

Bath & North East Somerset Council

MEETING	Cabinet	
MEETING DATE:	20 July 2021	EXECUTIVE FORWARD PLAN REFERENCE:
		E 3293
TITLE:	Commercial Estate Review Update	
WARD:	All	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Appendix 1: Commercial Estate review exec summary Appendix 2: Commercial Estate Workstreams & governance Appendix 3: Aequus repurposing methodology and process		

1 THE ISSUE

- 1.1 The report provides an update to the Cabinet on the outcome of the Commercial Estate review carried out by Montague Evans during the final quarter of the 2020/21 financial year and sets out the next steps in managing the Council's commercial assets.
- 1.2 The report refers to the current position of empty commercial units (voids) and the proposal to invest in these assets to address maintenance issues enabling marketing for new lettings and also consideration for repurposing to a changing in use to diversify the income generating potential.
- 1.3 The report also refers to the devastating impact Covid has had on the visitor economy and on the Council's commercial estate retail properties. This impact has in turn affected the Council's finances. The Council must therefore consider alternative sources of revenue generation from empty commercial properties through identifying alternative use through repurposing.

2 RECOMMENDATION

The Cabinet is asked to;

- 2.1 Note the findings and the executive summary from the Commercial Estate review.
- 2.2 Approve the Commercial Estate review plan, workstreams and governance arrangements and delegate to the Property Review Board / S151 Officer, responsibility for implementing the governance arrangements and required restructuring, respectively.
- 2.3 Approve the Capital budget of £2.337m for Commercial Estate Refurbishment Programme, utilising funding as described in section 5.2.
- 2.4 Approve the creation of a capital reserve to be funded from dilapidation and insurance income relating to capital refurbishments.
- 2.5 Approve the approach to Commercial Estate repurposing to residential accommodation using the Council's housing company Aequus, with delegation for transfer arrangements given to the Chief Financial Officer (S151) in consultation with the Cabinet Member for Resources and Economic Development.

3 THE REPORT

- 3.1 This report provides an update on the Commercial Estate review and the next steps for managing the recovery of the financial impact on the estate from Covid.

Commercial Estate review

The impact of Covid and government lockdowns has been significant on the retail economy in Bath, the Councils 2020/21 revenue budget required a net income return of £15.2m which is income that funds service across the Council including Childrens and Adults Social Care.

The variance to budget at year end for 2020/21 is an adverse position of £8m, of this variance c£5m is due to the downturn in realisable income during 2020/21. This is made up of rising voids, reductions in current market rent and outstanding debt that is now at risk. The remaining £3m is due to a technical accounting adjustment at year end that aligns the billing period and financial year as this needed aligning in the Councils accounts.

Commercial rental income loss has not been supported by government grant reimbursement; this income loss needs to be absorbed by the Council implementing mitigating actions.

Considering this risk a review of the performance of the Councils Commercial Estate has been carried out by Montague Evans.

Montagu Evans report findings:

Appendix 1 contains the executive summary from the review, the high-level findings identify that the Council has around 234 commercial assets and of these 80% are retail. The gross income generated off these is around £18.95m, however this is now at risk, following the income pressures faced by the Council in 2020/21 the income budget has been reduced by £5m for 2021/22.

Whilst there has been a reliance on visitors and tourist income in Bath, the economy remains strong and with rising demand for houses and with flexible working this creates new opportunities.

There is a strong case for change and the Councils Commercial Estate can be a catalyst to create new opportunities. The report and executive summary highlights the following:

Challenge	Opportunity
A Changing Market	Recalibrate offer to welcome tourists whilst reducing income reliance & address the needs of the resident community.
Governance	Develop a clear commercial vision and adapt governance and decision making to be more flexible to respond to market changes.
Investment	Invest and maintain the asset base and bring in resource to manage the portfolio as effectively as possible.
Data and Information	Further develop data to give an oversight of performance and help inform effective decision making.
Heritage	Work with partners and experts to establish Bath as a world leader in zero carbon for heritage.
Expertise	Undertake a review of existing resource and identify the expertise needed to tackle the key objectives.

Mission Statement & Route Map

Given the size and value of the Council's Commercial Estate to Bath and North East Somerset Council and its residents it is important to have a mission statement that will underpin an emerging strategy, this is proposed as:

“To establish the Commercial Estate as an exemplar landed estate, outstandingly governed, and commercially and socially impactful for the residents of Bath and North East Somerset.”

To achieve this a route map will need to be followed as the challenge should not be underestimated, however through good planning, governance and resourcing this is achievable and will create great opportunities. The route map in appendix 1 is summarised below:

Governance	Rolling business plan with objectives
Data	Effective data to drive decision making
Portfolio Structure	Differentiate commercial from traditional structure
Resourcing	Appropriate to investment portfolio size
Accountability	Transparent, empowered, and accountable

3.2 Progress to date

In alignment to the Council's new Senior Management Structure the responsibility for the Commercial Estate function now sits with the Chief Financial Officer (S151). This will create alignment with the development and leadership of the Council's wider financial strategy which includes income generation.

