

<b>Item No.</b> 17.	<b>Classification:</b> Open	<b>Date:</b> 18 July 2017	<b>Meeting Name:</b> Cabinet
<b>Report title:</b>		Commercial Property Portfolio: Addition of Income Generating Asset	
<b>Ward(s) or groups affected:</b>		All	
<b>Cabinet Member:</b>		Councillor Fiona Colley, Finance, Modernisation and Performance	

## **FOREWORD – COUNCILLOR FIONA COLLEY, CABINET MEMBER FOR FINANCE, MODERNISATION AND PERFORMANCE**

In 2016-17 the total income receivable from the council's commercial property portfolio was £11.65 million per annum. This is a vital source of income to support council services. However, this income had reduced by £2 million over recent years, as a number of sites have been either sold to help finance the capital programme or redeveloped to deliver new council homes.

In response, in April the council completed the purchase of a portfolio of three properties with an established annual rental income of £1.78 million. A further opportunity has now arisen to add to our portfolio by acquiring another commercial property in the borough. Having carefully assessed the capital value, income yield, financing costs and risks I am recommending the cabinet approves the purchase of this asset.

In this period of decreasing government funding for council services, this capital investment will generate much needed additional income into the general fund revenue budget and help support the delivery of our highly valued public services.

## **RECOMMENDATIONS**

1. That cabinet shall:
  - 1) Note the circumstances leading to the proposed acquisition of the freehold interest in the commercial property in question, and actions and investment due diligence being undertaken by officers and their advisors.
  - 2) Approve the acquisition of the freehold interest in the property, and all related costs.
  - 3) Delegate to the Chief Executive, advised by and in consultation with the Strategic Director of Finance and Governance and Head of Property, authority to:
    - a. Complete the purchase of the freehold interest in the asset;
    - b. Agree detailed transactional terms pursuant to Heads of Terms;

- c. Agree the financing structure to be adopted to fund the acquisition of the assets.

## **BACKGROUND INFORMATION**

### **Income from the commercial portfolio**

2. Rent from commercial property assets is a crucial funding source for council services. The nature, management and performance of the council's portfolio has been extensively reviewed over recent months; culminating in Cabinet giving its approval for a new Asset Management Plan for commercial property in December 2016.
3. Over the last four years, despite continuing improvement in the underlying rents obtainable from individual assets revenues had fallen by approximately £2 million, or 15%.
4. The cause lies in the release of assets in to other initiatives; to generate capital receipts, or otherwise into regeneration, Southwark Regeneration in Partnership Programme and Direct Delivery schemes to deliver a range of corporate priorities. Other significant reductions are expected to take place in the short to medium term.
5. Although a limited number of new income generating assets may be created through regeneration, appreciating that it is not the primary objective of these programmes to provide new commercial properties, officers have looked for other opportunities to replenish the diminishing asset base and incomes derived from it.

### **KEY ISSUES FOR CONSIDERATION**

6. At its meeting of 21 March 2017 Cabinet approved the acquisition of 9 Holyrood Street, Shand House and 22 Shand Street, a small portfolio of three freehold, multi-let office/studio buildings in the London Bridge area.
7. The acquisition was completed in April 2017, providing the council with an established income stream of an additional £1.78 million per annum.
8. An opportunity has been identified to acquire the freehold interest in an additional asset, to extend the income receivable from the council's commercial portfolio.

### **Sale process**

9. The council's offer for the property in question has been accepted in principle by the vendor. This is subject to formal approvals, and subject to exchange of legally binding contracts and simultaneous completion on or before the 21 July 2017. The vendor has issued completed Heads of Terms and the council and seller have entered in to a period of exclusivity to enable completion of the transaction within the timescale specified, if cabinet is agreeable.

### **Financial due diligence and the council's bid**

10. In advance of bidding, the investment opportunity and viable bid level was reviewed by independent property advisors who specialise in the acquisition and disposal of Investment property and are advising the council in this transaction.

