendix B is omitted.
 - b) Scrutiny report and presentation of 6th February 2020
- 1.3 The purpose of the Commercial Investment Framework is to provide the mechanism to help deliver the £450,000 net income from property investment as accounted for within the Council's Transformation Strategy.
- 1.4 Prior to Cabinet in February 2019 the matter of commercial investment had been considered by Overview Committee twice and the draft Framework had been presented to Asset Management Forum twice.

- 1.5 External legal advice had been commissioned through Bevan Brittan to advise on the Council's powers to invest commercially along with the mechanism by which this should be done.
- 1.6 The Framework incorporates a general introduction and background to commercial investment, legal and regulatory powers, objectives, types of investment considered and weighted scoring matrices for assessment of opportunities to ensure opportunities are considered in a structured and objective manner by relating all opportunities to the objectives set by Cabinet. The Framework also provided for new arrangement to ensure agile but safe decision making.
- 1.7 The new Commercial Investment Governance Model adopted as per the Framework provided for safe, accountable and democratic decisions to be taken in a more agile manner. Investment opportunities are considered against the relevant scoring matrix and if the necessary score and indicative return is achieved at this stage, the opportunity will be progressed by a dedicated Investment Assessment Team, before Outline Business Case to the Council's Senior Management Team and Portfolio Holders for Asset Management, Economy and Finance. If supported there would then be a Full Business Case with a decision to invest by the Deputy Chief Executive (whilst in post) in consultation with Leader and Portfolio Holders for Asset Management, Economy and Finance, jointly referred to within the Framework as the Investment Decision Making Group. For commercial investment opportunities exceeding the £5,000,000 limit then the Council's normal decision making route would apply.
- 1.8 Updates are provided through AMF (limited to non-commercially sensitive material) although in an AMF on 9th January 2020 shortly before we completed on the investment in Ocean we took forward a confidential agenda item on the Investment Framework.
- 1.9 On 6th February 2020 there was a report and presentation to Scrutiny around the process for assessing commercial opportunities. This report contains a link to this earlier item.
- 1.10 The investment in Ocean Blue followed the approach and governance arrangements within the adopted Investment Framework. In late 2019 there was a SWAP audit looking specifically at the adopted Commercial Investment Framework and the process therefore followed for Ocean and concluded in an assessment of reasonable assurance being given with recommended actions given in respect of more formal minute taking of the Investment Decision Making Group and sharing and recording of scoring for dismissed investment opportunities, neither areas of particular concern.

Terms of Acquisition and Business Case for investment in Ocean Blue

- 2.1 Marketing details are included as a link to this report and provide a useful summary.
- 2.2 There was a Full Business Case presented to the Investment Decision Making Group (Leader, Portfolio Holders for Asset Management, Finance and Economy) as per the adopted Framework along with Chief Executive, Deputy Chief Executive, Strategic Lead – Governance & Licensing and Strategic Lead - Finance. This document remains commercially sensitive but a summary of the non-commercially sensitive and key elements

will be provided below. The Decision Making Group supported the Deputy Chief Executive proceeding with the investment. There was a lengthy delay from this agreement through to the acquisition due to protracted legal issues needing to be resolved and immediately prior to exchange, Officers again sought the support of the Investment Decision Making Group which was given.

2.3 Executive Summary

Opportunity – To purchase the head lease of Ocean Blue for £2,700,000. There is a sub-lease in existence for 25 years from 2015 to LED with a rent payable from June 2019 of £200,000 per annum with a rent review in 2020 based on CPI and reviews thereafter every 5 years (subsequently determined at £217,417 per annum (plus VAT) effective from 11/06/2020). EDDC already own the land on which Ocean Blue is constructed and therefore through purchase of the head lease the 2 interests are merged and EDDC is then only restricted by the current lease with LED. Any other purchaser would be bound by restrictions in the head lease, and therefore a purchase by EDDC provides the opportunity with LED's agreement to restructure the LED lease at some point in the future and generate through marriage value a greater return. EDDC also own adjacent land and by purchase of this building (through way of the head lease) and therefore having control working with LED to vary uses, this generates wider opportunities to unlock potential of the wider area encompassing Queens Drive, Harbour View Café and Ocean Blue into one 'offering'. The Business Case to invest was based on the income stream from LED but for the reasons mentioned, other opportunities are open to EDDC that would not have been open to other purchasers and hence the investment is worth more to EDDC than other purchasers.

Financial Performance – There is a forecast net income in year 1 of £79,000 which represents a return of 2.79% increasing to £99,000 (est) and 3.47% in year 2. If a more cautious approach is taken to EDDC maintenance liabilities then £49,000 representing 1.73% increasing to £68,000 (est) and 2.40% in year 2. These rates of return are after borrowing costs and do not reflect possible enhancement in capital values.

