


Cabinet 28 July 2015	 TOWER HAMLETS
Report of: Corporate Director, Development & Renewal	Classification: Unrestricted
Sovereign Court, The Highway, Wapping – Change of Use Consent	

Lead Member	Councillor David Edgar, Cabinet Member for Resources
Originating Officer(s)	Service Head, Corporate Property & Capital Delivery
Wards affected	St Katharine's & Wapping
Key Decision?	Yes
Community Plan Theme	One Tower Hamlets; Great Place to Live

Executive Summary

The Council owns the freehold of Sovereign Court, Wapping Lane, Wapping, London E1. On 26th August 1987, it granted a lease of those premises to Lionnid Limited for a term of 152 years from 24th June 1987, and approximately 124 years of the term remain unexpired.

The unexpired residue of that lease is vested in White Coral Investments S.A. who trade as Al Mubarakia Limited (“AML”). AML’s title is registered at the Land Registry under title number EGL 203625.

AML wish to convert Sovereign Court from its existing 24 commercial office units to 124 residential units and have approached the Council for formal landlord’s consent to change of use, which is a requirement of the lease.

The Council acting in its freehold landlord capacity wants to charge a premium for the grant of its consent for change of user under the lease, as a result of the significant uplift in value to AML which the Council believes will be a consequence of the grant of the consent referred to.

Recommendations:

The Mayor in Cabinet is recommended to:

1. Agree to the change of use under the terms of the lease from office (Use Class B1) to residential (Use Class C3) upon such terms as the Council is advised by its advisers to accept and subject to payment of a premium of £7.35m on the payment terms described in this report.
2. Authorise the Corporate Director, Development & Renewal, after consultation with the Service Head – Legal Services, to agree the final terms and

conditions of any agreement or deed including a deed of variation of lease to implement the above decision.

3. Authorise the Service Head – Legal Services to execute all necessary documents to implement this decision.

1. REASONS FOR THE DECISIONS

- 1.1 Granting landlord's consent to a change of use from Offices (Use Class B1(a)) to Residential (Use Class C3) would create 124 residential units and deliver to the Council a premium, the details of which are set out in paragraphs 3.24-3.29 of the report, in return for the grant of its consent, whilst still retaining the freehold for the benefit of future generations of residents.
- 1.2 This would bring a currently under-used and vacant building in to full use and occupation and add to the housing stock in Wapping. This is entirely complimentary to surrounding uses.
- 1.3 This is a wholly sensible and commercial approach for the Council to take as a diligent landlord.

2. ALTERNATIVE OPTIONS

- 2.1 The Mayor in Cabinet could determine not to agree to the change of use as landlord, maintain the status quo and continue to collect the annual £10 ground rent for the residue of the term.
- 2.2 However, this is not recommended as it would require foregoing a significant premium and would be perceived as unnecessarily punitive when the tenant is offering to equally share the uplift in value.

3. DETAILS OF REPORT

LOCATION

- 3.1 Sovereign Court is located in Wapping on the north bank of the river Thames. Wapping is situated immediately to the east of the City of London, circa 3.8 miles east of London's West End and 1.8 miles west of Canary Wharf.
- 3.2 Wapping was traditionally associated with freight transportation, where there is still a high presence of warehouse premises to date. Many industrial warehouses were later converted to alternative uses, predominantly office and residential, following the establishment of the London Docklands Development Corporation in the early 1980s.

- 3.3 In terms of road links, the A10 and A13 along with other major roads can be easily accessed, providing connections to the M25 and M11.
- 3.4 The property is situated in a mixed use area, predominantly residential and industrial located to the south of The Highway. Neighbouring properties include a DHL Express Depot to the south, a hotel development site to the west and Tobacco Dock to the south west, which is formerly a warehouse converted to a conference centre.
- 3.5 Shadwell Station is 0.3 miles north of the subject premises and is served by the Docklands Light Rail (DLR) and the London Overground. Wapping station is 0.4 miles to the south and is also served by the London Overground.

