

Commercial Assets Update Report

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Purpose of the Report

1. To update members on commercial investments and management of the existing asset portfolio since the last half yearly update in December 2018.

Forward Plan

2. This report appeared on the District Executive Forward Plan with an anticipated Committee date of 6th June 2019.

Public Interest

3. This report is to update members on progress made to date since the previous update in December 2018 in purchasing new commercial investments that have been acquired to deliver the objectives of SSDC's Financial Strategy agreed in September 2017 and the Commercial Strategy agreed in August 2017. 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.
4. 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 and not to be disclosed.

Recommendations

5. That the District Executive:
 - a. Note progress made to date in acquiring new commercial investments
 - b. Note progress being made in securing income from our existing assets
 - c. Note progress being made in disposals and transfers of existing assets, resulting in a reduction of future liabilities associated with these assets.

Background

6. While presenting the "Commercial Services Income Update" report to District Executive in February 2018, members requested regular updates to show progress made in meeting the Commercial Strategy (approved by Council in August 2017). Following the update to Members in December 2018, this report is for noting the progress made to date by the

Commercial Property Team and their work on new investments as well as management of the existing asset portfolio.

7. This report is a succinct update of high level figures for new investments since December 2018, updated to 1 May 2019. It also updates members on work being carried out to increase income from existing assets and reduce liabilities. The Commercial Property Team has been stable in terms of staffing since the last report.
8. The former Property and Engineering team, combined with the more recently created Commercial Property, Land and Development Team all becoming the Commercial Property, Land and Development Team from January 2019. The team covers the broad range of property services functions within SSDC, including purchasing new commercial investments and management of the existing asset portfolio.
9. SSDC has a wide and varied range of assets that have been accumulated via various means 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 Yarlinton, albeit numerous tranches of land were retained for strategic purposes, i.e. potential ransom strips.
10. After the LSVT, SSDC 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 ransom strips. These assets do not generate a substantial annual income and are now in many cases costing SSDC money through increased maintenance and running costs. Some, however, provide opportunities to generate value through development, sale receipts and development to also provide Council Tax, business rates and New Homes Bonus grant funding.
11. As part of the Commercial Strategy, Council approved a commercial approach to Land and Property management in August 2017.

Commercial Investments

12. 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.
13. The financial strategy includes an ongoing annual net income target of £2m for commercial investment income by April 2021. This target is net of all costs of borrowing, acquisition, risk reserve and staffing and equates to a 7% return from the investment and a 3% return to the revenue budget. The investments made to date are aiding progress towards this target with commercial income in the 2019 / 20 revenue budget and beyond to protect and support services to the communities.
14. The Council currently has a £36m investment portfolio, comprising eight assets, providing a gross income (before cost of borrowing) of £1.75m per annum, with capital sales expected at Marlborough prior to the end of 2019.

15. A further five investment assets (totalling £17.5m) are under offer, which will increase gross income to £2.84m in 2020. By 2020 the portfolio is expected to deliver a gross return of 7.03%.
16. These have been funded through internal borrowing to date meaning that as well as getting the return on investment, the council is also benefiting from charging of interest on the internal loan. However, the Council is now at a point where it needs to utilise external borrowing. All borrowing will be asset backed (i.e. if the Council wished to pay off the borrowing it will have an asset to sell to achieve this) and are required to produce a rate of return for the Council which meets the Commercial Strategy targets and therefore, covers interest, capital debt repayment and produces additional income to support the revenue budget. In making investments the Council seeks to meet its corporate ambitions as set out in the Council Plan to maximise the benefits to the communities of South Somerset. The costs and funding of each investment is set out in Confidential Appendix, table 1.

Market Commentary

17. Globally the economic outlook is characterised by softening momentum and high uncertainty. In January 2019 the International Monetary Fund estimated global growth to be 3.7% during 2018, softer than earlier predictions, and has suggested continued weak growth in 2019 is likely. In January 2019 the Financial Times reported on the British Chambers of Commerce's suggestion that the UK economy is in a 'weak holding pattern'. They lay the blame at the feet of Brexit and particularly the lack of clarity on how it will be effected, with businesses holding back from any major investment until they understand how Brexit will impact the economy.
18. Brexit is likely to have unforeseen impacts, the majority of which are expected to be negative, at least in the short term. The government's own model suggests a 9.3% hit to GDP over 15 years should 'no-deal' prevail, with a best case 3% under the Chequers deal. In the long term, the independent strength of the UK economy versus the other nations in the EU is likely to be countered by the loss of the benefits of free trade within the EU and purchasing power that the EU enjoys, so the future remains occluded. Oxford Economics have predicted a growth rate of 2.0% by 2020.
19. 2018 saw £62.1 billion invested in commercial property in the UK, indicative of the ongoing appetite, with £8.5 billion invested in December alone. However, growth has begun to tail off; in February all property values dropped 0.3%, largely attributable to the retail sector which lost 1% of its capital value, while industrial and office stock saw nominal increases of 0.2% and 0.1% respectively. Colliers International forecast commercial property returns to slow to 1.2% in 2019, with income return growing 4.8% but capital values shrinking by 3.5%.
20. Markets are still more competitive than when the Commercial Strategy was approved which has meant that opportunities meeting the target returns for the Council have been harder to uncover. Nevertheless the Council remains active in its acquisition process and

the local market is aware of the desire to buy well. We remain confident in achieving the objectives set in the Commercial Strategy for 2021.

