

Item No. 24.	Classification: Open	Date: 11 December 2018	Meeting Name: Cabinet
Report title:		Commercial Property Portfolio: Addition of Income Generating Asset	
Ward(s) or groups affected:		All	
Cabinet Member:		Councillor Victoria Mills, Cabinet Member for Finance, Performance & Brexit	

FOREWORD – COUNCILLOR VICTORIA MILLS, CABINET MEMBER FOR FINANCE, PERFORMANCE & BREXIT

In the last financial year the total income receivable from the council's commercial property portfolio was £13.6 million per annum. This is a vital source of income which supports our highly valued public services in this period of decreasing government funding.

However, as a number of sites have been either sold to help finance the capital programme or redeveloped to deliver new council homes, there have been losses to the council's income from the commercial property portfolio. In response, during 2017, the council purchased four properties in the borough with an established rental income of £2.18 million per annum.

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.

RECOMMENDATIONS

1. That Cabinet shall:
 - 1) Note the circumstances leading to the proposed acquisition of the freehold interests, 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 associated costs
 - 3) Note the fees & costs of approx. 6.8% of the purchase price (professional fees, Stamp Duty Land Tax and VAT) associated with the process leading to completion of the purchase;
 - 4) 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 the 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. During the year 2016/17 total income receivable from the portfolio had declined to £11.65 million per annum exclusive. This represented a £2 million per annum shortfall compared to the figure of £13.65 million in charge as recently as 2013-14.
4. Therefore, revenues had fallen by approximately 15%, despite continuing improvement in the underlying rents obtainable from individual assets; and at a time when other service funding streams have also seen overall reductions.
5. Inevitably the cause has been 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, particularly new homes. We anticipate other significant losses in the short to medium term.
6. 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

Initial Intervention

7. 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 situated close to 160 Tooley Street. The acquisition was completed in April 2017, providing the council with an established income stream of an additional £1.78 million per annum, with growth opportunities and a commercial yield significantly above the level of interest available from money on deposit.
8. Subsequently, in July 2017 cabinet approved the purchase of 7 Holyrood Street, a multi-let office building and development site comprising 12,900 sq ft generating an additional annual rent of £406,000 for the portfolio.
9. In so doing these transactions replaced poorer quality assets released into other initiatives with significantly better ones in investment terms.

10. The proposed purchase would provide a significant commercial return to the council as part of its property portfolio. The rationale for the council to invest largely follows that for the 2017 Shand Street and Holyrood Street acquisitions.

Sale process

11. The council's subject to contract offer for the property has been accepted by the vendor. This is subject to formal approvals, and subject to exchange of legally binding contracts and simultaneous completion on or before the 19 December 2018. 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

12. The investment opportunity and viable bid level has been reviewed by independent property advisors, who specialise in the acquisition and disposal of Investment property, and who have successfully advised the council in other transactions including the acquisition of the Shand Street / Holyrood Street portfolio in 2017.
13. The bid is supported by investment valuations undertaken by GVA in accordance with the requirements of the Royal Institution of Chartered Surveyors Valuation Professional Standards ("the Red Book").
14. Due diligence work including legal and building survey reports is underway.

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 cost of this proposed acquisition, for a purchase price and associated taxation costs and professional fees, is to be fully financed by capital receipts. The current rental income generated by this property will be utilised to support the council's revenue budget commitments.

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. 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. In July 2017, cabinet authorised the purchase of an additional and adjoining site at 7 Holyrood Street.
20. The subject matter of this report is a further commercial property.
21. Approval of cabinet is therefore required in accordance with Part 3C of the constitution.
22. 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.
23. In view of the urgency to progress with the purchase of this site in order to avoid the current owner proceeding with another potential purchaser, external legal advisers have been appointed to act on behalf of the council. Significant improvements to the site have been undertaken in the last couple of years and some reassurance that these works have been carried out competently will be expected. It is noted that the council will be expected to proceed to exchange of contracts (and therefore a legal commitment to proceed to completion of the acquisition) by 19 December 2018.

Strategic Director of Finance and Governance

24. The proposed commercial property acquisition is to be financed in full by use of capital receipts, in part from the council's share from the development of land at Potter's Field.
25. As set out in the main body of the report the acquisition will provide significant ongoing commercial income which can be utilised to support council revenue budget commitments.
26. The use of capital receipts to finance this acquisition creates an opportunity cost, as capital receipts could have been used to finance other council capital expenditure and therefore to reduce the overall borrowing requirement for the council. It is expected that the income generated by this property over the long term is to be substantially greater than any savings that would arise from reduced debt financing costs.
27. For the 2017-18 financial year the council earned gross investment income from investment properties of £13.6m and the total value of investment property assets at 31 March 2018 was £232.4m, which equated to 1.1% of total council revenue and 5.8% of total net assets. The overall exposure to investment property and

reliance on investment property income to support revenue budget spending remains low.

28. The proposed acquisition is in compliance with the requirements of the 2017 CIPFA Prudential Code for Capital Finance.
29. Any such property investment exposes the council to potential risks. The investment case for this acquisition is underpinned by specialist advice, received from GVA and consideration of such risks have been accounted for within the offer price. This investment should provide the council with long term, stable and sustainable income to support council operations.
30. Upon completion of this proposed acquisition; the revenue budget implications will be fully incorporated within the Policy and Resources Strategy for 2019-20.

REASONS FOR URGENCY

31. The vendor has stipulated a timeframe that requires cabinet approval on 11 December and completion of legal formalities by 19 December, therefore the proposal cannot be deferred to the next cabinet meeting. Failure to meet the timeframe will result in the vendor withdrawing from the transaction and the investment opportunity being lost to the council.

REASONS FOR LATENESS

32. It has not been possible to circulate five clear days in advance of the meeting because we were waiting for key information.

BACKGROUND DOCUMENTS

Background Papers	Held At	Contact
None		

APPENDICES

No.	Title
None	

AUDIT TRAIL

Cabinet Member	Councillor Victoria Mills, Finance, Performance & Brexit	
Lead Officer	Eleanor Kelly, Chief Executive	
Report Author	Adrian Sancroft, Principal Surveyor	
Version	Final	
Dated	6 December 2018	
Key Decision?	Yes	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER		
Officer Title	Comments Sought	Comments Included
Director of Law and Democracy	Yes	Yes
Strategic Director of Finance and Governance	Yes	Yes
Cabinet Member	Yes	Yes
Date final report sent to Constitutional Team		4 December 2018