ORDER REMOVED 1/2/17.

~~CONFIDENTIAL~~

ITEM 575
POSSIBLE PROPERTY ACQUISITION OPPORTUNITY

MOVED Councillor Hewitson
SECONDED Councillor Hughes

That:

1. The report be received.

2. It be noted that a sale to Council is not currently the preferred option being pursued by the School.

3. The Mayor and CEO (or their sub-delegates) be authorised to meet with the School, if required, and negotiate with them about the potential purchase of their site.

4. Delegation be granted to the Mayor and CEO to purchase the site for a sum not exceeding $1 200 000, plus GST if applicable, plus Stamp Duty, with a three year right to occupy and further possible two year lease back, and to execute such contracts by the application of the Corporate Seal.

5. CT 5411/130 be excluded from classification as Community Land if it is acquired by the City of Unley.

6. Administration be authorised to borrow the funds necessary for the purchase if it becomes a requirement to do so, and in the manner they deem most appropriate for the prudent management of Council finances.

7. If funds are borrowed, an appropriate adjustment be made at the relevant quarterly budget update to reflect the debt servicing requirements.

CARRIED

DIVISION

A Division was called and the previous decision set aside.

Those voting in the affirmative

Councillors Schnell, Smolucha, Palmer, Hewitson, Koumi, Hughes, Lapidge, Sangster and Rabbitt.

Those voting in the negative

Councillors Palmer, Boisvert, Salaman and Hudson

The MOTION was declared **CARRIED**

ORDER REMOVED 1/2/17

~~CONFIDENTIAL~~

DECISION REPORT

REPORT TITLE:	POSSIBLE PROPERTY ACQUISITION OPPORTUNITY – KIRINARI COMMUNITY SCHOOL SITE
ITEM NUMBER:	575
DATE OF MEETING:	22 AUGUST 2016
AUTHOR:	DAVID LITCHFIELD
JOB TITLE:	GENERAL MANAGER, ECONOMIC DEVELOPMENT AND PLANNING

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1. EXECUTIVE SUMMARY

The property at 18 Trimmer Terrace is owned by Kirinari Community School Inc (the School). The School Management Committee has written to Council seeking to sell the school property to Council, and then lease it back for a period of five years. This proposal has come about because the School finds itself in difficult financial circumstances.

The nub of the proposal is:

1.1 Sale of the property at 18 Trimmer Terrace, Unley to Council for circa $1.5-$1.6M, being land value only as its market based highest and best use. (This is based on a formal independent valuation from CBRE – although the valuation was actually for $1.4m),

1.2 The School leasing back the property after settlement for five (5) years (or more ideally linked to the end of the school year, so maybe this is a 5.2 year initial term in practice),

1.3 Council granting an early exit opportunity prior to the term expiry with no penalty (say after 3 years),

1.4 The net rental to be determined at Council's 5-year cost of funds plus a premium of 2%. The School to pay all outgoings (but assuming no Land Tax applies)

The letter from Kirinari School is attached.

Whilst Council should not be seeking to place itself in a position as lender of last resort to failed community organisations, there are two strategic considerations at play with this opportunity. The first relates to a possible site for decanting of the Council Administrative functions if the redevelopment of the Civic complex becomes a reality. The School would be an appropriate site for such a purpose.

The second relates to the possible aggregation of a larger site for community and open space purposes. Council already owns 41 Oxford Terrace, which is contiguous to the School site. Council also owns 39 Oxford, which abuts 41. Council could explore options available in relation to the future acquisition of 43 Oxford; it may be possible to secure a future sale agreement or option in relation to this property, which would give Council a consolidated site of $4760m^2$ approximately, with 16 Trimmer the only non-Council owned property in this half block, and surrounded on 3 sides by Council owned land.

A Business Consultant working with Kirinari has advised that the School is now pursuing the option of sourcing "Angel Investors" instead of selling the site to Council. Adoption of the Recommendation will allow Council to act if those investigations fall through and the School approaches Council again.

