

Commercial Strategy and Investments Progress Report

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Purpose of the Report

1. To update members on progress with the Commercial Strategy and Investments made since the agreement by Council of the Commercial Strategy in August 2017.

Forward Plan

2. This report appeared on the District Executive Forward Plan with an anticipated Committee date of 7th June 2018.

Public Interest

This report updates members on progress made to date in implementing the Council's Commercial Strategy that was agreed by the Council in August 2017. The Commercial Strategy was agreed to support the delivery of the Council's Financial Strategy and aims to protect services for the community and support the delivery of the Council's ambitions and priorities for South Somerset in the context of significant government funding cuts to South Somerset District Council since 2010.

The delivery of the Commercial Strategy includes the purchasing new commercial investments that will generate an income for the Council that is in excess of costs, to help meet the funding targets set in both the Commercial Strategy and the Financial Strategy. The aim of this report is to give Members and the public an update on the performance and impact of the commercial strategy to date including its contribution to mitigating the impact of reductions in Government funding and protecting services.

Due to the sensitive commercial nature of investment acquisitions, and the need to manage risk and protect the value of the Council's investments over the long term, certain detailed information is included in a confidential appendix.

Recommendations

3. That the District Executive:
 - a. Note the progress in delivering the Commercial Strategy and in particular, the acquisition of commercial investments and in securing income from our existing assets

Background

4. In agreeing a new Commercial Strategy in August 2017, Council agreed that regular progress reports on the implementation of the strategy would be presented, including on the Council's commercial investment activity. Therefore this report is for noting the progress made to date by the Council including the newly appointed Commercial Property Team and their work on new investments as well as management of the existing asset portfolio.

5. This report is a succinct update of high level figures for new investments since August 2017. It also updates members on work being carried out to increase income from existing assets.

Property Team

6. The Commercial Property Team were appointed in early 2018 and comprise of the following;
 - Caroline White MRICS - ("CW") Commercial Property, Land and Development Manager (also service manager for Property and Engineering teams)
 - Peter Woodley MRICS - ("PW") Property and Development Project Manager
 - Rebecca McElliott - ("RM") Property and Development Project Manager
7. Through the Transformation Programme, the existing Property and Engineering Team, will cease to exist and the responsibilities of the team together with new, transformed posts, will also come under the management of the Commercial Property, Land and Development Manager. In addition to fulfilling the existing remit of the current Property and Engineering team, the new positions created following agreement of the Commercial Strategy by Council, will work on acquisitions, disposals and maximising potential from our existing assets. The team will also provide support to priority and strategic projects and other key developments.

Review of Assets

8. SSDC has a wide and varied range of assets that have been accumulated over the years. The creation of South Somerset Homes (SSH) in 1998 meant that many assets were transferred via a Large Scale Voluntary Transfer (LSVT) to SSH, now Yarlington, albeit numerous tranches of land were retained for strategic purposes.

After the LSVT, South Somerset District Council retained a portfolio of assets that mainly comprised of operational offices, listed buildings, industrial units, car parks and an assortment of land, i.e. grass verges, open spaces and strategic strips of land. Many of these assets do not generate a substantial annual income and are now in many cases costing the council money through increased maintenance and running costs. Some are surplus to the original requirement but could provide opportunities to generate value through development, being integral to the development plans of others and in so doing, provide direct income and / or indirect income such as Council Tax, business rates and New Homes Bonus grant funding

9. As part of the Commercial Strategy, Council approved a commercial approach to Land and Property management in August 2017. This included undertaking a review of all assets to determine their current and potential value in relation to the Council's operational, strategic, community and commercial objectives.

Commercial Investments

10. Since the introduction of the Commercial Strategy, SSDC has purchased a number of investment properties. This report summarises the high level figures to demonstrate the annual income achieved via rent or sales.
11. As part of the Commercial Strategy the Council agreed that the normal approval process may compromise the commercial interests of the Council. It therefore agreed an investment process which included:
 - a. All potential investments being required to meet the parameters of the Commercial Strategy agreed by Council including rate of return and the creation of a balanced portfolio