11. The council's bid is supported by investment valuations undertaken by the council's advisors in accordance with the requirements of the Royal Institution of Chartered Surveyors Valuation Professional Standards ("the Red Book").
12. Due diligence work including legal and building survey reports has been commissioned.
13. The purchase will provide a commercial return to the council as part of its property portfolio. The rationale for the council to invest can be summarised as follows:
  - An established income stream
  - A favourable yield, which will be significantly above financing costs and interest rates for money on deposit
  - Asset management opportunities to increase rents in the short to medium term and increase the value of the asset
  - Poorer quality assets released into other initiatives mentioned previously will be replaced by significantly better ones in investment terms.
14. As with any investment there is risk. However, the central London property market is perceived to be relatively resilient in times of uncertainty. In acquiring this portfolio there is future investment and strategic potential in an attractive and regenerating location, close to London Bridge Station, More London, Bermondsey Village and Tower Bridge/Butlers Wharf.

### **Community impact statement**

15. In formulating the recommendations of this report the potential impact on the Community has been taken into account, including people identified as having protected characteristics. No specific equality implications have been identified in relation to this report.

### **Policy implications**

16. The holding of investment property to generate income, which in turn is used to fund council services pursuant to agreed policies, is consistent with the new Asset Management Plan for commercial property agreed by Cabinet in December 2016.

### **Financial implications**

17. The financial implications for the council arising from this prospective purchase are contained in the closed version of this report.

### **Consultation**

18. In view of confidentiality requirements and commercial sensitivity in relation to this as yet uncompleted transaction external, consultation has not been undertaken. Internal consultation has taken place with all relevant departments, including the provision of advice from Director of Law and Democracy and Strategic Director of Finance and Governance.

## SUPPLEMENTARY ADVICE FROM OTHER OFFICERS

### Director of Law and Democracy

19. Paragraph 6 of the report refers to the decision of cabinet in March 2017 to authorise the acquisition of the freehold of three office / studio buildings along Shand Street in order to replenish some of the income stream from property investments which has been declining in recent times.
20. The subject matter of this report is a further property also in close proximity to the council offices at 160, Tooley Street which has become available for purchase. As with the Shand Street properties, this office building is subject to a number of leasehold interests (in this case there are 6 (six) separate leases) and which produce a rental income.
21. Approval of cabinet is required in accordance with Part 3C of the Constitution. Section 120(1), Local Government Act 1972 provides Local Authorities with the power to acquire any land by agreement for the purposes of (a) any of its statutory functions or (b) for the benefit, improvement or development of its area. Cabinet Members may therefore make the recommendations as set out in paragraph 1 of this report if they consider this to be appropriate.

### Strategic Director of Finance and Governance

22. This is a strategic investment for the council, which will provide a much needed source of income, whilst offering potential for development and asset improvement.
23. The financial implications are set out in Appendix 3 of the closed report and demonstrate a clear and immediate revenue benefit for the council.
24. This acquisition will allow the council to efficiently utilise existing resources and available external borrowing options to secure an asset with significant and varied long term potential whilst generating a secure source of ongoing funding.

## BACKGROUND DOCUMENTS

Background Papers	Held At	Contact
None.		

## APPENDICES

No.	Title
None.	

## AUDIT TRAIL

<b>Cabinet Member</b>	Councillor Fiona Colley, Finance, Modernisation and Performance	
<b>Lead Officer</b>	Eleanor Kelly, Chief Executive	
<b>Report Author</b>	Matthew Jackson, Head of Property	
<b>Version</b>	Final	
<b>Dated</b>	6 July 2017	
<b>Key Decision?</b>	Yes	
<b>CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER</b>		
<b>Officer Title</b>	<b>Comments sought</b>	<b>Comments included</b>
Director of Law and Democracy	Yes	Yes
Strategic Director of Finance and Governance	Yes	Yes
<b>Cabinet Member</b>	Yes	Yes
<b>Date final report sent to Constitutional Team</b>		7 July 2017