

Resources Policy Development & Scrutiny Panel

November 2016

Commercial Estate Update

Presentation Areas

- » Overview of the Estate
- » Performance
- » Management Team
- » Acquisitions and Developments
- » Strategic Direction

Overview of the Commercial Estate



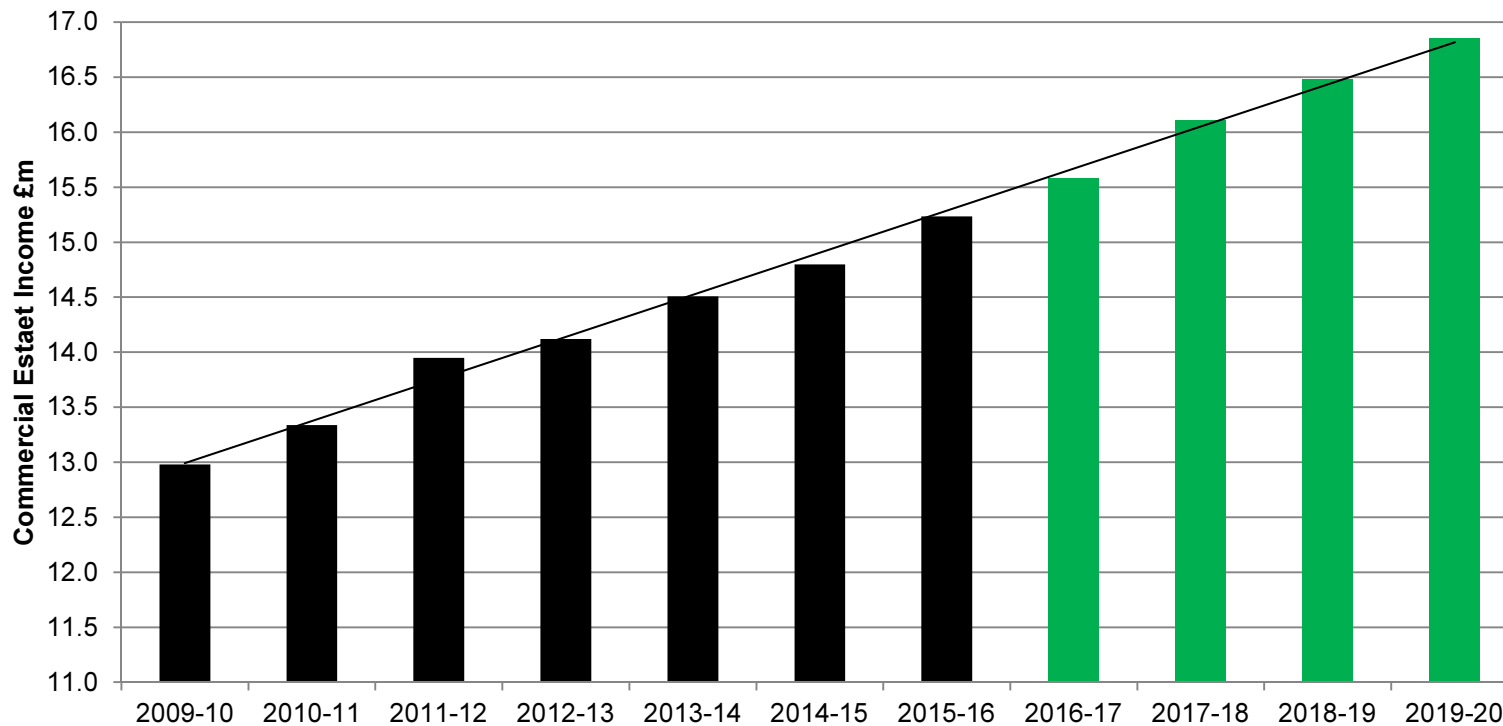
Bath and North East Somerset – *The place to live, work and visit*

Key Facts

- » 433 assets, comprising of 205 investment estate and 228 other (held for operational reasons but generate some income):
- » Current asset value of £250.4M (*Open market Red Book valuation*)
- » Produced a rental income in excess of £15.2 million in 2015/16
- » Forecasted to generate £15.6 million in 2016/17
- » Comprises retail, commercial, industrial & leisure properties located primarily in Bath City Centre
- » The investment estate produce a gross revenue return of around 5.5% in 15/16