DESCRIPTION

- 3.6 Sovereign Court comprises a neo-Georgian building arranged as four terraces. The terraces are linked, surrounding a central courtyard and are set over grounds and three upper floors, altogether providing 35 self-contained office suites. It is of traditional masonry construction beneath a flat roof, incorporating sash windows.
- 3.7 Car parking is provided in a separate building to the south of the property, whilst entrances to the office suites are via the centre courtyard.
- 3.8 The property is served by mains electricity, gas, water and drainage services.
- 3.9 The building is in reasonable condition and no major structural defects or wants of repair have been noted.
- 3.10 In its existing arrangement the building provides approximately 5,690 sq m of floor space arranged over the four terraces.

PLANNING

- 3.11 The Council's functions as planning authority are separate from its function as landlord under the existing lease of Sovereign Court.
- 3.12 On the 16th December 2014 the Council's planning department issued prior approval consent for application number PA/14/02898 "Application for Prior Approval for change of use from offices (Use Class B1(a) to 124 residential units (Use Class C3)". The proposed development would see the creation of 27 x studio flats, 53 x one bed units and 44 x two bed units.
- 3.13 This consent is entirely separate to the landlord's consent that this report is concerned with. The prior approval consent **was** in accordance with the Town and Country Planning (General Permitted Development) (Amendment) (England) Order 2013, which was laid before Parliament on 9 May 2013 by the Secretary of State for Communities and Local Government under the 2010-2015 Coalition Government and came into force on 30 May 2013.

- 3.14 The Order allows the change of use of buildings from B1 (offices) to C3 (homes) in order to provide new homes in existing buildings without requiring the applicant to go submit a full planning application. This process does not allow the Council as the Planning Authority to require, as a reason for issuing the prior approval, any Section 106 or affordable housing contributions from the applicant.
- 3.15 The proposed change of use is development and therefore attracts CIL. Normally, it would be calculated from the date the developer submits a prior Notice of Chargeable Development specifying when the change of use will be implemented. However, no additional floor space is being provided as part of the proposed development. Further, as part of the property is currently occupied and has been for a continuous period of six months during the previous 3 years, the entire floorspace of the property would be deducted and the CIL liability would be zero. In which case, a Notice of Chargeable Development would not need to be issued. On that basis the Council cannot seek any financial or in-kind planning obligations from the developer.
- 3.16 The site is not listed as a building of special architectural or historic interest nor is it situated within a conservation area.
- 3.17 The permitted development rights, under which the leaseholder submitted the prior approval consent, are time limited and due to expire in 30 May 2016. Before that date, the applicant must fulfil certain conditions in order to qualify for those permitted development rights and make the change of use.

TENURE

- 3.18 The property is held freehold by the Council and is subject to a lease dated 26th August 1987 for a term of 152 years from 24th July 1987 to Lionnid Ltd (now vested in White Coral Investments S.A, who trade as Al Mubarakia Limited).
- 3.19 The pertinent terms of the lease and the key tenant's covenants include;
- The lessee covenants, inter alia, to 'well and sufficiently repair, rebuild... and keep the demised premises and the tunnel' in good condition.
 - In relation to the land coloured brown on the headlease plan to keep landscaped all lawns laid out and any trees and shrubs planted thereon and from time to time to renew the turf of the lawns and the trees and shrubs and to keep the same property landscaped, cut and pruned.
 - To paint the exterior of all buildings on the demised premises in every five years with two coats of good quality and suitable exterior quality paint and the internal parts every seven years.
 - Not to make any structural alteration or addition to the demised premises and not to carry out any development or change of use within the meaning of the Town and Country Planning Act without the previous consent in writing of the lessor such consent and approval not to be unreasonably withheld or delayed.
 - Not to use the area shown hatched green on the headlease plan other than for light industrial purposes and offices and/or ancillary purposes

connected therewith and car parking. Not to use the land coloured brown on the same plan other than for landscaping and not to erect or place any building or structure whatsoever thereon.

- To pay the ground rent of £10 per annum by yearly payments in advance on the first day in April each year.

3.20 The discussions to date have primarily been in relation to the uplift in value and how this should be split between the Council as freeholder and AML as leaseholder.

LEASEHOLDER'S PROPOSAL

3.21 The Council has appointed Gerald Eve as its specialist valuers in respect of the approach from AML for a change of use. In considering the approach, Gerald Eve were asked to appraise the proposed redevelopment and advise on the potential uplift in capital value that would likely be achieved if the Council agreed to change the terms of the existing lease.

