

MIDDLESBROUGH COUNCIL



Report of:	Executive Member for Regeneration: Councillor Ashley Waters Executive Member for Finance and Governance: Councillor Chris Hobson Kevin Parkes: Executive Director of Growth and Place James Bromiley: Strategic Director of Finance, Governance and Support
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Submitted to:	Executive - 20 th December 2019
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Subject:	Town Centre Acquisition - PART A
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Proposed decision(s)	
It is recommended that the Executive: <ul style="list-style-type: none"> A. approves the freehold acquisition of the identified properties within the town centre; B. delegates the completion of acquisitions on the identified properties to the Executive Director of Growth and Place and the Strategic Director of Finance, Governance and Support, in consultation with the Executive Member for Regeneration and the Executive Member for Finance and Governance within the parameters of the report; and, C. subject to satisfaction of point B, approval for the appointment, via the relevant tender process, to procure a managing agent for any property acquired. 	

Report for:	Key decision:	Confidential:	Is the report urgent? ¹
Decision	Yes	Commercially confidential information has been reserved for Part B of this report. This is because the financial information cited may be prejudicial to the business interests and negotiations of an individual or business. Information relating to the financial or business affairs of any particular person (including the authority holding the information)	Non urgent

Contribution to delivery of the 2019 - 22 Strategic Plan

Business Imperatives	Physical Regeneration	Social Regeneration
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The proposal will improve the council’s ability to influence the makeup of the town centre, ultimately improving the levels of business rates that can be achieved for the town, increasing diversity of employment opportunities and improving the customer experience available in the town.

Ward(s) affected

Although based in the Central Ward, the impacts are anticipated to be enjoyed across all wards in Middlesbrough.

What is the purpose of this report?

1. This report seeks to update Executive on the challenges facing the town centre and the work being undertaken by the Future High Streets Fund (FHSF) and seeks approval for the investment in town centre property. This is for the purposes of (i) rationalisation of the retail floor space; and, (ii) repurposing of some of the town centre to create a more economically viable balance.
2. This report outlines the strategic case for the Council to acquire freehold commercial and retail property in the town centre. It also delegates the completion of acquisitions on the identified properties to the Executive Director of Growth and Place and the Strategic Director of Finance, Governance and Support, in consultation with the Executive Member for Regeneration and the Executive Member for Finance and Governance, within the parameters of the report.
3. The Council's appointed sector-specialist (Knight Frank) have provided assurance that the acquisition of properties outlined reflects a) value for money and b) an income stream in excess of Council borrowing requirements, and c) an operational surplus for at least the first five years. This opinion is based on the operation of properties continuing as is, and without additional investment.
4. However work continues to align this investment with the significant opportunity with the FHSF. If successful, it is proposed to invest in the properties to further enhance their sustainability and commercial value; further protecting the Council's investment.

Why does this report require a Member decision?

5. The proposed financial transaction exceeds the delegated authority financial threshold of £150,000 and also because the proposal is of strategic importance for the town, as such, requires Executive approval.

Report Background

6. Middlesbrough town centre and its amenities are of city-scale, having circa 1.8m sqft of retail floorspace. However, to be able to compete with major City Centres, there is a need to progress the overall offer in a number of respects. This will benefit the Tees Valley overall. Middlesbrough is the only centre that can provide the amenities and offer commensurate with a City Region population of c800,000, thus making the area more competitive.
7. With a significant catchment the Tees Valley is a relatively large conurbation, equivalent to many major cities outside London. This population has a significant skills base, consumer economy and investment market place; which is of huge appeal to employers and investors. No other centre in the Tees Valley can realistically provide such an offer. Middlesbrough is the main retail, events and employment hub for the Tees Valley. In being the 'de facto' City

Centre for the Tees Valley, Middlesbrough helps to promote the entire area and increases the probability of securing the presence of additional major employers, retail brands, events and talent.