This change is going through its transition phase with the implications on the wider Council Property teams being worked through under the leadership of the Interim Head of Property Transformation.

To enable operational and strategic management of the Commercial Estate the following workstreams have been mobilised to put in place structure and governance. These workstreams report through to the Property Review Board attended by the Chief Operating Officer and Cabinet Member for Resources and Economic Development. The workstreams are as follows:

- Service Performance
- Tenant Management and lettings
- Commercial Estate Recovery and investment planning
- Commercial Estate Strategy and Business plan

The workstream and reporting governance can be found in appendix 2.

The new governance arrangements will enable flexible decision making so the Commercial Estates team can respond to market interest in the B&NES Commercial Estate and have autonomy to enter new lease arrangements. This will encourage an outcome focussed approach that can be implemented at the required pace to keep up with market demand.

The list below highlights some of the achievements to date:

- Interim Structure for Construction Maintenance and FM agreed, applications received for acting up posts
- Draft Asset Strategy complete
- Baseline data provided
- 6 weekly Finance reviews put in place and started
- Compliance Manager JD drafted
- Project Board Created
- Data and Systems Review Brief Approved
- Commercial Estate Workstreams established
- Commercial Hub opening plan in place.
- Establishment of a PMO role
- Additional resource secured to deliver Commercial Estate priorities

Commercial Estate improvement and investment

3.3 The Commercial Estate review has identified that there are commercial units that need investment to enable them to be marketed for new tenants. The first phase of this work identified a capital investment requirement of £740k for 26 units. The works within this programme have been scoped and are progressing through tendering and commissioning, with an estimated completion date of 31st August 2021.

3.4 The phase two feasibility work has been completed and identified that there are further areas of investment required to meet historic maintenance liabilities and separation works to enable re-purposing to take place to enhance commercial return. The high-level programme is set out in section 5.2, a programme contingency is included and as well as provision to ensure Landlord energy efficiency and carbon reduction liabilities will be met, which becomes a legal requirement from 2023. The capital investment required to carry out the improvement works is estimated at £2.337m over two years

Commercial Estate Repurposing

The issue

3.5 The Commercial Estate portfolio has been heavily reliant on retail tenants to meet its annual income target, as highlighted in appendix 1 this makes up around 75% of the annual revenue. This has become a significant financial risk to the Council with trends emerging prior to the Covid pandemic and now crystallising from the devastating impact the Government lockdowns have had on the retail economy. To address this in the 2021/22 budget the Council adjusted its Commercial Estate income budget from £18.95m per annum in 2020/21 to £13.95 per annum in 2021/22.

This is a £5m budget pressure on the Council from income that is no longer deliverable due to increasing voids, current market rent being materially lower than the pre-pandemic levels and a high amount of outstanding debt in arrears on

the estate. This is income that is needed to fund core service provision in other services across the Council such as Children's Social Care and Waste.

The opportunity

- 3.6 To start addressing this challenge and diversifying the income from retail to other areas that are more stable there is the opportunity to utilise our assets and repurpose to other uses such as office and residential. Through the Council's property development company Aequus there is the opportunity to progress the conversion of unutilised retail assets into income generating residential units.

This approach will help diversify the estate and enable the opportunity to utilise Aequus as the Council owned housing company alongside the development of wider plans to explore the delivery of affordable and social housing.

The Council has appraised an option put forward by Aequus. The proposed option includes the leasing on a short term basis of Council-owned commercial units that are not providing the Council with much needed revenue currently. Aequus will convert the properties to residential use (including initial survey, planning consents and refurbishment to a residential specification) and seek to let the resulting residential units. Subject to a management fee and usual landlord costs e.g. maintenance, insurance etc, Aequus would then pass through the balance of rental payments to provide a revenue stream from what would otherwise be long term vacant properties. (Appendix 3 sets out the methodology & process in greater detail)

The Process

- 3.7 The Council would make an unsecured loan to Aequus in order that Aequus can undertake the conversion of the leased commercial properties to residential (the **Conversion Loan**). Once the Conversion works are completed Aequus would pay commercial interest at the secured rate. It is proposed that the Conversion Loan would be written off if the short term lease to Aequus is not renewed or is terminated. The Facility is already in place and the Conversion Loan would sit within that facility. The Council is lending at a commercial rate and the benefit of any write off will reside in the asset which reverts to the Council if the lease is not renewed or terminated
- 3.8 The amount of the loan facility that is available for working capital loans in relation to the cost of associated conversion works being undertaken prior to their transfer to the secured lending rate once the works are completed, will need to be reviewed once the programme has been developed. Any change in the approved loan facility limits will be informed by further scoping and feasibility work being undertaken by Aequus for the Council. It is proposed to delegate the agreement of any changes to the loan facility agreement and limits to the S151 officer in consultation with the Chief Executive, the Cabinet Member for Resources and Economic Development and the Monitoring Officer where this is within existing budget approvals.
- 3.9 To enable the transfer of properties once identified between the Council and Aequus the methodology and process is set out in appendix 3. This aligns with the outcome and the road map from the Commercial Estate review and will

enable the Council to make best use and future proof its Commercial assets to continue generating income for the Council. As the process sets out all transfers will be subject to business case approval to ensure commercial viability before material costs are incurred. Through the Commercial Estate recovery and investment workstream assets will be identified and worked through with Aequus to business case stage, the approval of business cases and property transfers will be managed through the Property Review Board. Transfer decisions will be made through delegation, proposed in this report, to the Chief Financial Officer (S151) and Cabinet Member for Resources and Economic Development.