- b. All potential investments being required to go through a rigorous assessment and due diligence process including assessment of risk and mitigation
 - c. That investments would be assessed by a newly established Investments and Acquisitions Group (IAG) comprising the Portfolio Holder, Commercial Director, S151 Officer, Monitoring Officer and Commercial Property, Land and Development Manager and that there is a requirement for a unanimously agreed recommendation from this group on investment proposals
 - d. That the final decision on investments be delegated to the Chief Executive in consultation with the Leader, up to an agreed limit (with no such proposals being considered unless a unanimous recommendation comes forward from the IAG).
12. The total amount invested to date is £26,056,000 on four commercial investments. These have been funded through a combination of reserves and borrowing. It is planned to utilise £18.1m of borrowing towards the funding of these investments with the balance from capital / revenue reserves. The costs and funding of each investment is set out in Confidential Appendix 1, Table 2.
13. Investments completed to date include:
 - a) Acquisition of a retail property for rent in Yeovil town centre, occupied by Marks & Spencer - Total Investment - £7.65m
 - b) Acquisition of a retail property for rent in Yeovil town centre, occupied by Wilkinsons (Wilko) – Total Investment - £4.23m
 - c) A land and housing property development in Marlborough - Total Investment - £4.29m
 - d) A battery energy storage facility - Total Investment - £9.84m
14. Through the approval of the Commercial Strategy the Council delegated responsibility to the S151 Officer to select the appropriate funding approach for commercial investments. To date the borrowing requirement for these acquisitions has taken advantage of ‘internal borrowing’ from cash balances through treasury management arrangements. It is likely that, as further strategic investment is progressed and further acquisitions made a proportion of this borrowing will need to be externalised as loans. This will be structured in a way that optimises borrowing costs and advice will be taken from Arlingclose – our treasury advisors – on the best approach to take.
15. The average annual rental / investment income for the three longer term investments is £1,160,000 per annum until 2024, when the annual net income will increase to a forecast £1,585,000 per annum. The Council’s budget going forward will benefit from this income to close the financial gap previously reported to Council in the Medium Term Financial Plan and in so doing, help protect services to South Somerset’s communities.
16. The financial strategy includes an ongoing annual income target of £2m for commercial investment income. This target is net of the costs of increased capacity within the Commercial Property Team as outlined above. The investments made to date are therefore making good progress towards this target.
17. The IAG has considered a number of other potential investment acquisitions including:
 - An energy storage facility in the north-west of England
 - A collection of retail properties in Somerset
 - An energy storage facility in the south-west of England
 - An office block in Somerset
 - Two separate housing developments in Somerset
 - An office block in Devon
 - A retail development in Devon
 - An industrial unit in Somerset

- A trading estate in Somerset
- A retail unit in Somerset
- A trading unit in Somerset
- An office block in Somerset

NB Please note that in addition to the above specific investments a significant number of additional available investments in the market are continuously sent for consideration by agents and private vendors, or researched directly by the commercial property team. These all require an initial period of time to read and consider against the Commercial Strategy investment criteria.

18. However, those specifically listed above have been rejected by the IAG or were rejected by the commercial team prior to consideration by the IAG. This has been for a variety of reasons arising in the assessment and due diligence process including:

- The asking price being in excess of the valuation placed on the investment by the Council/or independent professional advice.
- Unacceptable risk to income in future years.
- Unacceptable risk to the council in the development of the project.
- Vendors not being forthcoming with information required by the council.
- Vendors not presenting wholly accurate information or on analysis of the proposed investment.
- Vendors investment proposals being assessed as unrealistic in terms of the level of return, timing of return or risk.
- Potential investments placing the council's portfolio out of balance through over exposure to a sector or market.
- Due diligence of the tenant's business revealed that they were working in a potentially unethical field/controversial area of business that the council would not wish to be associated with, nor considered to be supporting/benefitting from linked rental income.
- and non-compliance with the Commercial Strategy aims and objectives.

19. Part of the Council's approach includes developing an effective working relationship with agents. Feedback from agents is that there is limited stock currently available generally within the market, resulting in some price inflation. The Commercial Team are working to ensure that SSDC does not overpay for property due to the lack of supply, and is not exposed to undue risk, for example within the retail sector, where significant changes are currently occurring nationally. The Council's Commercial Strategy also aims to create a risk-mitigated and balanced portfolio and therefore we will be selective to agree the best investments and negotiated terms that we can to meet our strategy objectives. Further details of investments considered are included in Confidential Appendix 1.

Battery Storage facility – further information

20. In May 2018 SSDC made its first venture into the new growth market of battery storage by purchasing the freehold of a site close to a large electrical substation. This is part of a £9.5m overall investment projected to produce a minimum net return of 7.5% (after all costs of borrowing are repaid) potentially rising to 14% or more.
21. Battery storage plants store energy for times when electricity suppliers encounter peak demand, such as morning and evening when householders use the most electricity.
22. Selling stored electricity is undertaken via an energy broker (Aggregator) who bids at quarterly auctions to guarantee energy providers stored electricity from batteries. This therefore helps energy providers create stability in supply and balance out peak demand as well as over-supply in

the national grid. The battery operators purchase and store cheaper energy at times of over-supply and then receive an income from selling their electricity to energy companies at times of peak demand and under-supply, on the provision they can provide electricity on demand within seconds of it being required.