2. RECOMMENDATION

That:

1. The report be received.

2. It be noted that a sale to Council is not currently the preferred option being pursued by the School.

3. The Mayor and CEO (or their sub-delegates) be authorised to meet with the School, if required, and negotiate with them about the potential purchase of their site.

4. That delegation be granted to the Mayor and CEO to purchase the site for a sum not exceeding $1 200 000, plus GST if applicable, plus Stamp Duty, with a three year right to occupy and further possible two year lease back, and to execute such contracts by the application of the Corporate Seal.

5. CT 5411/130 be excluded from classification as Community Land if it is acquired by the City of Unley.

6. Administration be authorised to borrow the funds necessary for the purchase if it becomes a requirement to do so, and in the manner they deem most appropriate for the prudent management of Council finances.

7. If funds are borrowed, an appropriate adjustment be made at the relevant quarterly budget update to reflect the debt servicing requirements.

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1. RELEVANT CORE STRATEGIES/POLICIES

1.1 Unley Central Vitalisation Strategy, incorporating Unley Central Precinct Plan and Draft Unley Central DPA

2. DISCUSSION

The Convenor of the Kirinari Community School Inc Management Committee (the School), Nick Glover, has written to Council asking that Council purchase the School property, CT 5411/130, and lease it back to the School for a term of five years. (Attachment 1 to Item 575/16)

Attachment 1

The School appears to have struggled in recent years to achieve a sustainable operating environment. The most recent financial accounts, (Attachment 2 to 575/16), indicate that the School experienced an operating loss of $298 479 in 2015, although $204 420 of this appears to be a one-off loss as a result of an adverse tax finding. The School also experienced a loss of $50 630 the previous year, and has total liabilities of $821 800.

Attachment 2

The School has some $620 000 of equity, almost all of it being in the property (and dependent upon achieving the property value stated in the accounts), and the consultant advising the School has indicated that the School accepts there is no future for the School with the current operating model. The School's goal is to continue to provide education to the remaining students until they complete their primary schooling. That would not be achievable for those students in year 1 if the School is relying on the leased property to deliver that outcome.

The School is offering to pay two years of lease payments upfront, and is seeking a lease fee set at Council's cost of capital, plus 2%, on the sale price, with the School assuming all maintenance obligations during the period of the lease.

A site plan of the School is at Attachment 3 to 575/16. The School is located in a Residential Historic Conservation Zone, which significantly restricts the ability to redevelop the site. The site comprises some 1575m^2, and improvements include the original villa refurbished to provide administration facilities, and the class rooms and a 'multi-purpose' space. The multi-purpose space was constructed in 2011 with a Commonwealth Building the Education Revolution (BER) grant. Under the terms of that funding agreement, there is a declining repayment obligation if the school ceases to operate. That obligation was $100 071 at the end of 2015.

Attachment 3

2.1 Viability of the School

In June 2016, the parents and wider School community were formally advised by the School's Management Committee that the School's cash position meant it could not continue to operate past the 2016 school year. This communication was issued at that time to ensure that parents had adequate opportunity to make other arrangements for their children for 2017.

Subsequently, the Committee has been developing an alternative option to capitalise the property and create an opportunity for the School's on-going operations and viability for at least the next five (5) years (and ideally the longer term – *the school's phraseology*). For this alternative option to be viable, the School must initially be able to lease the property back from the purchaser. It is believed that the School has not identified a commercial concern prepared to purchase the property on that basis, which is why Council has been approached.

The advice from the School Management Committee to parents regarding the financial situation may be critical to whether the School can continue to operate in coming years. It would be difficult to imagine that no negative enrolment impacts would eventuate from this advice. How the School is able to manage their costs against the subsequent income reductions if enrolments fall is the crucial question in regards to their survival. The precarious state of the School's finances make them a relatively high risk tenant, which explains their offer to pay two years lease fees upfront and proposal to hold remaining years payments 'in trust'. Such an arrangement suggests further risks for a lessor. If the School fails and falls into Administration, future lease fees held in Trust (as proposed by the School) would not necessarily come to the Council. It may require Council to become involved in litigation to access that money.

