Bath & North East Somerset Council

DECISION MAKERS:	**Councillor Tim Warren, Cabinet Member: Leader of the Council** **Councillor Charles Gerrish, Cabinet Member: Finance and Efficiency**	
DECISION DATE:	**On or after 10th September 2018**	EXECUTIVE FORWARD PLAN REFERENCE: E 3087
TITLE:	Acquisition of income generating investments to incorporate within the Commercial Estate to move to full approval from provisional.	
WARD:	N/a	

AN OPEN REPORT CONTAINING EXEMPT APPENDICES

List of attachments to this report:

Appendix One – Business Case 1 (Exempt by virtue of Paragraph 3 of Schedule 12A of the Local Government Act 1972

Appendix Two – Valuation Report 1 (Exempt by virtue of Paragraph 3 of Schedule 12A of the Local Government Act 1972

Appendix Three – Business Case 2 (Exempt by virtue of Paragraph 3 of Schedule 12A of the Local Government Act 1972

Appendix Four – Valuation Report 2 (Exempt by virtue of Paragraph 3 of Schedule 12A of the Local Government Act 1972

Appendix Five - B&NES Commercial Estate Investment Strategy 2018-19
http://www.bathnes.gov.uk/sites/default/files/banes_investment_strategy.pdf

1 THE ISSUE

1.1 This report sets out the terms of the proposed acquisition of income generating investment properties to move to full budget approval from provisional budget approval.

2 RECOMMENDATION

The Cabinet Members are asked to approve:

2.1 The acquisition of two investment properties which are in accordance with external legal advice but noting that the purchase of one of the properties does not meet with MHCLG guidelines as it is outside of the Bath and North East Somerset boundary.

2.2 Capital expenditure on the acquisition of the properties and any necessary adjustments to the 2018/2019 capital budget to reflect this approval.

3 RESOURCE IMPLICATIONS (FINANCE, PROPERTY, PEOPLE)

3.1 A budget of £47.5m was provisionally approved by Council in February 2018 for property acquisitions. Release of this funding is subject to a business case for each investment opportunity. Total costs of the proposed acquisitions are £12,170,000. This includes an estimated budget in respect of professional fees (as the due diligence is on-going) and contingency.

3.2 This report requests the full approval of the capital spend on the acquisition of two properties.

3.3 This proposal links to the already approved Medium Term Service Resource Plan which places a requirement to generate an additional £1.475 million net of income from the Commercial Estate as part of the 2017-18 to 2019-20 budget period.

3.4 The acquisition costs will be funded by service supported borrowing, costs of which have been factored in against future rental income projections. The business case assumes long term borrowing for the entire purchase and on this basis the level of annual rent of £785,761 offers good value for money as it delivers net income after borrowing costs on an annual basis of £334,973 which is a 2.75% yield on the initial investment, as well as providing the economic benefits as set out in paragraph 4.6 of this report.

4 STATUTORY CONSIDERATIONS AND BASIS FOR PROPOSAL

4.1 Changes were introduced by The Ministry of Housing Communities and Local Government (MHCLG) to the statutory guidelines in February 2018 which covered the following areas:-

- **Transparency and democratic accountability**
  The revised guidance retains the requirement for an Investment Strategy to be prepared at least annually and introduces some additional disclosures to improve transparency. The changes to the CIPFA Prudential Code include a new requirement for local authorities to prepare a Capital Strategy. (The strategy must be in place for 2019/20 and will be approved as part of budget setting for 2019/20. A Commercial Estate Investment Strategy 2018/19 was included as part of the budget setting proposals for 2018/19 and is attached as Appendix 5).

- **Principle of contribution**
  This requires local authorities to disclose the contribution that non-core investments make towards core functions. Authorities' core objectives include 'service delivery objectives and/or place-making role.' This clarification has been made to recognise the fact that local authorities have a key role in facilitating the long term regeneration and economic growth of their local areas and that they may want to hold long term investments to facilitate this.