8. Middlesbrough has the catchment of a city region but with the retail characteristics of a fragile town. The retail core of the centre is compact and its wider core includes significant commercial areas and major employment investments such as Centre Square (office), TeesAMP (manufacturing), Teesside University (education), the Student Village (residential), Boho Zone, the Digital City, rail station (transport) and Middlehaven (leisure and education) are all directly reliant on the high street offer as a key part of the 'package' they present. Additionally, it contributes towards increasing opportunities for urban living. Therefore ongoing investment and strategic direction in the centre is essential for the centre and peripheral areas. The Town Centre is the fulcrum of the town's economic engine and therefore its long term welfare is critical to the town's future economic growth.
9. However, whilst there is significant potential, current evidence still suggests an underperforming centre (when ranked regionally and nationally) and an oversupply of retail floorspace. There are high levels of retail property vacancies and the Council is aware that many businesses remaining in the town are finding that trading conditions are challenging (either locally or in many cases nationally). Further high street retail closures seems inevitable and there are few new retail businesses seeking space anywhere in the UK. Commercial property comprises one third of the offer in Middlesbrough and the other two thirds of space is retail – a healthy town centre has the opposite ratio. There is an imbalance with the lack of leisure and social offer for an attractive evening and night time economy. For the town centre to be successful there is a need for a shift to less retail and more diversification of uses.
10. In this context the private town centre property market is inevitably suffering. Because of the multiple ownership of property and the sunk investment by these companies it is difficult to bring about a rationalisation of retail floorspace. Intervention by the Council, is therefore crucial to make a significant step-change, to address the key market failures in a number of different ways including working with property owners, retailers and other occupiers. As detailed later within this report, this will also ensure that the town centre has a sustainable and viable economic offer. This is not something the market is currently commercially motivated to do, given national retail and economic trends. It is recognised that this is a challenging task however following early assessment, the Council believe it is essential that it intervenes in the property market to aid a transformation of the town centre and also it is the right time to purchase some strategically located commercial and retail property. Coupled with the relatively high retail vacancy rates, the over-supply of retail units and reliance upon retail creates further structural issues. With just 11% of the premises classified as leisure (bar, club, café, cinema, etc) the town is too reliant upon retail. Increasingly the modern consumer uses a town centre for

social, service and experiential activities and an increase in alternative uses must be encouraged.²

11. Retail and other businesses in the town need certainty and the Council is the only organisation that is in a position to bring about the changes that are urgently needed. Failure to do so is likely to result in the accelerated loss of more retailers.

Future High Street Fund (FHSF) and Towns Fund

12. The challenges of the High Street is recognised by the Government. Middlesbrough has recently been successful in the first stage of the FHSF bidding process. This is a bid for £20m, based on a series of interventions the Council propose for the town centre area. Part of this bid includes costs towards the repurposing, of some of the property, the Council seek to acquire. (Repurposing means using the buildings for other uses, including by extension or alteration).
13. The first draft submission is due in by 15th March 2020, with a final draft to be submitted by 15th June 2020. Outcome of the bid is anticipated by Summer 2020. A more detailed report on this will be brought to the Executive at a later date which will provide an in-depth overview of the bid.
14. The first draft bid will be predicated on a detailed business case, along with a series of proposals and a phasing delivery plan. The outcome of the repurposing exercise will form the basis for any proposals, along with the narrative of what this would achieve.
15. Guidance from Government has stated that it expects the Council to commit its own resources and also that investment should be on a specific scheme. The Government is advocating transformational change.
16. The FHSF bid anticipates that the initial investment will provide the circumstances to lever in additional private sector investment. Based on the ratios achieved as part of the Investment Prospectus, the aim will be to secure a leverage ratio of 1:5. Whereby every £1 of Council/FHSF investment aims to lever £5 of complementary investment.
17. Additionally, Middlesbrough has also been identified to be a beneficiary of the Town's Fund and potentially up to £25m may be available for investment and this will primarily focus on economic growth. When combined with the Council's own investments, the FHSF and the emerging Towns Fund, a coherent case is emerging whereby all of the investments are aligned, mutually-sustaining and help to create additional complementary leverage across Middlesbrough.

