

Part A

Report to: Cabinet

Date of meeting: 7 September 2020

Report author: Interim Head of Regeneration & Property

Title: Croxley Business Park – Update Report.

1.0 Summary

- 1.1 This report provides an over view of the current position in regard to the financial performance of Croxley Business Park (The Park) over the course of the last year, letting activity, the impact of Covid 19 and lockdown and the ongoing development and asset management initiatives that will assist in ensuring The Park remains a relevant and attractive location and setting for local and national occupiers.
- 1.2 Whilst Covid 19 has had a significant short term impact on some tenants leading to a number of requests for rent concessions, the Council, through its advisors have taken an active approach in negotiating suitable deferment terms, respective of the tenant's financial status and importance to The Park as well as the Council's financial position.
- 1.3 At the time of acquisition, Grant Thornton prepared a financial model to support its viability. A new model has recently been produced by Grant Thornton to enable accurate forecasting and scenario planning. This will be operational from Q3 this year. As part of the work to create this operational model, the original assumptions (relating to re-letting, voids, rent incentives and marketing) have been found to remain accurate. Therefore the original expected income is consistent with the contracted income as set out in the table below at paragraph 20.
- 1.4 The development of Building 1 remains on track for completion in Spring 2021 and The Park as had recent success in attracting three new tenants with lettings totalling nearly 35,000 sq ft. Such success will necessitate that further vacant suites are brought forward for refurbishment and that the current void rate for the office component compares favourably with other business parks of similar stature and scale.

2.0 Recommendation

- 2.1 That Cabinet notes the contents of this report and that it will be shared with and discussed at the Finance Scrutiny Committee meet on the 10th September.

3.0 Introduction

- 3.1 In July 2019 Watford Borough Council acquired a 40 year head lease in The Park structured as an “income strip” deal with the Council having the option to acquire the freehold of the Park at the end of the 40 year term for £10 from Croxley 1 Limited and Croxley 2 Limited as nominees of Croxley Master Trustee Limited, trustee of Croxley Master Property Unit Trust (the current freeholder).
- 3.2 The Council receives the full passing rental income from occupational tenants on the Park in return for paying a rent of £9.2m per annum which was indexed annually linked to RPI (based on June RPI figures), subject to a collar of 0% (minimum increase) and a cap (maximum increase) of 5%. The Council, in addition to retaining the profit rent, is responsible for all rental risk and planned and preventative maintenance (PPM).
- 3.3 Columbia Threadneedle Investments (CTi), the investment and asset management company who were the vendors of the Park, also made a payment to the Council of £92m to cover rent top ups and Planned and Preventative Maintenance. This payment was broken down as follows; £24m of this sum represented a rent top up for the first three years from purchase to cover any rent free periods on occupational leases whilst the £68m balance of the sum has been set aside to be used for planned and preventative maintenance over the term of the 40 year lease. This funding will be required in later years so has been invested to generate returns for the Council in the interim period.

4.0 Croxley Business Park

- 4.1 The Park adjoins and compliments the Western Gateway core policy area of Watford Borough and the 67 acre Watford Business Park (which the Council owns the freehold of). The Park sits in 75 acre parkland and the space provided includes 510,000 sq. ft. of office accommodation with a further 85,000 sq. ft. in the course of construction (which is being funded by CTi) and 189,000 sq. ft. of industrial space. Additional amenity space comprising circa 15,000 sq. ft. has been developed and funded by CTi in 2019, providing a gym, café and meeting space for 200 people which aids in tenant attraction and retention as well as being a useful facility to have on site.

- 4.2 The office accommodation that dominates the Park is provided in 9 standalone buildings which are let to a variety of tenants. Most buildings contain multi-let tenants apart from one. The Park is home to around 60 businesses including corporate occupiers such as Smith & Nephew, Kodak, Howden Joinery, Medtronic, Corona Energy, Glenmark Pharmaceuticals and Regus (the serviced office provider).
- 4.3 The industrial accommodation consists of industrial and warehouse accommodation totalling 189,000 sq. ft, contained in four separate blocks and split into 25 units the majority of which are under 8,000 sq. ft.
- 4.4 The Park usually has over 2,400 people on site and whilst this reduced to 100 in the depths of Covid lockdown, the current level is c400 with the expectation that this number will ramp up in September as schools reopen. The onsite facilities will also be reopening in September and the managing agents have put in place appropriate return to work plans and offered guidance and advice to occupiers on the Park.
- 4.5 Despite Covid 19 and the impact of lockdown, the Park has had success in attracting 3 businesses (all new to Watford) in the last 6 months, and fitting out works on c35,000 sq ft is currently underway in advance of their occupation.
- 4.6 Vibrant Foods, a leading producer of ethnic foods, has taken 14,230 sq ft on a 10 year lease on the ground floor of Croxley Park's Building 3. CSL Dualcom Limited, a provider of connectivity solutions, has also taken 10,045 sq ft of space on the second floor of Building 4 on an 11 year lease. Both lettings achieving a rent in the region of £30.00 per sq ft. Finally, medical devices supplier Clinisupplies Limited, is moving into 10,147 sq ft on the first floor of the Park's 1 Blackmoor Lane property on an 11 year term. The businesses are all new to the Park.
- 4.7 Proposals for further refurbishment of vacant floorspace are likely to come forward as a result, to ensure there is a range of suitable office product available for immediate occupation by tenants, in either any internal or external relocations.
- 5.0 **Building 1**
- 5.1 CTi have an ongoing responsibility to deliver the completion of Building 1 (comprising c85,000 sq ft of contemporary offices) in Spring 2021. They continue to provide an asset advisory service linking in with and instructing the agents and property management and professional teams.