- **Introduction of a concept of proportionality**

This requires local authorities to disclose their dependence on commercial income to deliver statutory services and the amount of borrowing that has been committed to generate that income based on an understanding of the overall risk that they face.

- **Borrowing in advance of need**
  By bringing non-financial investments (held primarily or partially to generate a profit) within the scope of the Investment Guidance it is clear that borrowing to fund acquisition of non-financial assets solely to generate a profit is not prudential. The Investment Guidance requires local authorities who have borrowed in advance of need solely to generate a profit to explain why they have chosen to disregard statutory guidance. The assumption is that any out of area purchases are only held for this purpose.

  There is therefore a requirement to explain why any guidance is not being followed and clearly explain the risks associated with the decision. These are clearly addressed below.

4.2 In terms of the Corporate Strategy the acquisitions have direct relevance in the following areas:

- A Strong economy & growth – The Council is able to exercise active management over its property holdings and seek to ensure a varied portfolio mix and diversification of risk.

- An efficient business – the acquisitions contribute significantly towards achieving the Council's strategic review targets as well as the Directorate Plan income generation aspirations.

4.3 In line with the Council's Financial Plan the income will be earmarked to protect frontline services, including the provision of adult social care; children and environmental services pursuant to the Council's general power of competence under s.1 Localism Act 2011.

4.4 The acquisition of the properties are in pursuance of the benefits (and in particular those of an economic nature) that it will confer upon the Council and its area, in accordance with s120 of the Local Government Act 1972. The acquisitions align themselves with the Council's Investment Strategy for the Commercial Estate.

4.5 The economic benefits conferred to the Council and its area specifically include:

4.4.1 Diversification and mitigation of risk to the portfolio, in terms of location, sector and type;

4.4.2. Council resourcing - the acquisitions will provide resources required to assist in the delivery of the Council frontline services, which benefits the Council and its area directly; and

4.4.2. Opportunity – There are limitations in terms of demand and supply from being geographically constrained. By seeking opportunities within an appropriate drive time distance and within the LEP and other neighbouring areas, outside B&NES, provides exposure to a larger number of significant assets.

5 THE REPORT

5.1 The Council has been given an opportunity to purchase two investment properties both of which are freehold acquisitions.

5.2 One of the properties is outside the Local Authority area boundaries.

5.3 Investment ‘Property One’ comprises an industrial unit with office, production and warehouse accommodation which extends to approximately 41,400 sq ft (3,846.16 sq m). The property, which lies just on the border with B&NES, is recently constructed and practical completion was achieved on 3rd August. It is held freehold.

5.4 The Council will acquire the investment with an Occupational lease in place. The lease is for a term of 15 years and is let to a single occupier of the whole. The initial rent is £370,000 per annum will generate an income, after payment of the Council’s debts costs (based on the expected annuity loan rate, and the assumed acquisition date of 1st September), of £144,050 per annum, after the first year. (In year 1, the repayment charges are less and the return, net of debt charges will be £202,889). There is a rent free granted, but this will be ‘topped up’ by the Vendor. There will be 2% fixed annual increases built into the lease.

5.5 A purchase price of £5,750,000 has been agreed in principle.

5.6 Due diligence is underway although the tenant is considered to be of good covenant strength.

5.7 The property has a very high office to industrial use accommodation (a ratio around 50:50). It is capable of being split into component parts; thus the office accommodation (either in whole or in part) can be let separately to the production/industrial accommodation, if required.

5.8 In accordance with the Commercial Estate Investment Strategy 2018/19 the Council is looking to diversify its portfolio. However due to the lack of suitable office and industrial investments within the Council’s own geographical area, this is an opportunity to acquire a mixed use asset close to the border. The proximity to the B&NES border means that the ability to manage the asset, in-house, is facilitated.