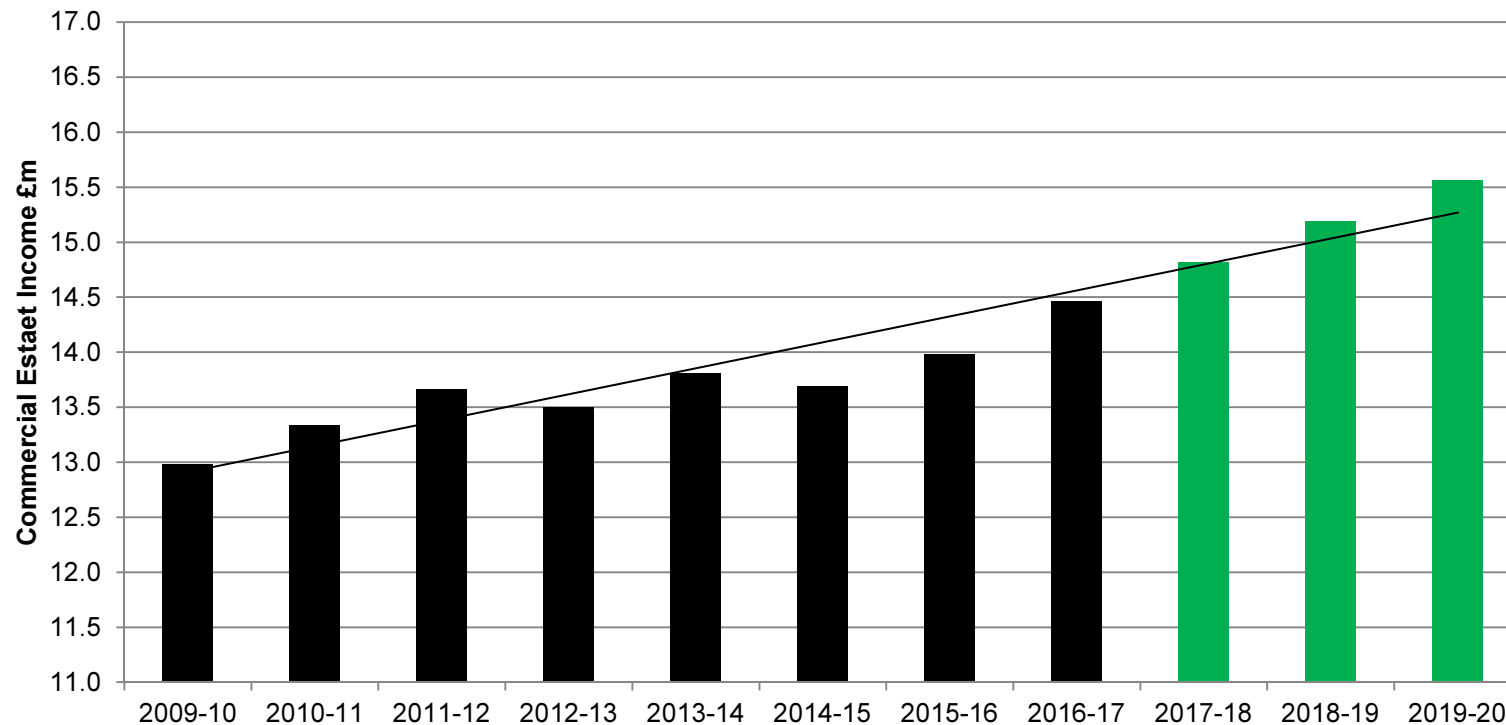
Gross Income Growth (Including Acquisitions)

Commercial Estate Rental Income 2009-2020



Gross Income Growth (Excluding Acquisitions)