2.2 Justification for a Council Purchase

The Strategic Property Acquisition Working Group established by Council has developed a Due Diligence checklist to enable Council to consider any property acquisition opportunities in a strategic fashion. The completed Due Diligence checklist for 18 Trimmer Terrace is attached (Attachment 4 to 575/16).

Attachment 4

Council will need to be sufficiently confident that it can deliver on its strategy to redevelop the Civic complex, or have a longer term strategy to consolidate a Village Green/Community space extension, to justify the proposed investment.

A recent Council workshop about a possible redevelopment of the Unley Community Centre complex generated considerable discussion around suitable venues for the temporary re-location of the Centre. A similar requirement will exist for the Civic administration complex. Whilst it may be possible to utilise the Town Hall as a temporary council chamber, there is no similar venue that immediately presents itself for the Civic administration requirements. Although being spread across several venues is probably inevitable, the School facility would appear, prima facie, to offer the best opportunity for rehousing the bulk of the administration. With around 586m^2 of buildings, many administration functions could be accommodated there. Some of these facilities may require a cosmetic spruce up before Council occupation.

The timing of a redevelopment of the Civic complex is still very much up in the air, but a realistic time for earliest commencement of construction is the beginning of 2020, and it could take 12-24 months longer. This could align well with a five year lease, or an early exit request by the School, but will involve some fortuitous synchronising of events.

[redacted]

[redacted]

[redacted]

One minor additional benefit that would accrue from purchase of the School site is the eventual easing of traffic congestion in that section of Trimmer Terrace at school drop off and pick up times.

2.3 The Financial Equation

It has been made clear to the School's consultant that any purchase must be a strictly commercial transaction for Council.

There are a number of matters that need to be taken into account. Whilst the School Management Committee has vowed to explore options for the School continuing to operate, it must be made clear that it will not be from the 18 Trimmer Terrace premises after the expiry of the lease. This can be explicitly stated as a Special Condition of sale.

Even allowing for the tax ruling, the School made an operating loss of $94 059 in 2015, and is expecting an operating loss of more than $135 000 in 2016. There must be doubts, following the informing of parents about the School's financial predicament that enrolments will hold up at 2016 levels in future years.

This will further impact on operating performance. The current expenses include no rent provision, so the Management Committee appears to accept that the draw-down of the existing assets for future rent payments is appropriate.

Kirinari's proposed terms and Administration comments on each of these are as follows:

The desired commercial structure is as follows:-

a. Sale of the property at 18 Trimmer Terrace, Unley to Council for circa $1.5-$1.6M, being land value only as its market based highest and best use. (This is based on a formal independent valuation from CBRE),

The CBRE Valuation obtained by Kirinari values the property at $1.4m (Attachment 6 to XXX/2016). The quite restrictive zoning provisions for the Residential Historic Conservation Zone do not offer a lot of scope for flexibility. The original dwelling at the front of the allotment is a Contributory Item. The Development Plan states:

The expansion or redevelopment of a building to be used for non-residential purposes in a residential zone may be appropriate where the proposed non-residential use is confined to a site used, in whole or in part, for non-residential purposes, and:

(a) the proposed use is non-intensive and primarily serves, or has long established direct associations with, the local community and improves the range and quality of community facilities or other services to that local community; or

(b) is located adjacent to a non-residential use, or a non-residential zone boundary, so as to provide a buffer for nearby residential occupiers to the activities arising from that non-residential use; or

(c) improves existing unsatisfactory site conditions.

The low potential to redevelop the site for future non-residential uses and the requirement that the occupier has long established direct associations with the local community is quite restrictive. The CBRE valuation is probably reflective of the site value for a purchaser to renovate the former dwelling and remove the non-residential components.