5.9 Investment ‘Property Two’ is located within the Council’s geographical area. It comprises a fully let neighbourhood scheme which is anchored by a superstore and extends to a site area of 2.95 acres.

5.10 The property comprises a purpose built food-store and six retail units. It was constructed in the 1980s and provides approximately 36,383 sq ft (3,379.98 sq m) of accommodation.

5.11 Due diligence is being undertaken. Approximately 83% of the total income is secured to the food-store, the remainder is a mix of national (6%) and local covenants (10%). The current gross income is £416,550 per annum (current net income is £415,761 per annum) and the weighted average unexpired lease term is 6.39 years to expiry and 6.13 years to a break option (on the food-store). The property benefits from a 214 space open surface car park. The property is held freehold.

5.12 The food-store occupational agreement is subject to a reversionary lease at a rebased rent from £353,750 per annum to current passing rent with six month's rent free from the completion of the lease (effectively extending the lease from 2020 to 2025).

5.13 There will be a review on day one, to no less than £345,000 per annum. The rent free will be 'topped-up' by the Vendor.

5.14 Adopting an assumed acquisition date of 1st September, the initial rent of £415,761 per annum will generate a current income, after payment of the Council's debts costs (based on the expected annuity loan rate, and the assumed acquisition date of 1st September), of £190,923 per annum, after the first year. (At year 1 the repayment charges are less and the return, net of debt charges will be £240,453).

5.15 A purchase price of £5,700,000 has been agreed in principle.

5.16 There is a service charge which is payable by the tenants (based on apportioned percentage contributions on gross lettable floor areas demised.) The Council also has a service charge liability due to adjoining ownership(s).

5.17 External acquisition agents have been engaged to assist with the purchases and also independent Valuers to support the business cases.

5.18 The 'out of area' investment sale has been competitively marketed and we have been advised that a number of parties submitted bids. The business case for the acquisition is set out in Appendix One.

5.19 The 'in area' investment has been marketed for a short period although discussions have been on-going with the Vendor's agent due to the Council being considered to have a 'special' purchaser interest.

5.20 Independent valuation reports have been commissioned for each of the proposed acquisitions and these are contained in Appendices Two and Four. This confirms the purchase prices to represent market value.

5.21 Location and site plans are included in the Valuation Reports in the Appendices.

5.22 The offers made to date are subject to Cabinet Member approval to the items contained in the ‘Recommendation’ section above.

5.23 The acquisitions are to be funded principally through long term borrowing.

5.24 More detailed analysis of the acquisitions and supporting business cases are provided within the appendices attached to this report.

5.25 The investments were introduced to the Council by two Investment agents working for independent firms at different times. Investment One was introduced in May, although the property was not placed ‘under offer’, with agreement to heads of terms until 5th July. In respect of Investment two, whilst the Council has been aware of the impending sale for a period of time, negotiations could not commence. The Investment was placed ‘under offer’ on 28th June but a delay in the completion of the reversionary lease has meant that due diligence (because of uncertainty surrounding the transaction proceeding) could not be progressed until after 25th July. The above has resulted in the necessity to publish details of the two acquisitions at the same time; and for the sake of expediency, together in one report item.

6 RATIONALE

6.1 The rationale for these decisions is largely on a value for money basis, having considered the risks to the Council of not taking them. Documents to support the rationale are contained in the Appendices.

7 OTHER OPTIONS CONSIDERED

7.1 None

8 CONSULTATION

8.1 The decision is being taken under the special Urgency provisions of the Council’s constitution (Rule 16). The Chief Executive, Monitoring Officer (Head of Legal and Democratic Services), Section 151 Officer (Chief Financial Officer) and the Corporate Director responsible for Economy and Growth has been consulted. The Chair of the Resources Policy Development and Scrutiny Panel has been informed.

9 RISK MANAGEMENT

9.1 A risk assessment related to the issue and recommendations has been undertaken, in compliance with the Council's decision making risk management guidance.

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Background papers	None

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