Commercial Estate Rental Income 2009-2020



Breakdown of portfolio by type

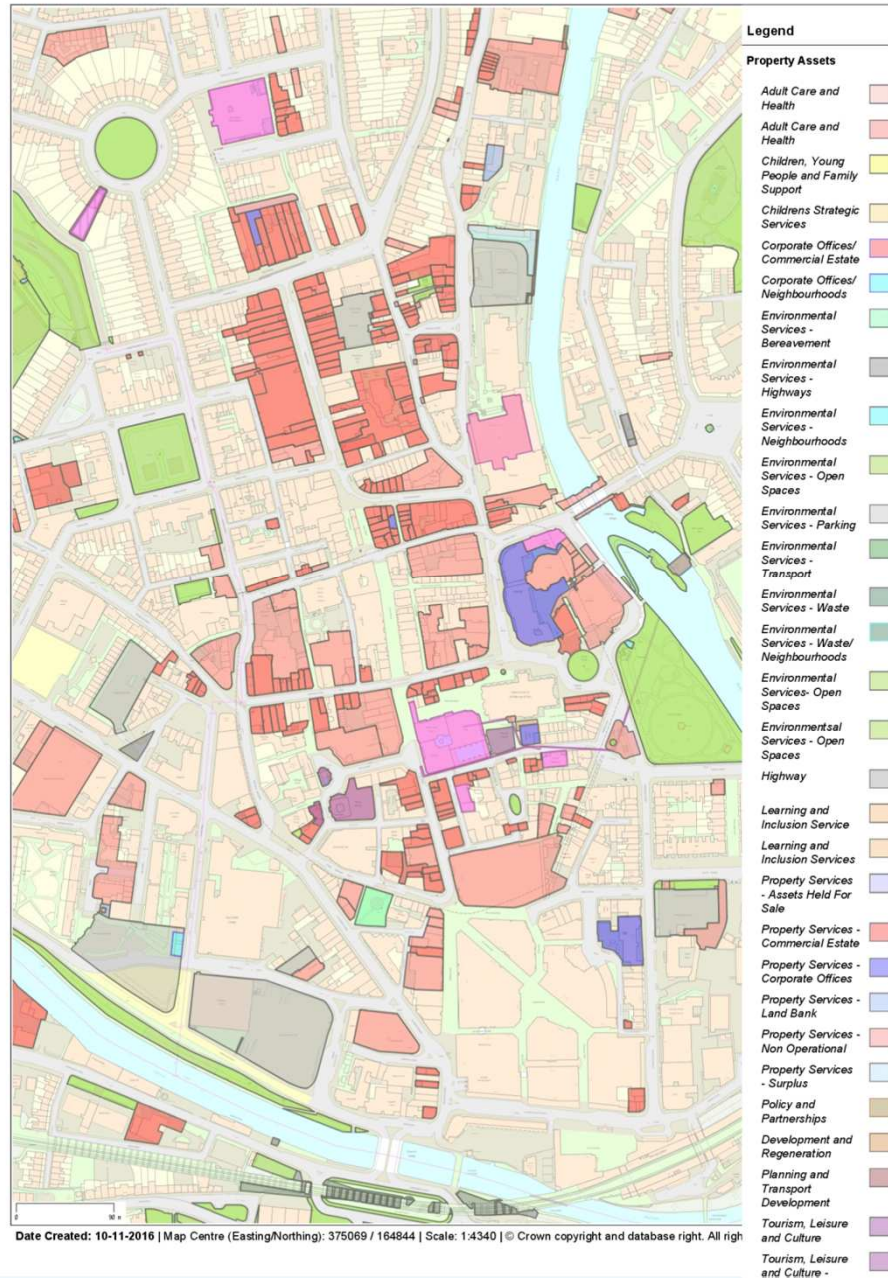
Retail	Prime	55
Retail	Secondary	56
Retail	Tertiary	55
Licensed		21
Offices		10
Industrial		8
Other		228
Total Commercial Estate		433

Property types



Bath and North East Somerset – *The place to live, work and visit*

Commercial Estate Ownership - Bath



Interesting facts

- » 1249 - Earliest recorded acquisition – property in South Street purchased for 3 marks and 4 shillings (£2.20 today) by the Mayor of Bath
- » 1646 - First recorded by-law for managing Corporation's estates
- » 17th Century lease provisions included “that every person that hath a thatched house shall not mend his house with thatch but shall repair it with tyle or slate.”