23. The site is a rare opportunity as its proximity to a power distribution substation makes connection to the national grid relatively straightforward and cost effective. The site already has planning permission for battery storage use and formal agreement from the distribution network operator (DNO) to connect the battery plant to their substation. Permission has also been secured for installing the required cabling across a public highway. By the end of 2018 the site will be operational and selling electricity to suppliers.

Asset Management Update

Summary Position

24. Having reviewed much of the existing asset portfolio, it is evident there are numerous legacy issues which require working through, from in-house systems to record keeping, implementation of outstanding rent reviews to updating of legal agreements. These changes will enable the performance monitoring of our assets to be more efficient as we move forward.
25. Overall, there has been no substantive change in terms of rental income over the last quarter. However, the review and identification of small parcels of surplus land and property is underway. The first assets should come to the market shortly following the Disposal Asset Group approved procedures. Much of this will generate little by way of capital receipts, although these can be considered for reinvestment to generate better returns elsewhere – in particular to meet the transformation funding target for ‘flexible use of capital receipts’. The disposals will also deliver estate management savings to SSDC, reducing our asset costs for the future and in turn improving the overall quality, values and returns of the wider portfolio. Examples of such assets would be the recently sold Burlingham Barn and the Barwick Follies which are under offer at present.
26. The team is also supporting broader property, land and development projects across the District, in some cases taking the lead role in driving matters forward to deliver regeneration and economic development, maximise SSDC land values and generate business rates, council tax revenues and New Homes Bonus grant funding.
27. The following provides an overall update.

Agreed terms (further detail shown in Confidential Appendix 1):

- Sale of Amenity Land at 74 Holyrood Terrace
- Lease re-gear at 6/7 South Western Terrace to allow local restaurant to expand and facilitating disposal as an investment property
- Re-letting Unit 6 Yeovil Small Business Centre
- Potential occupation of space by new public sector tenant Brympton Way. This will generate an additional rental and service charge income thus lowering SSDC overheads and meeting the One Public Estate Initiative of lowering property costs overall for the public purse.
- Grant of Easement at Essex Close, Chard, to facilitate housing development
- Grant of new lease for office space to Julian House at Petters Way, Yeovil

Acquisitions

- Purchased Land at 30 Fore Street, Chard, to be strategically held as part of the town centre regeneration area.

Commenced marketing of

- Amphora House, Langport
- Unit 8, Yeovil Small Business Centre for let

Current Negotiations

- Grass Verges at 7 to 47 Milford Road – Following an approach regarding disabled access over grass verge at Milford Road, now in discussion with the adjoining property owner regarding disposal of 3 areas of grass verges within cul-de-sac.
- Land in Curry Rivel – Land strip to an adjoining site for housing development, terms agreed in principle based on a percentage uplift in value of adjoining land.
- Mudford Village Hall Car Park – A free to use car park which is leased in from the Village Hall Trust and costs SSDC money in terms of maintenance and management. Concerns over fly parking, which SSDC cannot control under existing car parking order. Therefore, looking to hand back car park to Trust in return for creating some additional overflow parking to ensure long term viability of Hall. This will be an “invest to save” proposal, leading to surrender of lease and loss of obligations.

Disposals to Parish Councils & CAT's

28. Agreed outline terms in principle for restricted disposals (with restrictive covenants and overage arrangements/call option to be passed on) to Parish Councils in respect of:
- Ash Recreation Field
 - West Chinnock Recreation Ground
 - Two small parcels of highway land at Beercrocombe

Completions

- 11 South Western Terrace, Yeovil
- Burlingham Barn, Tintinhull

Financials

29. Potential disposals and potential additional rental income via rent reviews as part of the first phase of disposals have been identified, but are still to be agreed and confirmed for disposal as per the DAG approved process.
30. The team has tendered for and appointed three local Agents to support the team to investigate opportunities, generate value and market surplus assets. Working collaboratively with the Economic Development team and Yeovil Innovation Centre we can also use these agents for the marketing of new lettable units at YIC and YIC2. This platform will assist in raising the YIC profile and secure the best terms and maximum occupancy; in accordance with the agreed terms of the centre's occupancy criteria.