² Middlesbrough Town Centre Economic Assessment, December 2018 – CMS (Savills)

Challenges facing the Town Centre

18. The Council has a clear understanding of the challenges facing the high street economy. This has been informed by recent empirical evidence. As such, it can demonstrate that:

- *The turnover of the town centre has decreased significantly in recent years – between 2008 and 2016, convenience spend reduced by over 33% (£49.5m to £33.1m), whilst comparison spend reduced by 40.8% (£503.4m to £298.2m -Knight Frank);*
- *Middlesbrough has suffered sustained decline in national retail rankings;*
- *Middlesbrough is suffering the highest level of rental reductions of any main town centre in the UK;*
- *Middlesbrough has suffered the loss of major high street brands in recent years;*
- *Crime and anti-social behaviour is a significant issues for businesses, residents and visitors;*
- *Footfall in central Middlesbrough is decreasing rapidly;*
- *Middlesbrough sustains a very limited visitor economy; and,*
- *Distressed property market, where owners cannot afford to invest.*

(Middlesbrough's Expression of Interest for the FHSF Bid, November, 2019)

Strategic Objectives

19. As demonstrated throughout this report, there are a number of key areas which need to be addressed to ensure the town centre has a positive future. The acquisition of the property is merely one stage in the overall process. There are a number of key objectives, for the town centre, which are summarised below:-

- To create a greater influence over the sustainability over the retail sector overall, as part of the FHSF work, a business case is required to demonstrate why the intervention is essential, and provide a delivery programme. The outcome of this work will ensure the Council has sufficient analysis and due diligence to provide a comprehensive way forward.
- Create a vibrant property market through gaining collective control – acquisition followed by control over key assets will allow strategic intervention, and a more holistic and sustainable approach to be taken. Strategic direction over uses will allow new/alternative uses to enter the town centre.
- Respond to retail decline – the town centre has a significant oversupply of retail floorspace. A programme of managed reduction in retail floorspace in key areas, including a programme of relocation support (where applicable) will provide a future for key properties in the centre. This would be followed by repurposing in which will attract new inward investment, as new opportunities will be available in central locations which previously were predominantly only available to the retail market.

- Rebalance the economic mix and diversify uses to residential, commercial and leisure leading to a more balanced and attractive offer – using national market intelligence, and analysis, a series of options will be presented. New opportunities for housing and leisure could be unlocked, and would be a welcome addition to the centre. Alongside the physical change, it is recognised there is need to enhance the customer and visitor experience, working with internal and external stakeholders, it is anticipated features to enhance safety and security, would ideally be incorporated. Overall, this would result in greater numbers of both visitors and new residents.

Evidence

20. In recognising fragilities in the area, the Council commissioned an economic assessment of the retail and commercial areas, to provide an evidence base on which to tailor a package of interventions. The process benchmarked Middlesbrough against national trends, highlighting deficiencies and areas of improvement. In parallel, an analysis of retail floor space trends (Experian-Goad reports 2015 and 2018) was also carried out. This data has informed the development of specific priorities, actions and responsibilities, which should be taken forward by all, not just the Council.
21. In conclusion, Middlesbrough has an oversupply of retail floor space, in proportion to the amount of commercial activity. Middlesbrough currently has a retail core vacancy rate of c19% on a base of 1.8m sqft of floor space³. Given that the bulk of the floor space is currently under the ownership of four large shopping centres, the situation perpetuates when it is a buyers' market and one tenant is seeking competitive terms from multiple landlords: driving the market rent down.
22. As a consequence, there is a requirement to make a fundamental structural change to the economic centre and rebalance the economic mix. Similarly, this leads to the necessity to focus upon the conversion of surplus retail space to complementary economic uses which will drive the footfall, animation and confidence in the area.