Current Commercial Estate Objectives

- » **The maintenance of the architectural significance of Bath** as a World Heritage City is actively promoted and encouraged.
- » The estate is to **contribute towards the resources** necessary to enable the Council to meet its corporate and strategic objectives.
- » **Support Economic Development** initiatives.
- » **Maintain a diverse and appropriate range of retailers** to promote Bath as a destination
- » **Provide workspace accommodation** for new, small and expanding businesses within the B&NES area.
- » **Enable residential uses in the vacant upper floor** accommodation in retail centres.

Statutory powers

- » The Commercial Estate is held under the provisions of **Section 120(1)(b) of the Local Government Act 1972** and gives the Council express powers to acquire land by agreement for the benefit, improvement or development of their area. The Act also provides that a principal council may acquire any land, whether situated inside or outside of its area.
- » **Localism Act 2011** provides a general power of competence which a local authority can exercise anywhere in the United Kingdom, or elsewhere.
- » Other Councils acquire property in accordance with **s120 anywhere within the UK or beyond**. This will however require further legal investigation.

Performance of the Commercial Estate



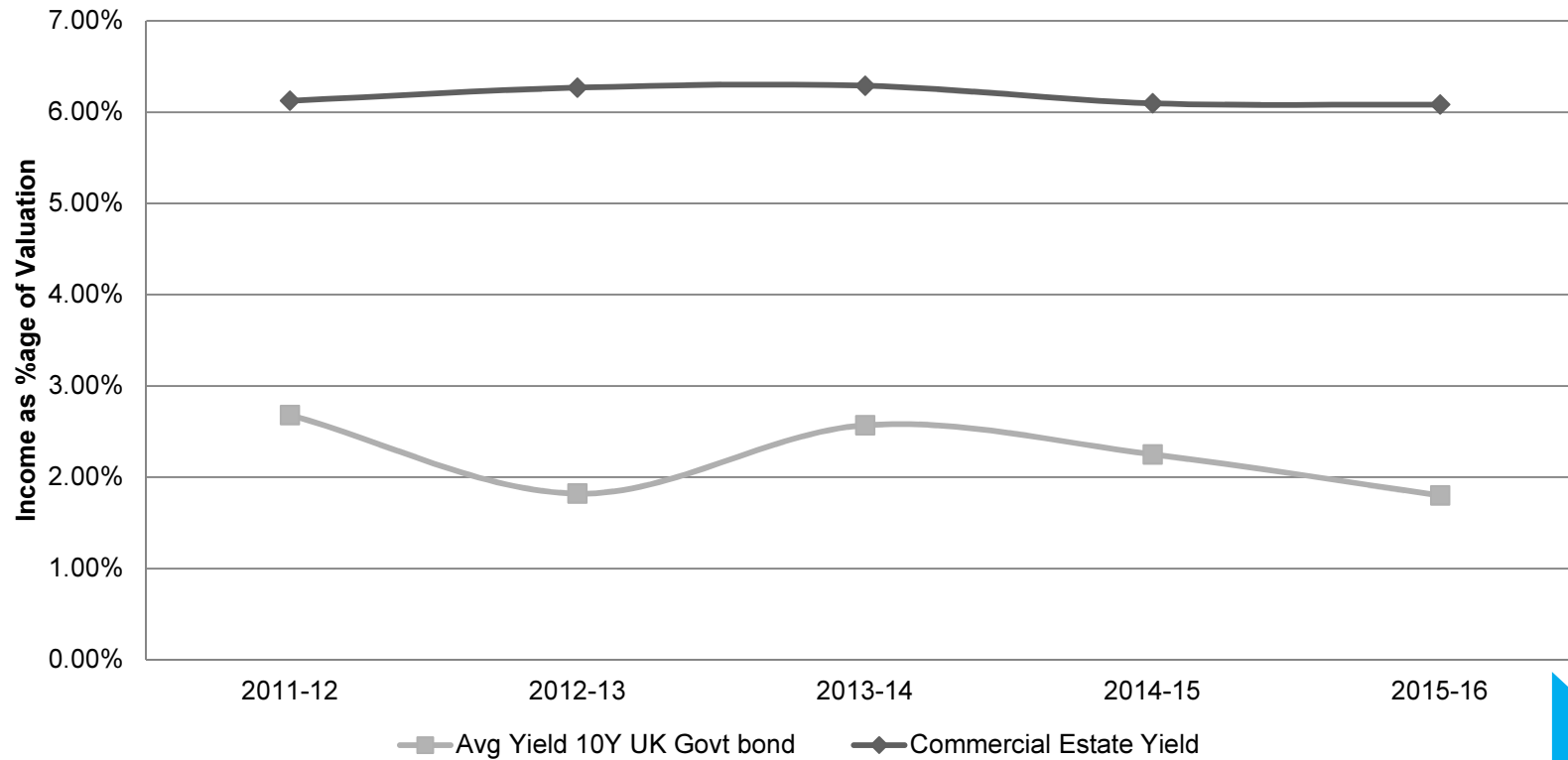
Bath and North East Somerset – *The place to live, work and visit*