3.22 Gerald Eve paid regard to the existing use of the building in accordance with the lease, the local office market in terms of existing use value, the costs of conversion and the localised residential housing market.

3.23 AML are similarly being advised by DTZ. The Council has had sight of their detailed valuation report and both advisors are in agreement on the uplift in value generated by a conversion of the building to 126 residential units. This uplift in value has been determined to be £14.7m by the Council's valuers, Gerald Eve. It is standard market practice in these situations for landlords and tenants to share uplifts in value in the region of 30% to 50%, depending on the complexity of the scheme and risk. Given that this development holds little risk, other than timing, the parties have agreed to a 50% split in the uplift in value, representing a significant windfall for the Council in actually doing very little whilst still retaining the freehold.

PROPOSAL

3.24 The change of use consent will be granted subject to the payment of a premium, on the terms set out below. This premium has been calculated based on 50% of the uplift in value.

3.25 The uplift in value has been determined by Gerald Eve to be £14,700,000 on the basis of their calculation of the existing use value and the residual valuation based on an unrestricted residential scheme. Unrestricted in this context refers to a scheme in which the residential units are intended to be sold in the open market, therefore reflecting the values which could be achieved on that basis.

3.26 Based on the above, the Council will receive a premium of £7,350,000 in total, which will be paid in tranches as set out below.

- 3.27 The first payment would be for 25% of the premium (£1,837,500) would be paid on signing the variation and providing the change of use consent.
- 3.28 The second payment would be for a further 25% of the premium (£1,837,500) would be one year after signing the variation and providing the change of use consent.
- 3.29 The remaining 50% of the premium would be paid over a term of 20 years, uplifted at 3.5% per annum and smoothed to a fixed annual sum of £258,577. The first of these payments would be due one year after the second payment.
- 3.30 The lease will also be varied to incorporate an overage clause, to secure the Council's interest in the event that the values achieved are above that determined by the Council's valuers.
- 3.31 The agreement with the tenant will also incorporate protections for the Council in the event of non-completion and/or onward sale.

4. COMMENTS OF THE CHIEF FINANCE OFFICER

- 4.1 This report seeks Mayoral approval for the change of use of Sovereign Court from office (Use Class B1) to residential (Use Class C3). The Council is the freeholder of the property, on which it has granted a lease for a 152 year term to Al Mubarakia Limited (AML).
- 4.2 If consent to the change in use is given, the value of the asset to AML will increase significantly - by an estimated £14,700,000. As a result, it is proposed that the Council will be entitled to a payment of 50% of the value of this increase (paragraph 3.23).
- 4.3 The premium received by the Council will therefore be £7,350,000 at current prices, although a staged payment process is proposed. The income stream will be a capital resource, fully useable by the Council for any purpose, either within the General Fund or Housing Revenue Account capital programmes.
- 4.4 It is proposed that the premium will be payable in stages as outlined in paragraphs 3.26 to 3.29. An initial 25% of the £7,350,000 premium will be payable on the date of signing of the variation, with a further 25% due on the first anniversary.
- 4.5 The remaining 50% (£3,675,000) will be payable in even instalments over the next twenty years, after a 3.5% uplift has been applied to the balance outstanding each year. This equates to an annual charge of £258,577 over the twenty year period i.e. total uplifted payments of £5,171,540.

4.6 In summary, the expected capital receipts by financial year are:

2015/16:	Signing of Variation	£1,837,500
2016/17:	First Anniversary of Signing of Variation	£1,837,500
2017/18 to 2036/37:	Annual Instalments for Twenty Years	£258,577 per annum

4.7 In addition to the guaranteed level of receipts above, the agreement will be subject to an overage clause to protect the Council's interests if values increase by more than are currently anticipated in drawing up the lease.

4.8 Arrangements should be put in place to ensure that all appropriate sums - both the annual premium instalments and any overage payments that may materialise - are recovered when they fall due over the course of the twenty year repayment period.

4.9 As stated in the report (paragraphs 3.14 and 3.15) the change of use does not result in any Section 106 or Community Infrastructure Levy obligations, or any affordable housing liabilities.