The School have indicated that un-named property developers are prepared to offer a slightly higher price than the valuation, but not when they also have to meet the other Kirinari requirements.

b. Settlement in three (3) months or a shorter period if possible. No deposit is required. The transaction to be on GST terms as required by Council,

This would be satisfactory if Council wished to proceed.

c. Kirinari leasing back the property at settlement for five (5) years (or more ideally linked to the end of the school year, so maybe this is a 5.2 year initial term in practice),

This would be satisfactory if Council wished to proceed. No rights of renewal would be offered. Under the proposed structure the first three years of the lease term would be for no consideration, with remaining two at a lease fee of $84 000 per annum plus CPI from 2016.

d. Council granting an early exit opportunity prior to the term expiry with no penalty (say after 3 years),

The early termination of the lease may well work to Council's advantage, and therefore this is worth considering. Council could look to impose a minimum notice requirement of twelve months' notice prior to early exit, or could look to impose a break fee at a lesser rate than the annual lease. Early exit in Commercial leases frequently requires a pay-out of the balance of the lease term, or a requirement that the tenant find a sub tenant.

e. The net rental to be determined at Council's 5-year cost of funds plus a premium of 2%. Kirinari to pay all outgoings (but assuming no Land Tax applies). For the purpose of the rental calculation, the principal to be based on the settled purchase price (net of GST),

With the current Council cost of funds, this would equate to a yield on the property of around 5.75%-6% ($1.4m at 6% = $84 000 per annum annual lease fee). For a relatively short lease, to a tenant of acknowledged financial fragility, that is quite a low yield, but the property is not in a Prime Commercial location but a prime residential location. Residential property yields for rental properties are rarely above 4%.

f. The rental to be indexed annually to CPI,

This would be satisfactory if Council wished to proceed.

g. Kirinari providing 2 years rental in advance to Council,
Recommend that Council counter-offers $1.15m with the School granted a three year right to occupy for no consideration, plus a further two year lease term at $84 000 per annum, plus CPI increases that are calculated from 2016/17 onwards. If accepted by the School, other conditions above would need minor modification.

h. Council to note that Kirinari will further its exploration of a partnership with an international education provider which may extend to joint management, joint use, transitional arrangements or other mutually beneficial structures,
Kirinari be required to acknowledge in the Special Conditions of the contract that they accept, without question, that their tenure in the property will not extend past the end of the lease term. Thought could also be given to an 'adverse publicity' bond being held by Council's solicitors to discourage persons associated with the School from making disparaging remarks in public or to the media about Council terminating the School's occupancy – as occurred with 41 Oxford Terrace.

i. All process and legal costs of drafting and independent advice/negotiations (with Council acting reasonably with regard to any negotiations it seeks) to be met by Kirinari from the proceeds of the sale.

This would be satisfactory if Council wished to proceed.

If Council accepts the proposal as put forward by the School, and decides to sell the property at the end of the lease, Council is unlikely to be out of pocket. Stamp Duty on a $1.2m ($1.32m GST inc) purchase is $42 286.67, and the 2% lease premium over the Council's cost of capital is worth $24 000 per annum. This assumes a zero net balance from GST. Even though the site would not accommodate a north-south orientation tennis court, a residential allotment of this size in this location is unlikely to be worth substantially less than $1.4m.

As advised in the letter from the Convenor, the School is endeavouring to come to an arrangement with an international education provider regarding the future of the School. Precisely what this means is unclear. They have recently had discussion with the Montessori organisation. A proposal is being investigated that would ensure the existing property is available for future school use. The proposal involves identifying "Angel Investors". As the School's bankers have advised them that there will be no increase in their debt ceiling, the School is working to a tight timeline, and it is the view of Administration that there is unlikely to be agreement on this concept in time to make it a reality.

In brief summary, there appears little financial risk to Council if they choose to acquire the property.

4. ANALYSIS OF OPTIONS

Option 1 –

1. The Mayor and CEO (or their delegates) be authorised to meet with School representatives and negotiate with them about the potential purchase of their site by Council.

2. That delegation be granted to the Mayor and CEO to purchase the site for a sum not exceeding $1.2m, (noting that the opening Council position should be $1.15m, as this aligns with valuation), plus Stamp Duty, plus GST if applicable, with a five year leaseback incorporating a three year right to occupy for no consideration and further two year lease on commercial terms, and execute such contracts by the application of the Corporate Seal.