Way Forward

23. As highlighted in paragraphs 9 and 10 there is a need for the Council to intervene to help sustain the long term future of the town centre. The Council has the opportunity to purchase key commercial and retail property, for the longer term objectives of rebalancing and repurposing the heart of the town centre. All of the above evidence demonstrates the need, and requirement, for such intervention. Ideally, and perhaps in a more commercial scenario, the market would undertake such, however given all the challenges Middlesbrough faces, the private sector is unable to undertake such transformative measures, hence the public sector needs to intervene to redress.

³ Middlesbrough Town Centre – Structural Issues with the Retail Environment, Knight Frank, May 2019

24. The Council has appointed specialist retail agents, Knight Frank, to advise and support the process, leading to acquisition, and will advise on the repurposing programme / strategy. This will be tested by market analysis. Knight Frank have significant experience and knowledge in this sector, with particular expertise in representing Councils to make informed decisions on retail and commercial acquisitions.
25. Knight Frank have represented numerous Council's, including Stockton, Wigan, Banbury, Bolton and Shrewsbury, in similar circumstances where national factors have resulted in high vacancy rates, and there was need for intervention. In these circumstances, similar to Middlesbrough, private sector intervention was lacking, and the Council's became frustrated with the existing situations. In particular Bolton Council made the decision to acquire a central shopping centre, in order to give the private market investment confidence in the larger area vision, recognising the lack of investor interest. Following successful acquisition, the Council has proposed a major mixed-use scheme including a transport interchange, health centres, a cinema, residential and some office space. The Council worked closely with the other major shopping centres to align the overall vision, and to develop the repurposing.
26. Knight Frank have been commissioned to provide:
- an independent valuation of assets;
 - due diligence on all information provided by Vendor(s);
 - an assessment of current lease(s);
 - undertake all specified building and condition surveys;
 - agree the final terms and conditions
 - an assessment of current management arrangements and assess any implication for any currently directly employed staff;
 - proposals for support on stakeholder consultation with directly affected tenants and staff;
 - advice and guidance on operational issues leading to the appointment of a managing agent;
 - assessment of national markets and trends to lead to repurposing options; and,
 - any other associated work which arises as part of the acquisition, which requires their input, to ensure the Council is correctly advised, prior to agreeing final terms and conditions.
27. The repurposing work outcome will demonstrate where the reduction in retail is best placed, along with what non-retail uses would be in the centre. It is likely that alternative uses will include leisure, food and beverage, with proposals of where new urban living options would be most attractive and viable. Reconfiguration of the estate will result in a reduction in the volume of lettable floorspace. However, the repurposing business case will be developed with the expectation that alternative uses will create more sustainable rent and rates yields.
28. In parallel to the above work, ongoing dialogue is needed with the other main shopping providers in the town. Information, at the appropriate time, will be

relayed about the Council's investment, as well as the overall plan. They will be consulted and updated throughout the process. In addition, following any acquisitions, should any relocations be required, the ideal position would be elsewhere in the centre, hence a good working relationship is key.

29. The disclosure of commercially sensitive financial information in this report would undermine Middlesbrough Council's negotiating position with the vendors and/or existing tenants. This information is explored and analysed in Part B of this report.

Strategic Rationale for Acquisition

30. The purchase of the proposed town centre commercial and retail properties presents a number of opportunities to rationalise and repurpose a key part of the town centre and the delivery of the strategic ambitions of Middlesbrough Council. The headline business case is predicated on:-

- Early analysis suggests that, subject to commercial due diligence, the investment income will comfortably service the costs of any debt and facility management costs.
- However, the rent roll could decline over the coming years, as the market for retail floorspace readjusts. The investment income is projected to sustain the costs of acquisition, for the medium term.
- With a future aspiration to repurpose the property, future rental rates and income have a significant opportunity to recover into a sustainable operating surplus.
- Although not critical to the core business case, opportunities such as the FHSF and other external regeneration funding, can be aligned with this investment to add value and maintain rental levels for the long term. Clearly the council intervening in the manner proposed will increase the likelihood of a successful bid.