Performance

- » Rental growth of circa 2.7% per annum over last 6 years
- » Growth of gross income from £13M in 09/10 to £15.2M in 15/16
- » Forecast growth to continue
- » Gross revenue return of over 6% in 15/16
- » Total debt at October 2016 - £19M giving a gearing of only 7.6% LTV (*Standard Life Investment Property Income Trust maintain gearing at 30% LTV*)

Gross Revenue Return Performance

5 year Gross Revenue Return for the Commercial Estate

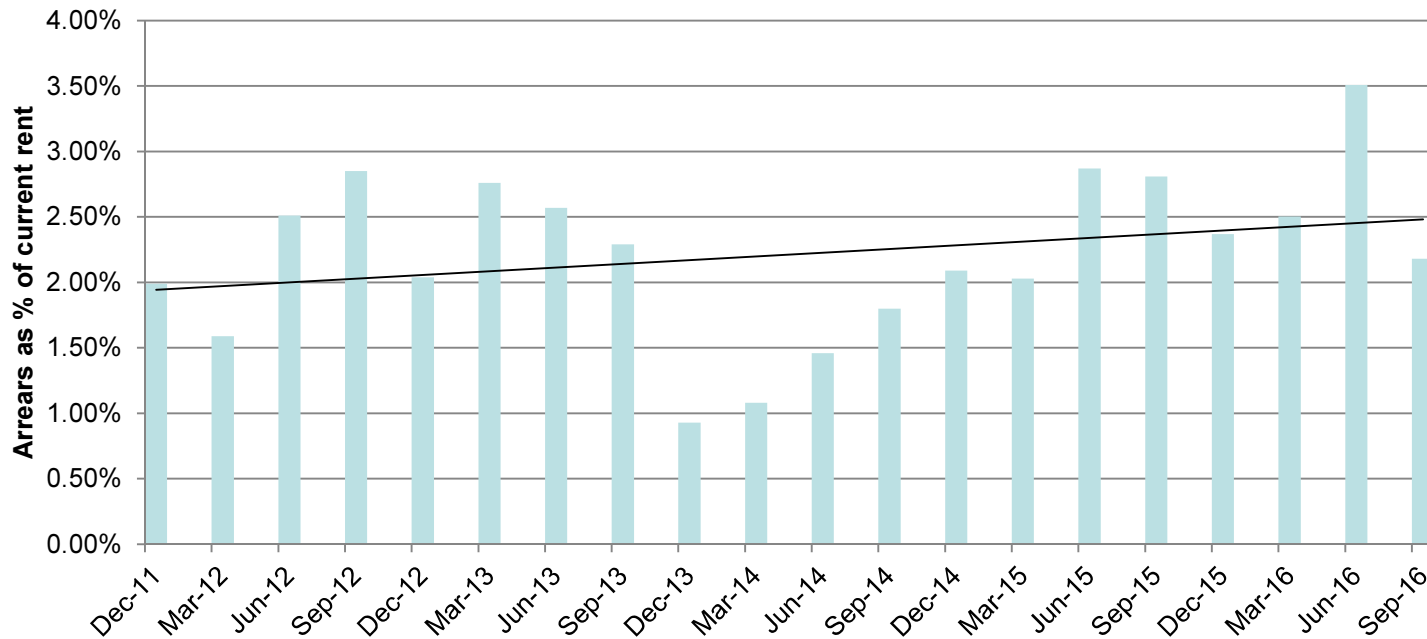


Bath and North East Somerset – *The place to live, work and visit*

Rent Arrears

- Trend line between 2 and 2.5%
- Sector benchmark for debt management around 5%

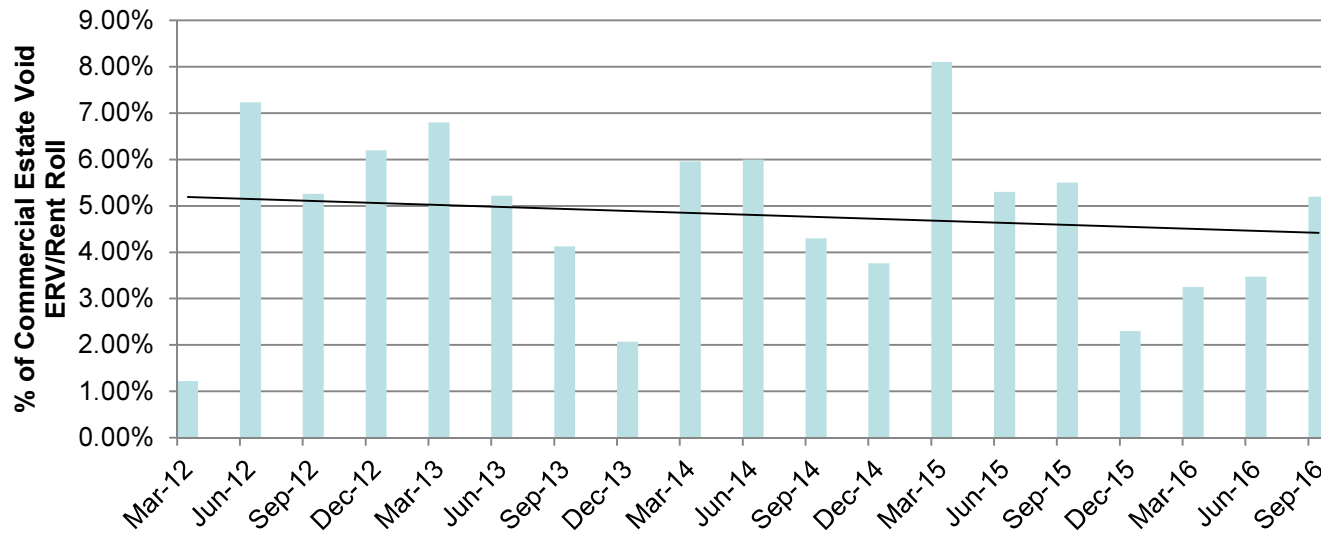
Commercial Estate - Average Arrears (excludes managed debt)



Voids

- IPD voids data -
- Spring Board Retail Intelligence reported the national town centre vacancy rate in the UK was **9.1%** in January 2016
- The UK Retail Vacancy rate increased for the first time since Q2 2012 in Q3 2016, climbing to 12.4%
- B&NES trend line around **5%**

Commercial Estate - Temporary Voids



Management Cost

- » Landlord and Tenant team direct staffing budget 10/11 was £428K
- » In 16/17 the direct staffing budget has reduced to £402K or **2.6% of total rent**
- » Staffing number **reduction of 11%** in last 4 years
- » Benchmark data for management cost indicates **around 5% is the norm** for a large estate
- » 16/17 the revenue budget for **maintaining the estate, excluding staff, is £376K**. This covers maintenance, servicing, utilities and insurance, funded from gross rent income.

Management Team of the Commercial Estate



Internal Staffing

- » **Head of Service** – A Fellow of RICS (the Royal Institution of Chartered Surveyors) and RICS Registered Valuer with 30 years' experience in both public and private property sectors.
- » **Team Manager** - A Member of RICS and RICS Registered Valuer. Experience in both public and private sectors.
- » **Senior Estates Surveyor** - A Member of RICS. The majority of experience gained within the private sectors.
- » **Estates Surveyors x 5** – Management Surveyors. All posts require that the Surveyors are professionally qualified members of RICS. Current Surveyors have a variety of experience; the majority of which has been gained in the private sector.
- » **Estates Technicians x 2**. One is qualified to Tech RICS level.