Compliance with Commercial Investment Framework (CIF) – Achieves the necessary scores within the weighted scoring matrices to be considered by both the Income Only Fund (IOF) and Income Plus Fund (IPF) as per adopted Commercial Investment Framework. That said, the year 1 financial return fails to score the 3% needed for the IOF and therefore it was proposed that EDDC use the IPF but then flip this investment over to the IOF after year 2 at which time it is anticipated the financial return will qualify.

2.4 Background

This investment opportunity was marketed in summer 2018 and at a time prior to the Framework being adopted. The Council's Senior Management Team, Leader and Portfolio Holders for Asset Management, Finance and Economy supported an offer being made, subject to the usual due diligence and Council approvals. An offer of £2.7m was made for the acquisition of the long lease and eventually increased to £2.85m before being declined by the vendor. The vendor then progressed the sale with a third party who we're told offered in excess of £3m. That sale fell through and in mid-December we placed a new offer, again subject to contract, due diligence and approval, at £2.5m increasing this to £2.7m which was then accepted with conditions that the vendor would top up rent to £200,000 from date of acquisition to review date in lease along with completing any outstanding external repairs, decoration and other obligations placed on the vendor within

the lease to LED. Prior to offers having been made the Council had already commissioned LSH Property Consultants to advise on the attractiveness of this as an investment to both a) the market, and b) EDDC as a ‘special purchaser’.

2.5 Investment Details – Property & Accommodation

Marketing details are attached, but to summarise:

- Modern three storey detached building constructed circa 2013 with an iconic design incorporating feature curved roofs, wooden cladding, extensive glazing and roof terraces to 2nd floor.
- Ground floor comprises 12 lane bowling alley, gaming area, restaurant and convenience store.
- First floor incorporates soft play area with café and a coffee and restaurant, newly refurbished with external terraces.
- Second floor provides a function suite with 2 terraces used for corporate hire, weddings and other events.

Areas as follows and on a GIA basis:

Floor	Sq m	Sq ft
Ground Floor	1,932.16	20,798
First Floor	1,892.52	20,372
Second Floor	720.48	7,755
TOTAL	4,545.16	48,924

2.6 Investment Details - Tenure

The Council already owned the unencumbered freehold of the site (land).

There was a long leasehold agreement in place from the Council to Harlequinns Bowling & Leisure Ltd dated 17th January 2013 as follows and it is this which was acquired. By acquiring this leasehold then the Council merged its freehold and leasehold interests and in effect (at least) this lease falls away. The Council now owns the land and building and is free to do what it so wishes, subject to the terms of the LED lease along with planning restrictions.

The terms of the lease acquired is as follows:

- **Term** 125 years from 17 January 2013
- **Use** Multi –function leisure development pursuant to A1, A3, D1 & D2, bowling alley, children’s play area, retail, café, restaurant
Restrictions - No public house, casino, arcade, nightclub, fun fair, dance club, bingo hall or hot food takeaway. Bar sales on ground floor are restricted to only when bowling alley is open. As for the 1st floor, any bar selling alcohol shall only be run in conjunction with and ancillary to a restaurant and / or café and shall be closed when this restaurant / café is closed.
* A Deed of Variation dated 10th June 2015 permits amusement machines providing they are not for “betting or participation in a lottery”. This deed of variation is only in place whilst LED are in occupation.
* No selling alcohol on the second floor (LED do in fact sell alcohol – and there are cash registers at the second floor bar)
- **Alienation** – no restriction
- **Right of pre-emption** if Council sells land before 16th January 2034.

The entirety of the property is let on a single lease dated 10 June 2015 to LED Leisure Management Limited.