Additional Considerations for the Council

31. The following are key considerations, which require further advice and input are as follows:-

- Consultation with those directly affected – it is anticipated that Knight Frank will advise on the formal process and procedures to support those directly and indirectly affected. Council officers will put together a support and consultation process, prior to completion of acquisition, to ensure adequate controls are in place.
- Transfer of Undertakings / Protection of Employment (TUPE) – if any issues are applicable, this will be covered by the Knight Frank work, this will be assessed as part of their commission.
- Relocation packages/incentives for those who may relocate in the future – as part of the repurposing work (subject to the detailed business case for repurposing and funding being available for such).
- Any overall refurbishment works for the property and/or Public realm – due diligence work (via condition and building surveys) will address this and

assist in providing a comprehensive assessment of what the Council is buying.

- Day to day Management and Lettings/Site Management – Knight Frank will advise on principles for this, with the Council having to procure an operator (prior to completion) to undertake such. Given the nature of this service, approval is sought for external resource, via procurement, as there is not the capacity nor expertise to deliver this in-house.

Headline Terms of Acquisition (Middlesbrough Council)

32. In acquiring the proposed properties, the following terms are anticipated:

- freehold acquisition;
- assignment of existing tenancies, where applicable, to Middlesbrough Council;
- purchase price and terms determined by an independent valuation conducted by Council appointed agents, Knight Frank; and,
- otherwise unencumbered disposal – i.e. no restrictive terms.

Proposed Use(s) of Property Following Acquisition

33. Whilst opportunities will be explored for repurposing, it is intended that the facilities will continue to operate as normal, and will have no impact upon day to day trading.

Timescales

- October 19 – Valuations completed on proposed retail units, for acquisition (completed);
- November 19 – End of Jan 20 – Knight Frank undertake due diligence, and to agree Heads of Terms with vendors;
- End of January 20 – detailed business case and terms brought for consideration, seeking approval to conclude acquisition;
- By end of February 20 – Repurposing work concluded;
- March 20 – Executive briefing on detail for FHSF bid and overall master plan and proposed delivery programme;
- 15th March 20 – FHSF bid submitted;
- Spring 20 – anticipated properties would be in Council ownership;
- 15th June 20 – Final FHSF bid submitted; and
- Summer 20 – outcome of FHSF bid.

What decision(s) are being asked for?

34. It is recommended that the Executive:

- A. approves the freehold acquisition of the identified properties within the town centre;
- B. delegates the completion of acquisitions on the identified properties to the Executive Director of Growth and Place and the Strategic

- Director of Finance, Governance and Support, in consultation with the Executive Member for Regeneration and the Executive Member for Finance and Governance within the parameters of the report; and,
- C. subject to satisfaction of Point B, approval for the appointment, via the relevant tender process, to procure a managing agent for any property acquired.

Why is this being recommended?

35. The proposed acquisition of retail and commercial property, achieves the following outcomes:
- Middlesbrough Council can enable commercial property transformation with all of the associated strategic benefits, in a realistic, yet optimistic, timescale.
 - the proposal delivers the consolidation of a prime land holding in the centre;
 - the investment would put Middlesbrough in a positive position to be successful in accessing FHSF;
 - the acquisitions will enable the Council and partners to have greater control over the ability to bring about transformational change in the town centre; and,
 - the Council can develop the overall plan, and strategy for the town centre to secure a long-term economically viable future

Other potential decisions and why these have not been recommended

36. **Do Nothing:** a significant risk in not acquiring these properties may lead to further decline in both the level of managed retail reduction and in the condition of the properties and ancillary spaces. Without public sector intervention, and future strategic ambition to repurpose and rebalance the current offer, it is expected that the centre will continue to decline, with further job losses, retailers leaving, and an overall reduction in Business Rates yield to the Council.
37. **Council purchase the proposed retail and commercial property (recommended):** by purchasing the properties, the Council can strategically manage, and lead on the rebalancing of the town centre, which is crucial, given the troubling retail evidence collated. Following analysis of options, of where the Council's investment would be most sustainable, this was the most attractive financially. Whilst the Council would be responsible for the initial capital outlay, given the current high occupancy rate, it is anticipated that income stream would outweigh any other immediate costs. However, this will decline in the medium term with a view to recover such longer-term through the repurposing.