4.10 Following the change in use, as residential units there will be a possibility that leaseholders could exercise their right to collective enfranchisement. The Council's advisors consider this to be unlikely (paragraph 9.5), however if this were to happen the leaseholders would be required to purchase the long lease held by AML Ltd as well as the freehold held by the Council. As such, the Council would be fully recompensed for the value of the freehold and any costs incurred

5. LEGAL COMMENTS

5.1 The tenant requires the Council's consent to the proposed residential use and the Council, as landlord, is entitled to refuse such consent. It is this which enables the Council to require that it shares in the uplift in value to the tenant which will result if the Council does grant its consent.

5.2 The proposal that the Council should grant its consent to a change of use under the lease is not a disposal of real property and nor is it an acquisition of a chargeable interest giving rise to a charge to Stamp Duty Land Tax.

5.3 The Council will also be asked to consent to the necessary internal alterations to the buildings consequent upon the change of use, if the Council consents to the change of use. Such consent for alterations would be given by deed.

5.4 The Council is obliged under section 3 of the Local Government Act 1999 to "make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness". The granting of the consent and any associated

transactions as mentioned above which may be required to give effect to this proposal satisfy the best value duty for the reasons set out in section 7 below.

- 5.5 When exercising its functions the Council has a duty under section 149 of the Equality Act 2010 to have due regard to the need to eliminate unlawful discrimination and advance equality of opportunity and foster good relations between those who share a protected characteristic and those who do not (the public sector equality duty). In this instance the Council is exercising its function as freeholder where a lease has already been granted. It is proposed that the consent to change of use be given for a premium which will be available to the Council for the exercise of other functions.

6. ONE TOWER HAMLETS CONSIDERATIONS

- 6.1 Securing the premium will raise a significant capital receipt which will be available to support the council's overall capital programme which supports all service areas to deliver on the Community Plan objectives, as reflected in the Strategic Plan.

7. BEST VALUE (BV) IMPLICATIONS

- 7.1 The proposal presented in this report satisfies the Council's Best Value duty.
- 7.2 The proposed transaction represents an effective use of the Council's estate and will secure a significant capital receipt for little outlay on the Council's part.
- 7.3 The Council has appointed Gerald Eve as its specialist valuer in respect of this transaction and they have confirmed that the proposed premium is the best consideration reasonably obtainable.
- 7.4 Gerald Eve's professional advice accords with the advice from DTZ, who were the valuers commissioned by the tenant.

8. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

- 8.1 There are no immediate environmental implications arising from this report.

9. RISK MANAGEMENT IMPLICATIONS

- 9.1 Delay in finalising the agreement could leave the leaseholder choosing not to proceed with the proposal as they may feel they have insufficient time to carry out the necessary works under the permitted development rights they have. This will be mitigated by ensuring the decision is implemented as soon as possible.
- 9.2 The variation of the lease will incorporate an overage clause, to secure the Council's interest in the event that the values achieved are above that determined by the Council's valuers.

- 9.3 The agreement with the tenant will also incorporate protections for the Council in the event of non-completion and/or onward sale.
- 9.4 Officers have considered the possibility of the individual leaseholders of the flats, once sold, being able to exercise their right to collective enfranchisement. As their immediate landlord will not be the Council, but the head lessee, this would require them to buy out the long lease held by AML Ltd, in addition to the freehold held by the Council.
- 9.5 The Council's advisors on this matter, Gerald Eve, have stated that the likelihood of collective enfranchisement being exercised is minimal, given the number of flats in question. This is because the minimum number of participating tenants must equal half the total number of flats in the building; as there will be 124 flats in the building, at least 62 of the flats of qualifying tenants must participate in the action.
- 9.6 In any case, even if collective enfranchisement action was successful, the Council would receive the value of the freehold and any costs incurred throughout the process. In addition to compensating the council for its freehold interest, the collective leaseholders would also be required to compensate the head lessee for the value of their relative interest.

10. CRIME AND DISORDER REDUCTION IMPLICATIONS

- 10.1 There are no immediate crime and disorder implications arising from this report.

11. SAFEGUARDING IMPLICATIONS

- 11.1 There are no immediate safeguarding implications arising from this report.

Linked Reports, Appendices and Background Documents

Linked Report

- NONE

Appendices

- NONE

Background Documents – Local Authorities (Executive Arrangements)(Access to Information)(England) Regulations 2012

- NONE

Officer contact details for documents:

N/A