

## Part A For General Release

<b>REPORT TO:</b>	<b>Cllr Simon Hall – Cabinet Member for Finance and Resources</b>
<b>SUBJECT:</b>	<b>Acquisition of the Freehold interest for 60 Vulcan Way as a Commercial Investment Asset</b>
<b>LEAD OFFICER:</b>	<b>Jacqueline Harris Baker Executive Director Resources</b>
<b>CABINET MEMBER:</b>	<b>Cllr Simon Hall Cabinet member for Finance and Resources</b>
<b>WARDS:</b>	<b>New Addington South</b>
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 freehold 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.: N/A**

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 freehold interest in 60 Vulcan Way on the terms detailed in this report.

#### **2. EXECUTIVE SUMMARY**

- 2.1 As part of the Council's Financial Strategy presented to Cabinet on 24<sup>th</sup> September and Full Council on 8<sup>th</sup> October 2018, the proposal to adopt a full Investment Strategy to generate income to help delivery 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 on a key strategic site in Vulcan 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 freehold interest in 60 Vulcan Way has been identified and the Council has an opportunity to acquire this unit. This is seen as a good strategic location offering an income stream from the existing tenant together with further opportunities to increase the income potential through market reviews and potential redevelopment of the asset as we will be purchasing with the benefit of planning consent for redevelopment.
- 3.6 The property is currently occupied by Alliance Healthcare as their South London distribution centre and they have been located here for 33 years. The building is in reasonable repair but is dated with limited eaves height compared to modern requirements. The building was originally constructed in the 1950s but has been improved more recently including an increased eaves height section in the middle of the unit to allow higher racking
- 3.7 The lease was recently renewed for a period of 5 years and has approximately 3.5 years left. The lease was agreed on a short term basis by the Administrators in order to be able to sell the asset on. The unit is used as the main distribution centre serving the south east area from the Hampshire/Wiltshire border through to Kent and supplies all the major hospitals and GP pharmacies as well as Boots pharmacies and other chemists throughout this area. The site employs over 300 staff and operates 24 hours a day. The current tenants have invested in the building especially over the last 10 years and anticipate spending a further £250k in the next 6 months to improve the flooring and conveyor belt system.
- 3.8 Alliance Healthcare (Distribution) Ltd had a pre-tax trading profit of c£147m and are Experian rated as very low risk.
- 3.9 Whilst the asset is only being purchased with the benefit of the remaining 3.5 years of the current lease, discussions with the tenant have not indicated that they are looking to move. The lease is a standard Full repairing lease with a current rent of £385,000pa which is based off a low £6.00psf and therefore there is the possibility of an uplift on renewal or securing a longer lease term through re-gearing the existing lease.
- 3.10 In addition the current owners have obtained outline planning permission for up to 59,700sq ft of industrial space and the site could accommodate a number of different layouts due to its rectangular shape which could provide for smaller or medium sized units. This provides some additional long term security regearing the value of the asset
- 3.11 The property has an EPC rating of D and is therefore comfortably within the current requirement for being able to let the property under the MEES Regulations.

- 3.12 As part of the due diligence work an external valuation has been obtained together with a full legal report on the lease and freehold title. Financial checks have also been undertaken. CBRE have also been appointed to advise on the purchase
- 3.13 The terms detailed in the Part B report are considered to be reasonable and would offer a sound medium to long term investment
- 3.14 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, and more recent advice in respect of the purchase from CBRE and Elford Commercial Surveyors for local market conditions valuation and building condition advice.

#### **5 PRE-DECISION SCRUTINY**

- 5.1 The original Investment strategy was presented at Scrutiny on 4<sup>th</sup> September 2018.
- 5.2 The recommended amendments which mainly centred on the reporting and approval governance were included within the revised Strategy that was adopted following Full Council on the 18<sup>th</sup> October 2018.

#### **6. FINANCIAL AND RISK ASSESSMENT CONSIDERATIONS**

##### **6.1 Risks**

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

The existing lease has a 3.5 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. Whilst the existing lease length is relatively short, the property is well suited to the current tenant and they are looking to invest further in the property. The planning consent that has been secured provides security should the tenants not renew.

The tenant is an established company that is part of a the Alliance Healthcare Group 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 over a considerable time period. 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.

## **6.2 Options**

As this is the purchase of a freehold interest 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 this is a key location where they are looking to help secure and develop opportunities longer term.

## **6.3 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 and S151 Officer

## **7. LEGAL CONSIDERATIONS**

- 7.1 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

## **8. HUMAN RESOURCES IMPACT**

- 8.1 There are no human resources impacts.

## **9. EQUALITIES IMPACT**

- 9.1 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 freehold interest will have a neutral effect.

## **10. ENVIRONMENTAL IMPACT**

- 10.1 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.

## **11. CRIME AND DISORDER REDUCTION IMPACT**

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

## **12. REASONS FOR RECOMMENDATIONS/PROPOSED DECISION**

- 12.1 The acquisition of the freehold will provide a significant rental income in the medium term and could offer possible asset management opportunities in the longer term.

## **13. ALTERNATIVE OPTIONS CONSIDERED**

- 13.1 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. 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,

## **14. DATA PROTECTION IMPLICATIONS**

- 14.1 **WILL THE SUBJECT OF THE REPORT INVOLVE THE PROCESSING OF 'PERSONAL DATA'?**

NO

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**BACKGROUND PAPERS:** Investment Matrix