31. Some rent reviews have not been instigated in recent years, potentially due to a lack of perceived rental growth or cost of implementation of reviews outweighing benefit. New leases will, therefore, have automatic uplifts negotiated where possible and appropriate, based on either RPI (subject to minimum and maximum %'s) or a stated %. This will make management easier, ensure rental growth, increase revenue income, add capital value and reduce the associated cost of renegotiating rents on a regular basis.
32. In order to ensure a dynamic process for decision making by the Disposal of Assets Group (DAG), a simplified reporting system has been introduced, setting out the background, recommendations and reasons for minor disposals. Substantial disposals and development agreements will continue through the usual process, as per the approved procedures.

Financial Implications

33. The financial implications for the progress with commercial investments and of asset management activity are set out above within the report and also in further detail in the Confidential Appendix.
34. The Council has approved a large sum for commercial investment. The Commercial Strategy has been live for ten months, and good early progress has been made in establishing the team to deal with acquisition, ongoing management and ultimate disposal of land and property assets including investment properties.
35. This report demonstrates that a number of acquisitions have been progressed, and some have been considered and rejected for a variety of reasons. This demonstrates the strategy is working, with the overall outcome that the Council is making good progress in acquiring a balanced portfolio of investments that is on track to meet overall income generation targets within the financial strategy.
36. Detailed and robust due diligence has been completed with extensive involvement of the Council's finance and legal specialists together with external advisors (e.g. valuers, tax specialists, legal advisers, sector specialists) to support the property team in completing robust business cases that underpin recommendations and investment decisions. The decisions made have been through the agreed governance arrangements as approved by the Council with the Investment Assessment Group providing unanimous recommendations to the Chief Executive and Leader for final decisions.
37. The financial implications of completed acquisitions including costs, income and funding arrangements will continue to be incorporated in budget setting and monitoring processes, in line with the Council's financial procedures framework.

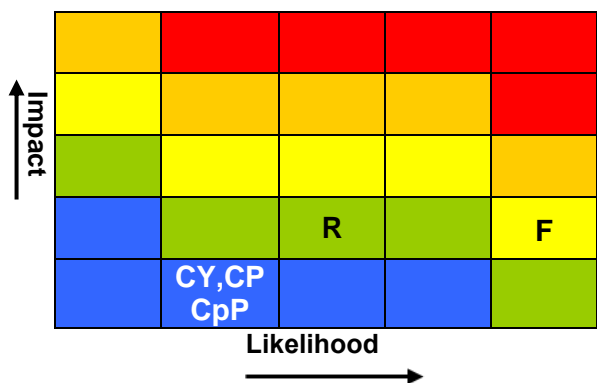
Risk Matrix

The risk position is stable as rental income is currently secure. Sales of the site in Marlborough are due to commence later this year, which will see further income to SSDC.

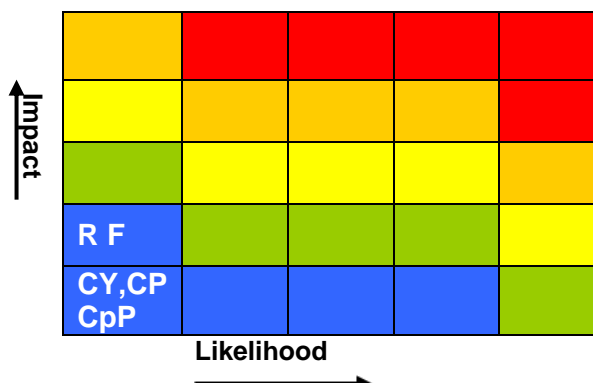
Key

Categories	Colours (for further detail please refer to Risk management strategy)
R = Reputation	Red = High impact and high probability
CpP = Corporate Plan Priorities	Orange = Major impact and major probability
CP = Community Priorities	Yellow = Moderate impact and moderate probability
CY = Capacity	Green = Minor impact and minor probability
F = Financial	Blue = Insignificant impact and insignificant probability

Risk Profile before officer recommendations



Risk Profile after officer recommendations



Council Plan Implications

This report links to the following Council Plan objectives

- Actively manage assets and resources to ensure the best financial or community return
- Seek business opportunities for the council
- Work with businesses and use our assets

Carbon Emissions and Climate Change Implications

The Battery Energy Storage facility will assist in the use of renewable energy in the grid, taking excess electricity produced in off-peak times from renewable production and providing electricity to the grid at peak times, negating the use for fossil fuel based peak capacity systems. The site also has potential to develop a medium sized photovoltaic array but this is not currently part of the investment proposal.

Equality and Diversity Implications

38. This report is for information purposes only.

Privacy Impact Assessment

39. Please consider:

- This report does not contain personal data, apart from names of officers.

Background Papers

- The Commercial Strategy 2017