4 STATUTORY CONSIDERATIONS

- 4.1 The Council may dispose of the properties held in the General Fund under s123 Local Government Act 1972 provided the disposal under the short term leasing arrangements represent the best consideration reasonably obtainable.
- 4.2 The Council may use its General Power of Competence under the Localism Act 2011 to act for a commercial purpose (i.e. take actions to maximise revenue from assets with residential potential in view of the covid-19 pandemic) provided it carries out those activities through a company.
- 4.3 General Consent C¹ may be relied upon for the provision of "financial assistance" to Aequus in the form of the Conversion Loan. Section 24(2)(a) of the Local Government Act 1988 (**The 1988 Act**) provides that financial assistance consists of "a grant or loan to that person" and the General Consent C provides that " a local authority may provide any person with any financial assistance (other than the disposal of an interest in land or property): (a) for the purposes of or in connection with the matters mentioned in section 24(1) of the 1988 Act". Section 24(1) refers to the conversion and improvement of any property which would be the case here.
- 4.4 The Council would need to satisfy itself that it fulfils its fiduciary duty if and when the time comes to take the decision to write off the Conversion Loan but it is expected that the uplift in value of the asset through the conversion works will evidence that.

5 RESOURCE IMPLICATIONS (FINANCE, PROPERTY, PEOPLE)

- 5.1 To manage the implementation of the Commercial Estate review there will be a fixed term resourcing requirement to ensure that additional capacity and skills are brought into the Commercial Estate function to manage and deliver the recovery plan and route map. As this is needed in response to the Covid pandemic a one-off £412.5k allocation of Covid grant has been committed as follows:
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Resource requirement	2021/22 £000	2022/23 £000	Total £000
Commercial agent support	75	37.5	112.5
Business plan and strategy development	100	50	150
Programme co-ordination	50	25	75
Programme budget	50	25	75
Total			412.5

5.2 The programme approval for 2021/22 & 2022/23 is summarised below, along with funding identified from provisional programmes:-

	2021/22 £'000	2022/23 £'000	Total £'000
Programme Approval (Total)	1,810	527	2,337
Dilapidation Payments (3 rd Party Contribution)	267	0	267
Corporate Estate Planned Maintenance (Corporate Supported Borrowing)	601	431	1,032
Commercial Estate Refurbishment Programme (Corporate Supported Borrowing)	942	96	1,038
Total	1,810	527	2,337

5.3 This report is requesting approval for the creation of a new reserve for commercial estate receipt of insurance and dilapidation income relating to capital works. The proposal would be to carry out capital costs from the refurbishment programme when a need arises, subsequently applying the income received, typically after lengthy negotiations to a later programmes, likely to be in future financial years.

5.4 A separate report for consideration at this meeting is for Bath City Centre High Street Renewal (E3260) and notes proposals to seek WECA funding for 'vacant unit action' seeking £255k grant. Proposal will be submitted to bring vacant shops back into active use along with cultural and commercial and arts initiatives. The programme will be used to match fund costs of projects and some grant may become available to provide funds for additional works.

6 RISK MANAGEMENT

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

6.2 The substance of this report is part of the Council's risk management process. The key risks in the Council's budget were assessed by each Director, with these risks re-assessed on a monthly basis as part of the budget monitoring process.

7 CLIMATE CHANGE

7.1 All future maintenance and investment into the commercial estate will need to consider the Council's priority to address the climate emergency and be carbon neutral by 2030. This will require retrofitting and improvements to heritage assets.

7.2 The Council will need to consider the opportunity highlighted in Appendix 1 in the case for change to work with our partners to become a leading authority in zero carbon heritage assets.

8 OTHER OPTIONS CONSIDERED

8.1 Other options considered include do nothing which is not considered a viable option as under the Councils Policy and Budget Framework income to support the wider operating costs and delivery of Council services needs to be managed responsibly and appropriately.

8.2 For assets being considered for repurposing alternative options will be presented through the business case approval process to ensure the best course of action is agreed.

9 CONSULTATION

9.1 Consultation has been carried out with the Cabinet Member for Resources and Economic Development, Directors, Section 151 Finance Officer, Chief Executive and Monitoring Officer.

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Background papers	Property Services review – December 2020 Cabinet https://democracy.bathnes.gov.uk/documents/s63758/E3244%20Property%20Services%20Service%20Review.pdf
Please contact the report author if you need to access this report in an alternative format	