Impact(s) of recommended decision(s)

38. The proposed acquisition of commercial and retail property within the town centre allows for the continued progress of one of the key regeneration initiatives within the Investment Prospectus.

39. The project offers significant potential for transformational change in Middlesbrough's economy and places Middlesbrough on the national map as a leisure and visitor destination.

Legal

40. The acquisition is to be undertaken via the appointment of external legal resource. Given the complex nature of the purchases, and the resource it would require, it is proposed that this is the most appropriate method.
41. Subject to the necessary approvals from all parties, the aim is to complete the acquisition of the properties by Spring 2020. In parallel, arrangements would be made to agree a managing agent, for the day to day management of the tenants, and the area(s).

Financial

42. Knight Frank have provided a comprehensive assessment of the investment particulars and, whilst considering market trends and risk, considers the investment commercially viable with a projected operating surplus for at least the first five years. This includes the Council's borrowing costs with respect to the acquisition of the properties. This viability may well extend beyond this period subject to lease negotiations.
43. If the Council is successful in the FHSF bid, whilst not essential to the acquisition business case, this would only add value and security to this investment. It would allow for major investment that as a consequence will be able to provide long term sustainability for these assets.
44. It has been confirmed that the acquisition of this property can be financed within the current MFTP Assumptions (borrowing margins). This funding request lies outside of the current Capital Programme allocation and represents an additional request for funding.
45. The acquisition transaction would be subject to, Stamp Duty Land Tax (SDLT) and VAT; the latter being directly recoverable.

Policy Framework

46. The acquisition of property within the town centre accords with the City Centre Strategy, particularly under reducing town centre retail vacancies, increasing the leisure offer and increasing strategic town centre investment. There is a strong alignment with the two main priorities: giving businesses confidence; and, attracting additional users and visitors. In addition, this accords with the Mayor's vision to attract inward investment, and opportunities for new urban living.

Equality and Diversity

47. Not applicable.

Risk

48. The most significant risks for the Council are summarised below (references in brackets for the Council’s Corporate Risks):

- Long term voids following acquisition – whilst currently occupancy is stable, external factors could affect the long-term income stream (01-005) Appointment of a suitably qualified managing agent will mitigate this risk, actively market the property.
- Narrow window of opportunity – if this acquisition is overlooked, it diminishes the Council’s ability to intervene in the High Street market and rebalance the economic mix.
- Unsettling retailers with the change of ownership - it is proposed that the Council works closely with all those directly affected, and provides support.
- The Council is not successful in the FHSF bid – Knight Frank’s analysis does not assume a successful future FHSF bid. Should the bid not be successful, the Council would be in a position to assess the merits of investing further in the property.
- Repurposing work does not translate into attracting inward investment – it is anticipated that the repurposing work will be encouraged by Knight Frank including detailed market assessment and analysis, in line with discussion with potential operators and future tenants. It is envisaged that this would outline key and realistic opportunities, prior to any repurposing work being delivered, hence mitigate this scenario.

Actions to be taken to implement the decision(s)

49. Given the progress to date, it is recommended Next Steps are:

- Knight Frank to continue with the due diligence, and negotiation of Heads of Terms;
- Following advancement on the negotiation process, final terms and conditions, to be brought to the Executive Director of Growth and Place and the Strategic Director of Finance, Governance and Support, in consultation with the Executive Member for Regeneration and the Executive Member for Finance and Governance, for approval to proceed with the transaction; and,
- Work to continue to incorporate requirements of the final FHSF bid, led by the Council, working in partnership with appointed consultants.

Appendices

None

Background papers

None