Note – Excludes staff dedicated to management of the R&M

Critical Partner

Work with BNP has been focussed on four key areas:

- » Challenge the status quo ensuring industry best practice.
- » Composition of the investment portfolio
- » Understanding and mitigating the risk of the retail focus
- » Assist in the Development of an investment strategy based on the development of AMP's to support an acquisition and disposal programme in pursuance of the growth of secure net income.

Acquisitions and Estate Development



Bath and North East Somerset – *The place to live, work and visit*

Acquisition and Restructures

In the last 3 years the Council has acquired:

- » 47 Milsom Street –Freehold purchased, £5.15M. Gross Rent £246,750 p.a with initial gross revenue return over 5%
- » Jolly's - £5.46M restructure resulting in increase in rent of £418,500 p.a, 7.7% gross revenue return
- » Seven Dials –Long leasehold purchased for £8.4M. Rent £588,800 p.a, over 7% gross revenue return
- » 30-35 Westgate Street – November 16 £7.8M investment for the freehold purchase generating £446,400 pa rent with a gross revenue return of over 5.7%

Office Development - BQS



Bath and North East Somerset – *The place to live, work and visit*

Major Commercial Estate Development

- » BQS - 60,000 ft² office
- » £16.2M investment in Grade A Office space
- » HoT's with existing Bath employer securing high quality jobs in the city
- » Producing commercial return
- » Long lease commencing 18/19
- » Joint working with Community Regeneration

Investment Funding

- » The previous acquisitions have to date been **funded through borrowing.**
- » Public Works Loan Board rates are currently at low levels and it is recommended the Council takes **advantage of these rates to fund further investment acquisitions**
- » To supplement the borrowing, the Council has also recently approved that **capital receipts** from disposal of underperforming and surplus commercial estate assets be ring **fenced for future investments**

Emerging Strategy for the Commercial Estate



Bath and North East Somerset – *The place to live, work and visit*

Context - Strategic Review Targets

» Increase gross income:

» 16/17 - £15.6M

» 17/18 - £16.1M

» 18/19 - £16.5M

» 19/20 – £16.9M

Performance Targets

Working with our Critical Partner, BNP, the following draft performance targets have been developed:

- » Increasing the annual **net income by £1.25M** within three years and 1% over the IPD Annual Property Index thereafter.
- » Reducing exposure to the Retail **sector to 80%** of total ERV within three years and **70% within six years**.
- » Reducing the income secured against higher risk covenants to **no more than 40%** of the total gross rents payable within three years and 30% within six years
- » Maintaining the average property **voids at 1% below IPD**

Existing Estate Management

Growth of secure net income

- » **Achieve increased revenue** generation and improve the resilience of that income by seeking to **rebalance** the portfolio slightly more away from its dependence on retail.
- » **Challenge of existing assets** to justify their retention, re-investment or disposal, together with an acquisition strategy that focusses on increasing the quantum of non-retail stock within the estate.

Acquisition– future approach

- » **Further acquisitions funded by debt** ,taking advantage of the current low PWLB rates where they exist, will seek to achieve the correct balance between investment return and security of income, through **rebalancing the estate** away from over reliance on retail .
- » Limited availability of good quality non-retail investment stock within B&NES.
- » The property market is suggesting that rental growth in the industrial and distribution warehouse sector is forecasted to outperform retail by a significant margin over the next five years
- » **Potential for the Council to purchase investment opportunities beyond the BANES boundary.**

Commercial Estate Objectives

Are these still correct?

- » **The maintenance of the architectural significance of Bath** as a World Heritage City is actively promoted and encouraged.
- » **The estate is to contribute towards the resources** necessary to enable the Council to meet its corporate and strategic objectives.
- » **Support Economic Development** initiatives.
- » **Maintain a diverse and appropriate range of retailers** to promote Bath as a destination
- » **Provide workspace accommodation** for new, small and expanding businesses within the B&NES area.
- » **Enable residential uses** in the vacant upper floor accommodation in retail centres.

Questions for PDS

The panel is asked for its views on the following:

- » The emerging strategy to rebalance the portfolio through acquisitions
- » The emerging strategy to borrowing to invest
- » The emerging strategy to invest outside of the B&NES area
- » The proposed performance targets
- » The Commercial Estate Objectives
- » The BNP Critical Partner letter of November 2016