- **Term** - 25 years from 10 June 2015
- **Current Rent** - £200,000 from year 5 (June 2019) increased to £217,417 from June 2020.
- **Other Rent** - one peppercorn per annum (if demanded) for equipment.
- **Repairs & Maintenance** –
 - LED responsible for interior of the Building so as to include:
 - the internal plaster, plasterboard and surface finishes of all walls
 - the whole of any internal, non-load bearing walls that are entirely within the Property
 - the floorboards or floor screed or other floor surfaces above the joists or other structural floor supports supporting them
 - the ceiling plaster, plasterboard or other ceiling surface below the joists or other structural ceiling supports supporting them
 - all Service Media that exclusively serves the Property
 - the rooftop condensers for the heating and cooling systems for the Building and the pipework serving them
 - the CCTV system including those parts mounted on the exterior of the Building
 - the floor surface only of the balconies
 - the L's Fixtures & Fittings
 - EDDC responsible for:
 - the main structure of the Building including the roof and roof structures, the roof system, the foundations, the external walls and cladding, the internal load bearing walls, the structural steelwork, the columns, beams, joists, the guttering and guttering system, the structure of the balconies (including any balcony railings or walls) and the parapets and mansafe system
- all parts of the Building lying below the floor surfaces or above the ceilings of the Property
- all of the external windows window frames and glazing in them the external doors and the external door frames and glazing in them
- all boundary walls, fences and railings of the Building
- automated window and door systems
- all Service Media (save for Service Media that exclusively serve the Property)
 - *Note: Tenant also responsible for cleaning and clearing of guttering and downpipes along with keeping glass in windows clean. Also for maintaining the bowling equipment (incl shoes, balls etc) and play area equipment.*
- **Service Charge** – For sums incurred or to be incurred on maintenance and treatment of cladding only up to maximum of £2,500 per annum increased annually in accordance with RPI.
- **Use** – As per headlease.
- **Break option** - Tenant only Break in year 15 on giving not less than 6 months' notice (2030) – 10 years term certain remaining
- **Rent Review** - Every five years in line with CPI, subject to cap and collar and with 1st review due June 2020, now implemented and agreed.
- **Insurance** – Landlord insures but recovers cost from Tenant. Includes plate glass.
- **Alienation** - Not to assign or charge part only, on the grant of underlease –not to assign, sub-underlet or charge part only, assign or sub underlet of whole is permitted with landlords consent. Underlease rent to be at market level in accordance with the rent reviews.

LED have sublet circa 1500 sq ft to David and Lucy Calland (t/a Budgens) in 2016 for 10 years with a tenant only break in 2021. The rent is stepped across the 1st 5 years.

Lambert Smith Hampton advised the Council and before offer was submitted, advised the following:

- Value to market as an investment based on income from LED. Acknowledged that the investment was worth an additional sum to the Council over and above other purchasers on basis of Council's marriage value and ability, unlike any other purchaser, to amend / lift restrictions within the lease such as use and alienation clauses and by doing so increasing rental value. There is also the marriage value from owning immediately adjacent sites. These figure are not provided in this report due to commercial sensitivity.
- Rental value should Council own and LED vacate – By subdividing the building into parts and relaxing the user covenants (which only the Council as purchaser can do) would generate an enhanced value. Again, this figure is not provided in this report due to commercial sensitivity.

The Council has advice on the value based on the LED income stream, the value should LED vacate and the building be split into separate entities but for the same principal uses and for the scenario should LED vacate and the uses at the building change. This advice informed the Council in its decision to invest and on its purchase price.

There is also the added dimension of the Queens Drive space and Harbour View Café site. In bringing forward the proposed new leisure scheme at Queens Drive the Council will need to give consideration as to the extent to which any new offering will either compete or complement existing businesses such as at Ocean Blue.

2.8 CIF Objectives

The Treasury Management Code and therefore also the Investment Framework prioritises, in order of importance the following 3 criteria, all achieved through this investment:

- Security – protecting the capital sums invested from loss –Enhanced in this instance through marriage value by merging the Council's existing freehold interest with the leasehold interest.
- Liquidity – ensuring the funds invested are available when needed i.e. asset could be disposed – By merging of interests and marriage value created this opportunity excels in this.
- Yield – an acceptable rate of return from investment – Acceptable for Income Plus Fund (IPF) from year 1.

Whilst at 1st sight this investment opportunity seems to most neatly sit within the Income Only Fund (IOF)– purely to drive a commercial return, its proximity to the Council's adjacent land at Queens Drive and Harbour Road Café along with the ability by merging interests in Ocean and lifting covenants to potentially achieve a more vibrant and dynamic mix within and as part of a wider scheme incorporating Queens Drive space makes it possible to use the Income Plus Fund (IPF). The investment opportunity was scored against both weighted scoring matrices, agreed previously by Cabinet to inform the types of investment to pursue and the tests and criteria for each were passed.

2.9 Agreed Due Diligence Post Offer

Building & Structural Survey - Commissioned through NPS Group and considered External Envelope, Internal Envelope, Structural Report and Building Services Report. Identified no areas of particular concern.

2.10 Relationship with LED

This investment is managed as a commercial investment with the sole objectives of protecting the capital sum invested from loss, ensuring liquidity i.e. asset can be disposed of if needed and ideally at an enhanced value and that there is an acceptable yield generated from the investment. The fact that it is LED as tenant is irrelevant and in respect of their occupation of this building, they will be treated in exactly the same way as any other commercial tenant and with no preferential treatment given whatsoever. If LED default on lease obligations then EDDC to take same enforcement / forfeiture actions as with any investment.