M&S, Yeovil

21. Continues to provide annual revenue to SSDC. M&S announced a 7% increase in profits in 2018, and continues to transform its business model, shifting towards food and signing a new home delivery deal with Ocado. Despite a turbulent year, M&S shares on 24th April 2019 were 3.3pts up on the same date in 2018. M&S has announced a significant number of store closures as it continues to modernise its business. Yeovil has not been affected by any proposals thus far. SSDCs investment is linked to a long term lease to M&S.

Wilko, Yeovil

22. The property is tenanted until 2025 by a strong covenant and performs well as an anchor store to the town. There are no indications from Wilko that there is any intention to leave Yeovil. With the sale of Glovers Walk and regeneration of this area of town on the horizon we expect that this will remain the case for the foreseeable future.

Residential Development, Marlborough

23. This development has progressed well and is a few weeks away from practical completion. The three new build houses are effectively complete. The 15 apartments are formed by refurbishment of an existing building. As would be expected, this element has involved a significant number of individual unknown items needing to be resolved. These, combined with the agreed design improvements and some winter weather impact, have extended the construction programme. It remains our expectation that the scheme will be sold out prior to the end of 2019.
24. Agents' forecasts for the Marlborough location show that the capital value of similar residential units has grown this year. The sales of completed homes should generate a healthy receipt for SSDC, that can be reinvested into our town centre regeneration schemes. The additional community benefit of this scheme is that whilst it is out of SSDC area we are using local contractors wherever possible, aiding the local economy.

Energy Storage Scheme

25. The on-site project roll out was completed in April. Members and press were invited to a successful site visit day in March which helped raise awareness.
26. Testing and energisation of the facility is now in the control of National Grid and Western Power Distribution, and we hope to be energised in the coming months. We are working with them to advance final legal agreements and national testing standards sign off as quickly as possible.

27. The valuation of the site, as at 31 March 2019, for our accounts purposes confirmed that the facility and land was valued at more than the project costs expended. This may well rise in terms of the investment Market Value, once energisation and trading was established. Therefore, we expect the investment valuation to have significantly increased by the end of this financial year end and will seek an updated valuation at this time.

Unit 1-2 Dunball Industrial Estate, Bridgwater

28. Purchased in January 2019, this property marks the first industrial investment made by the Council. Industrial property is currently the best performing sector of the commercial property market due to supply and demand imbalance. It was identified as a purchase due to its situation adjacent J23 of the M5 and the likely increase in demand as a result of work at Hinkley Point.

Linden House, Bristol

29. Purchased in February 2019 as a result of the identification of the Central Bristol office market having historically low availability and rental voids. The long-leasehold, quality Grade B offices have been tenanted by the developer, a FTSE 250 covenant, since its construction in 2003.

Imperial House, Newport

30. Purchased in March 2019 this Grade A office is single let as the HQ to a national covenant who formed locally. It is amongst the best office buildings in Newport and is within a mile of J28 of the M4. The office is in excellent condition having been constructed in the 1990's and wholly refurbished in 2013. The opportunity was identified following the removal of the Severn Bridge toll which brings Bristol within half an hour's drive, and is likely to see an upturn in rents locally.

Hotel and Retail

31. A headlease interest in a brand new development comprising hotel and retail unit which will generate a secure long term rental income to SSDC.

Properties Currently Under Offer

32. Properties currently under offer are reviewed in the Confidential Appendix.

Commercial Investments Considered and Rejected

33. SSDC consider some 40 investment opportunities each month. We have a regularly updated set of criteria for agents identifying target yield, lot size, sector, unexpired term, location and tenant.

34. The Commercial Property Team continue to ensure that SSDC's name is in the market place and we are developing a reputation for acting quickly and professionally. This

ensures that SSDC is offered the most attractive opportunities and does not overpay for property.

35. SSDC's Commercial strategy also aims to create a risk-mitigated and balanced portfolio and therefore we will continue to be highly selective, in order to meet our strategic objectives.

Asset Management Update

36. Since the previous update to District Executive in December 2018, a number of enquiries have been received regarding the potential disposal of SSDC assets. These disposals can 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.
37. We have sustained a focus on seeking to identify and deliver small development sites within existing SSDC landholdings. To date 12 pre-applications have been submitted and a number of these have received a favourable response from SSDC Planning. Two outline planning applications have been submitted. The first application is due before committee in June. The second application is in the very early stages and an update will be provided in due course. Following a review of all the available SSDC land ownership data a number of other opportunities have been identified and are subject to further investigation.
38. There are a number of residential and non-residential opportunities in the pipeline and Disposal Assessment Group (DAG) will be updated further as these opportunities progress.