- 5.2 During early lockdown only a limited amount of construction works was able to be undertaken on site, in order to make the site safe. However as restrictions were lifted, construction work accelerated and at this stage there is no expected delay to completion of the development in Spring 2021.
- 5.3 CTi, as well as having the responsibility of managing the construction of Building 1 take a lead on managing the letting of the development and a team of letting agents have been appointed. In addition to the Park's usual agents of Stimpsons and Bray Fox Smith, CBRE have been appointed to ensure the property is fully exposed to a national occupier audience utilising their connections with major UK and global corporates.
- 5.4 During the course of late 2020 and early 2021, the marketing activities for this development will be developed and enacted with a major push in the immediate pre and post completion period. Enquiries are generally quiet at present due to Covid and the usual summer lull, however the Park's benefits as a spacious and edge of town location is likely to be a positive benefit in such a campaign. It may well be the sort of desired location away from city centres that some occupiers want in a 'Covid world'.

6.0 **Financial Viability**

- 6.1 As noted above, the Council now has an operational cashflow model, built by Grant Thornton in conjunction with Council officers and Lambert Smith Hampton Investment Management (LSHIM). This will enable accurate forecasting in the future and scenario planning as required.

The current position as at Quarter 2 is shown below.

As noted in the summary, the original assumptions made at the point of acquisition remain correct. Therefore the contracted income figure reflects expected income required by the Council. Contracted income is the rent on the lease for each tenancy and ignores any rent free periods the tenants may be on at the quarter day. Demanded rent allows for rent free periods and does not include rent where a tenant is in a rent free period. In the current conditions, demanded rent is higher than contracted at the time of reporting as rent is being demanded on a monthly basis (in some cases) and in some cases higher to allow for rent concessions made in March and other requests from tenants, for example to be invoiced a larger amount in advance. In order to establish the extent to which the investment is operating at the expected levels, the quarterly rent received compared to quarterly contracted income shows a difference of £372,703.

Planned and preventative maintenance (PPM) figures are excluded from the calculation of net income because the top-up fund provided covers this cost.

| Croxley Park | Q2 2020 | Q1 2020 | Change |
|--|----------------|----------------|---------------|
| Annual Contracted Income | £12,138,176 | £11,827,478 | £310,698 |
| Quarterly Contracted Income | £3,034,544 | £2,956,869 | £77,675 |
| Quarterly Demanded Rent | £3,535,917 | £2,640,263 | £895,654 |
| Quarterly Received Rent | £2,661,841 | £2,398,997 | £262,843 |
| Vacancy (% by sq ft excluding Building 1) | 17% | 14% | +3% |
| Aged Debt (90 days plus) | £1,300,498 | £122,960 | £1,177,518 |
| PPM Costs | £123,730 | £358,825 | £235,095 |
| Ground Rent | £2,225,000 | £2,225,000 | £- |
| Net Income | £436,841 | £173,997 | £262,844 |

LSHIM provide regular updates post quarter rent day and the table below highlights the progress made in the 6 week period after the June quarter day. It should be noted that 4.62% of rents are on agreed monthly repayment terms, ie not quarterly. LSHIM undertake similar investment and asset management mandates for other private and public sector clients. The

information provided by LSHIM suggests that the rent collection data of over 75% rent collected at the 42 day point is close to and slightly above the average of 5 comparator funds.

Rent & Service Charge Collection Rates post June Quarter Day

| | Gross Rent Demanded | % Collected | Gross Service Charge Demanded | % Collected |
|-----------------------|----------------------------|--------------------|--------------------------------------|--------------------|
| 26 th June | £2,595,456 | 28.09% | £700,227 | 27.03% |
| 7 Days | £2,595,456 | 36.74% | £700,227 | 33.97% |
| 14 Days | £2,595,456 | 64.73% | £700,227 | 55.44% |
| 21 Days | £2,595,456 | 67.00% | £700,227 | 57.09% |
| 28 Days | £2,595,456 | 67.88% | £700,227 | 58.22% |
| 35 Days | £2,595,456 | 73.14% | £700,227 | 63.16% |
| 42 Days | £2,595,456 | 75.57% | £700,227 | 64.51% |

7.0 Impact of Coronavirus

7.1 The coronavirus outbreak forced most of the working population and certainly the majority of the office based sectors to work from home over the last 6 months. This has the potential to kick start rapid and widespread digital progress and technical upskilling for individuals, leading to longer term structural changes in how and where people work. There is a possibility that real estate could look quite different after the coronavirus pandemic. These changes might have happened over time naturally however this pandemic has accelerated the change dramatically.