This would be the recommended option if Council considers that the merits of purchasing this property outlined in the *Discussion* section are sufficient justification for doing so.

The downside of proceeding to purchase the School site is that if the Civic site redevelopment ultimately proves to be unviable, Council will have no particular use for this site. If it is purchased at or around the authorised sum, the worst case financial downside for Council is considered to be relatively small.

Purchasing the site would expose Council to the possibility of the type of adverse publicity experienced when Council was considering the future use of 41 Oxford Terrace, which was generated by School staff, students and families. The option of some penalty mechanism in the event of adverse publicity generated by members of the School community could be considered as part of the negotiations.

The future use of the site as part of an easterly extension or relocation of the Village Green has superficial appeal, but it will none the less be expensive open space, and consolidation of larger sites can take decades to complete.

There remains the possibility that the School will be able to gain a last minute 'rescue' through a third party that would negate the need for the sale to Council.

<u>Option 2 – Advise Kirinari that Council has no interest in purchasing the site</u>

This is the safe and easy option. There will be no impact on Council's balance sheet. It is the loss of potential future opportunities that is the biggest disadvantage of this option.

There may be other potential buyers examining the proposal, although the consultant working with the School on disposing of the property has advised that there is no other potential purchaser at this time.

4. RECOMMENDED OPTION

Option 1 is the recommended option, if Council considers there is sufficient merit in the purchase.

5. POLICY IMPLICATIONS

5.1 Financial/budget

- If the Recommended Option is adopted and the property acquired, the cost to Council (including Stamp Duty, conveyance and legal expenses) of the purchase will be between $1.2m and $1.26m plus GST
- Considering the size and location of the allotment, it is not considered that Council is at risk of suffering significant capital loss if it decides to sell the property again in the future.
- There is no allocation of funds in the current budget.
- The acquisition would need to be fully debt funded. There will be no revenue for debt servicing purposes for the first three years of the loan. This will need to be a budget variation for 2016/17. There would need to be allocations in future budgets for debt servicing purposes if the acquisition goes ahead.
- If the loan is funded via the overdraft, the current interest rate is less than 4%, but if Council were to take out a new fixed term loan specifically for the purchase, the interest rate will be of that 4% order.
- Principle and Interest Payments on a 10 year, fixed term loan of $1.2 m equate to $146 776 annually.
- Maintenance costs will be the responsibility of the School during their tenancy.

- Rates on the property will be $1331.25 for 2016/17. This rate revenue will be lost to Council if there is no tenant in the building after the end of the School lease.
- The School will meet the reasonable costs of Council for the transaction.

5.2 Legislative/Risk Management

- Legal advice has been obtained in relation to the structure of the purchase and lease agreement.
- The sale agreement can be subject to the completion of a satisfactory dilapidation assessment of the property, although the requirement that the buildings are of reasonable standard is relatively short term, so possible developing structural issues are not considered to be a concern.
- The risk of the School going into Administration during the term of the lease is considered to be moderate to high, but the proposed structure of the sale and lease back deal will mitigate this risk to Council.

5.3 Staffing/Work Plans

- There will be no requirement for additional staff if the purchase proceeds. It will create additional work for some existing staff members, particularly in relation to on-going management of the property.

5.4 Environmental/Social/Economic

- Subject to a change of heart by a future Council, the acquisition of the property will mean that at the end of the lease term, Kirinari School will no longer be a fixture on the Unley landscape.

5.5 Stakeholder Engagement

- Not appropriate

6. REPORT CONSULTATION

Executive Management Team
Manager Finance

7. ATTACHMENTS

- Letter from Kirinari Community School Inc
- 2015 Kirinari Financial Accounts
- Kirinari School Site Plan
- Due Diligence Check List for 18 Trimmer Terrace
- [redacted]
- CBRE Valuation for Kirinari Community School Inc

8. REPORT AUTHORISERS

Name	Title
David Litchfield	GM, Economic Development and Planning
Peter Tsokas	Chief Executive Officer