

Part A For General Release

REPORT TO:	Cllr Simon Hall – Cabinet member for Finance and Resources
SUBJECT:	Acquisition of the Long Leasehold interest in 37-39 Imperial Way as a commercial investment
LEAD OFFICER:	Jacqueline Harris-Baker Executive Director Resources
CABINET MEMBER:	Cllr Simon Hall Cabinet Member for Finance and Resources
WARDS:	Waddon
A new Corporate Plan and Medium Term Financial Strategy (MTFS) were agreed by Cabinet in September. The MTFS included an Asset Investment Strategy. The securing of additional net revenue through acquisitions of this type are critical to ensuring that resources are available to deliver the priorities in the Corporate Plan.	

FINANCIAL IMPACT

The purchase of the long leasehold interest will secure a significant annual rental income and opportunities to further enhance the revenue income and capital value through active asset management

FORWARD PLAN KEY DECISION REFERENCE NO.: Not a key decision

The Cabinet Member for Finance and Resources, in consultation with the Leader, is asked to approve the following recommendations:

1. RECOMMENDATIONS

- 1.1 That the Cabinet Member for Finance and Resources agrees that pursuant to the Asset Investment Strategy contained within Medium Term Financial Strategy approved by Full Council on the 8 October 2018 the Council purchases the long leasehold interest in the Selco unit at 37-39 Imperial Way on the terms detailed in this report.
- 1.2 Agrees that, for the reasons detailed in paragraph 3.8 of the Part B Report, the Executive Director (Resources) be given delegated authority, acting in consultation with the Cabinet Member for Finance and Resources, to make any amendments to the terms of the acquisition of the long leasehold interest considered necessary after the decision has been made.
- 1.3 Note that where any significant amendments are made under this delegation, the amended terms for the acquisition of the long leasehold interest for 37-39 Imperial Way will be published on the Council's website within 1 month of completion of completion of the lease.

2. EXECUTIVE SUMMARY

- 2.1 As part of the Council's Financial Strategy presented to Cabinet on 24th September and Full Council on 8th October 2018, the proposal to adopt a full Investment Strategy to generate income to help deliver the financial strategy of the council was formally adopted. This provided authority for property investment purchases that meet the criteria set out in the Investment Strategy to approved under delegated authority from the Cabinet member for Finance and Resources in consultation with the Leader
- 2.2 The Investment Strategy reflects the Council's aspiration to secure medium to long term revenue returns from sound property investment within Borough. It is important to acknowledge that to maximise the benefits from property investments, the assets need to be held for a longer period due to the acquisition and disposal costs and the short term fluctuations in capital values. However, if chosen carefully the revenue returns should be consistent and less prone to fluctuation due to the protection within the lease agreements.
- 2.3 An opportunity has been identified which meets these criteria to purchase an asset that will deliver a secure income over a long period on a key strategic site in Imperial Way. This acquisition is in line with current guidance in respect of prudential borrowing.

3. DETAIL

- 3.1 The Council is looking at the opportunity that investment in property can provide to help generate a secure revenue stream over the medium to long term and also the acquisition of assets that offer future revenue potential with higher returns and unlock the development of strategic sites.
- 3.2 The adopted Investment Strategy sets out the process, targets and an assessment matrix and allows the decision making process to be delegated to senior officers and the relevant cabinet member.
- 3.3 Under the adopted Investment Strategy, all potential acquisitions will be considered against a number of key elements set out within a matrix and these will include:
- **Location** – the proposal is to have all investments within borough unless there are exceptional circumstances to justify an out of borough purchase (eg linked to a wider portfolio of assets, supports local employment or business retention)
 - **Covenant Strength** – to secure the required security of revenue it is important to secure grade A covenants. By exception, weaker covenants may be considered if there are refurbishment/redevelopment benefits.
 - **Tenure** – unencumbered freehold or long leasehold titles without any restrictive covenant terms
 - **Lease terms** – ideally 15-20 years on Full Repairing basis in a single occupation to minimise management costs.
 - **Building Age** – new build or have been subject to a comprehensive refurbishment. Older buildings in sound condition, such as Davis House, may also be considered on the right terms

- **Lot size** – This will reflect the quality of the above requirements but a range of values should be considered to help reduce risk and offer some flexibility.
- **Net Yields** - These must reflect the total costs including SDLT, Agents fees and legal costs together with the cost of borrowing to give a true return on the investment to the Council
- **Property use** – certain uses will not be considered and it is suggested that these follow the requirements of the pension fund
- **Portfolio mix** – to spread the type of investment so that not all investments are in one market sector (Suggested 30% Offices, 20% industrial, 40% other and 10% retail)

The investment will be considered against these criteria and categorised into Excellent, Good, Fair and Marginal investments