7.2 As at the end of the June quarter, the Office void rate (excluding Building 1 which is under construction) stood at 17% (of which 5% was under offer at the time) and the Industrial void rate stands at 25%. The relatively high vacancy rate for the industrial component reflects on the high office content that these units were developed in the late 1980's with, whereas modern day businesses require typically a 10-15% office content. The service charge levels on The Park may also be a factor for such occupiers and the Council is expecting our advisors to bring forward recommendations to address these

issues. The office vacancy rate at 12% (allowing for the recent lettings) is compatible with other business parks such as Chiswick Park at a vacancy rate of 15%. The figure however may also be distorted by the high occupancy turnover rate in Building 6 which comprises a series of small starter and incubator units, and where tenants have been particularly impacted by Covid.

- 7.3 Many occupiers will now be asking themselves whether they need the quantum of office space in the future. There will be occupiers who had rolling leases with serviced operators across the UK who are able to exit their contract at a months' notice, and for them the decision has been more immediate.
- 7.4 For other companies on traditional leases, they will not be able to make these decisions until their lease expiry or if they have the benefit of a break option event.
- 7.5 There are individual cases where tenants on Croxley Business Park have requested rent holidays / payments plans, these are being looked at on a case by case basis and with the long term income of the Park in mind. It is likely however that the post-pandemic office will need to adapt after a prolonged period of remote working. There will be a cultural shift and a greater acceptance from everyone around flexible working.
- 7.6 As at 30th June 2020, the total debt at Croxley Park rose from £1,292,291 (inclusive of VAT) at the end of Q1 to £2,402,206 (inclusive of VAT) by the end of Q2. The 10 largest outstanding amounts are tracked by LSHIM and reported quarterly to the Property Investment Board (PIB),.. The risk associated with debt is under constant review. Two occupiers have entered administration since lockdown in March. It is difficult to determine whether there will be others, but the risk is mitigated by work being done to negotiate packages with other tenants experiencing financial difficulty, ensuring deferred income packages to ease their immediate cashflow issues but provide greater assurance that they will remain as tenants and that the Council will recoup the income over the life of the lease (and in some cases receive a greater overall income as a result).
- 7.7 It is unlikely that everyone will work from home all the time but demand for office space will be lower, with a greater demand for flexibility. It will also be important that employees have adequate space within the office environment to social distance; this will be far easier in those offices that have a larger employee to sq ft ratios. We therefore may experience occupiers seeking larger floorplates in order to accommodate this, with Croxley (and other business parks) generally well positioned to support this.
- 7.8 Croxley Park is well placed to be able to offer employers and employees greater flexibility and a better work / life balance. The park benefits from its campus like feel with green environment and open spaces. The events that

are run by the park management team will continue to attract those employers and employees who are looking for their office space to provide not only a place to work but also a place for social interaction with other workers.

7.9 LSHIM were appointed as the Council's investment and asset managers in 2016, and following the acquisition of the long lease interest at The Park (where they provided advice to the Council), their scope has widened to incorporate a regular review of all activity at Croxley Park and the provision of quarterly reports which are presented to PIB, which provides further detail on ongoing and proposed asset and property management activities, and as such remains confidential.

8.0 **Conclusion**

The impact of Covid 19 was an unforeseen 'Black Swan' event which has disrupted all forms of working and domestic life, the long term impacts of which remain to be seen and understood. In relation to the real estate industry, there is a significant degree of uncertainty as to when and in what numbers office workers will return to the office and to what extent the technological advances made during lockdown enabling a higher degree of homeworking will accelerate a further shift to agile working between home, office and elsewhere.

Most commentators however agree that a workplace is necessary for collaborative working and the need to respect social distancing measures will impact on tenant demand for office space. Despite such uncertainty the level of contracted rent has increased since purchase and significantly, risen over the period between Q1 and Q2. The Park, with its level of amenity, spacious setting of buildings and lower storey levels (max of 4 storeys in Building 1) has continued to operate throughout and lockdown and allows tenants to put in place measures to ensure their workforce are within as safe a surrounding as can be provided and as such, the letting agents remain confident that the Park will continue to receive an encouraging level of tenant interest, as demonstrated by the recent lettings.

9.0 **Implications**

9.1 **Financial**

9.1.1 The Council is actively monitoring all aspects of the investment through the financial model and conducting scenario planning where necessary. As noted above, the performance of the investment continues to be monitored closely

to ensure that the Council receives the expected returns. The current challenge regarding the impact of Covid19 is the key reason for any variance from the original modelling. Debts continue to be investigated and, as noted above, relief packages negotiated. This is in the context of the emergency legislation which came into effect in April as a result of Covid19 which has reduced the ability to take action to recover debts. It is anticipated that this will cease at the end of September, after which normal enforcement activity is likely to resume.

9.2 **Legal Issues** (Monitoring Officer)

9.2.1 The Group Head of Democracy and Governance comments that there are no legal implications in this report.

Background papers

None

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