The following provides an overall update:

Agreed terms on SSDC existing assets (further detail shown in Confidential Appendix):

- Extension of Chard Cemetery on SSDC owned land (yard at Zembard Lane and rear of 2 Crimchard)
- Sale of land adjacent 3 Belvedere Road, Yeovil to deliver estate management savings
- Lease for West Street Car Park store to a local charity to provide them with a place to operate from
- Licences for a number of Mobile Banking facilities to operate within SSDC car parks
- Refurbishment of a vacant housing property which will enable the disposal of a smaller, less efficient property

Current Negotiations on SSDC existing assets

- Churchfields, Wincanton potential redevelopment (subject to the relocation of occupants) a report will be brought to District Executive with a final recommendation when negotiations and research has been completed.
- Land rear of Poppy Close and Jasmine Close – potential disposal of land for garden extension
- Potential Community Asset Transfer of West Chinnock Recreation Ground to the Parish Council
- Renewal of lease for Chard Museum to enable future planning and funding

Completions relating to SSDC Assets

- Disposal of land North of Pent House, Penn Hill Park (Yeovil)
- Renewal of lease for business based in Dovecot building, Bruton
- Sale of Amenity Land at 74 Holyrood Terrace, Chard
- Sale of Amphora House in Langport
- Lease of units at Yeovil Small Business Centre
- Licence for youth club, Langport to utilise a section of the car park for outside activities

Disposals to Parish Councils & CAT's of SSDC Assets

- Community Asset Transfer of the Market House, Castle Cary to Castle Cary Town Council

Acquisitions

- Ham Hill Country Park has three landowners and the District Council recently purchased 74 acres of core Country Park land from one of the private landowners. Purchase enables its permanent inclusion in the Country Park and secures the ownership of the sites car parks, ice cream pitch and 14 key heritage assets.

Financial Implications

39. 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.

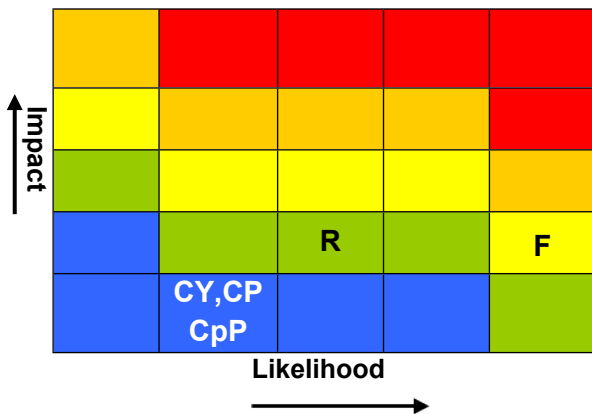
40. SSDC has approved a large sum for commercial investment. The commercial strategy has been live for 21 months, and good progress has been made by establishing the team to

deal with acquisition, ongoing management and ultimate disposal of land and property assets including investment properties.

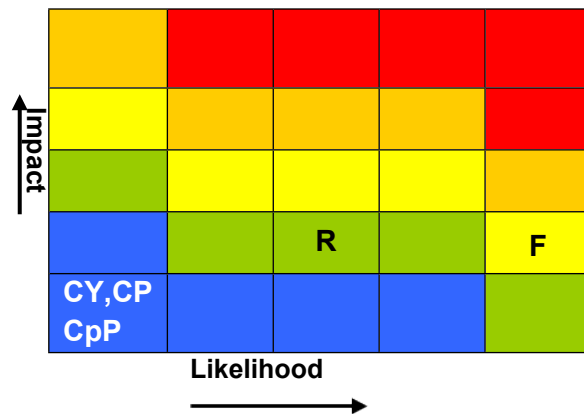
41. This report demonstrates that a number of acquisitions have been progressed, and some have been considered and rejected for a variety of reasons. This demonstrates the strategy is working, with the overall outcome that SSDC is making good progress in acquiring a balanced portfolio of investments that is on track to meet overall income generation targets within the financial strategy.
42. Detailed and robust due diligence has been completed with extensive involvement of SSDC'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 SSDC with the Investment Assessment Group providing unanimous recommendations to the Chief Executive and Council Leader for final decisions. Arrangements have been reviewed by Internal Audit and the minor improvements recommended have been implemented
43. 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 SSDC's financial procedures framework.

Risk Matrix

Risk Profile before officer recommendations



Risk Profile after officer recommendations



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

Council Plan Implications

This report links to the following Council Plan objectives:

- Protecting Core Services
- Take a more commercial approach to become self-sufficient financially
- Supporting the Regeneration of Chard, Yeovil and Wincanton
- Supporting local businesses

Carbon Emissions and Climate Change Implications

None

Equality and Diversity Implications

This report is for information purposes only

Privacy Impact Assessment

There is no personal information included in this report

Background Papers

- SSDC Commercial Strategy 2017
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