- 3.4 The Council commissioned external advice from CBRE in respect of investment opportunities. This advice has been used together with the experience from other Council's and guidance from CIPFA to help formulate the proposed strategy.
- 3.5 An opportunity to acquire the long leasehold interest in 37-39 Imperial Way has been identified and the Council has an opportunity to acquire this unit. Although the asset is currently under offer, the potential purchaser has failed to perform and the seller has withdrawn the papers and given the Council exclusive rights to purchase for a limited 2 week period. This is seen as a good strategic location offering a very secure income stream from the existing tenant together with further opportunities to increase the income potential through market reviews and capital value through active asset management.
- 3.6 The building was originally constructed in the 1900s but has seen extensive recent refurbishment including new build which has created a unit suitable for modern warehouse and trade counter use. It provides a mid-sized unit of approximately 35,000sq ft on an 1.7 acre site with good customer parking to the front and service yard to the side and rear.
- 3.7 The asset is being purchased with the benefit of a 15 year lease to Selco which runs from June 2016 and therefore has approximately 11.5 years remaining at a current rent of £400,000pa. A ground rent, currently £32,000 is payable under the long leasehold title that is being acquired giving a net annual rental of £368,000
- 3.8 The terms of the acquisition are detailed in Part B of this report but offer a secure rental income over the medium term of the lease.
- 3.9 As part of the due diligence work an external valuation has been obtained together with a building survey and full legal report on the leases. The accounts for 2018 have been obtained and an Experian credit check undertaken. Local agents SHW have also been appointed to advise on the purchase
- 3.10 The terms detailed in the Part B report are considered to be favourably and would offer a sound medium to long term investment
- 3.11 The potential acquisition of the asset has been carefully considered in line with the adopted Investment Strategy and a matrix assessment has been completed as set out in the strategy. On balance it is considered that this opportunity

represents a “good to excellent” investment that meets the requirements of the Investment Strategy. The Matrix is included within Appendix 1 of this report.

4. CONSULTATION

- 4.1 Consultation and advice regarding the general investment strategy was obtained from CBRE, local market advice from SHW and independent valuation and building condition advice from Elford Commercial.

5 FINANCIAL AND RISK ASSESSMENT CONSIDERATIONS

5.1 Risks

The principle risk is the commitment of a significant capital sum against the receipt of a rental income stream.

The existing lease has an 11.5 year income stream without any break options. The lease is on a full repairing and insuring basis which will minimise the risks for the landlord. The tenant is an established company that is part of a the Grafton Group plc with very low risk ratings as identified in the Experian report and the lease payment schedule demonstrate no current arrears and sound payment record by the tenant. There is always a risk that the tenant could default but the lease is in a standard form that would allow the landlord to take action should difficulties arise. The covenant strength of the tenant and the current growth being demonstrated by the company is likely to help minimise this risk

The acquisition cost is classed as capital expenditure. The council has the opportunity in the current market to purchase at relatively low fixed interest rates which limit the revenue cost of the purchase.

5.2 Options

As this is the purchase of a long leasehold subject to a lease in place there are few options available other than not to purchase the asset. The Seller requires a straightforward clean disposal as is common with investments and therefore there are no alternative options around the purchase. The Council do not have to purchase the asset but as it already owns the freehold this is likely to offer additional asset management opportunities.

5.3 Future savings/efficiencies

This property will be purchased specifically to generate a net revenue stream after financing costs in the short to medium term.

Approved by Lisa Taylor, Director of Finance, Investment and Risk

6. LEGAL CONSIDERATIONS

- 6.1 The Director of Law and Governance comments that under section 120 of the Local Government Act 1972, the Council has the power to acquire land for the purposes of any of its function. In addition under section 12 of the Local Government Act 2003, the Council has a broad power of investment and may invest for any purpose relevant to the Council’s functions under any enactment or for the purposes of the prudent management of its financial affairs. The

recommendations in this report are therefore within the powers of the Council.

Approved by Sean Murphy, Director of Law and Governance & Deputy Monitoring Officer

7. HUMAN RESOURCES IMPACT

7.1 There are no human resources impacts.

8. EQUALITIES IMPACT

8.1 An initial equality impact assessment has been undertaken and determined that no major change - the Equality Analysis indicates that the proposal to secure the asset through the purchase of the long leasehold interest will have a neutral effect.

9. ENVIRONMENTAL IMPACT

9.1 The purchase of the property will have no environmental impact. Any future changes to the buildings or redevelopment will be in line with current legislation.

10. CRIME AND DISORDER REDUCTION IMPACT

10.1 The site will continue to be managed responsibly and will look to minimise any risks.

11. REASONS FOR RECOMMENDATIONS/PROPOSED DECISION

11.1 The acquisition of the long leasehold asset will provide a significant rental income in the medium term and could offer possible asset management opportunities in the longer term.

12. ALTERNATIVE OPTIONS CONSIDERED

12.1 The opportunity to acquire this asset has arisen through the work currently being done by the Assets team as part of the investment strategy and secure future revenue to support the Councils key service and strategy delivery.

12.2 The only alternative option would be to reject the opportunity on the grounds that it did not represent value for money, was of unsuitable quality or did not meet the proposed investment requirements. The detail provided in the body of the report demonstrates this is not the case,

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BACKGROUND PAPERS: Investment Matrix