



Agenda Item No: 7

Report to: Cabinet

Date: 24th September 2020

Report Title: Corporate Property Performance Annual Report 2019/20 and update to the Property Acquisition, Investment and Disposal Strategy

Report Author: Philip Bond, Senior Commercial Estates Officer

Portfolio Holders: Cllr Clokie, Portfolio Holder for Corporate Property and Projects.

Summary: The revenue generated by the Council's corporate property portfolio contributes significantly to the Council's income. The income generated for the financial year ending March 2020 is shown in the Corporate Property Income Schedule attached at Appendix 1.

This report provides a summary of how our main commercial assets are performing and the work the Council is undertaking to improve or maintain such performance.

Whilst this report looks back to the financial year 2019-2020 due to the unparalleled events over the past 18 months such as the collapse in the retail shopping market, the impact and uncertainty caused by Brexit and the coronavirus pandemic this report will also consider what impacts these events may have on the council's property portfolio in the short term.

In this context the Council is reviewing its asset base in line with its agreed Asset Management Strategy and will be considering opportunities to dispose of assets which will assist in the replenishment of its capital reserves, which will not detrimentally affect the running of Council's activities. As a result of considering these opportunities it has become clear that the Property Acquisition, Investment and Disposal Strategy does not specify a financial constraint on disposal of assets and the Strategy has therefore been amended to be transparent.

Key Decision: No

Affected Wards: None specifically

Recommendation: That Cabinet is asked to recommend to the Council to:

- b) note the revenue performance of the Council's corporate property portfolio during the financial year 2019/2020 as provided for in the Corporate Property Income Schedule attached at Appendix 1 and;
- c) note the risk assessment in relation to the council's future income from its commercial assets particularly in light of the impacts of the coronavirus pandemic and
- d) approve the clarification added to the Property Acquisition, Investment and Disposal Strategy as provided in the attached Appendix 2.

Policy Overview: The Council's investment in commercial property and development opportunities is crucial to delivering *"a viable and sustainable replacement for Formula Grant"*. This is one of the underpinning parts of the council's Corporate Plan.

Financial Implications: The financial implications are detailed in the Corporate Property Income Schedule attached at Appendix 1.

Legal Implications: An amendment to clarify the Property Acquisition, Investment and Disposal Strategy previously approved

Other Material Implications: There are none.

Risk Assessment

The portfolio is risk assessed on a regular basis, prior to any acquisition, potentially with disposals and during the budget monitoring updates.

The risks relating to each property are assessed at the time of acquisition and disposal as part of the insurance renewal process and where the tenants change. This report considers a detailed assessment of the potential threats that the coronavirus pandemic may have on income from commercial assets.

Equalities Impact Assessment: Not applicable.

Appendices: **Appendix 1 – Corporate Property Income Schedule 2019/2020**

Background Papers: Annual reports are presented to Cabinet each September.
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Report Title: Corporate Property Performance Annual Report 2019/2020

Purpose of the Report

1. This report, which comes to Cabinet annually, reports on the revenue performance of the Council's corporate property portfolio during the previous twelve months. It also advises of the work undertaken to increase and maintain the profitability of the portfolio and investment activity during the past twelve months and going forward. It also seeks approval of a delegated authority to dispose of assets up to a value of £2 million to replenish capital reserves which have been affected by the coronavirus pandemic on the council finances and a delegated authority for the decision to dispose to be put into effect.

Background

2. In March 2015 the Government produced a four year financial settlement for Local Government, the net effect of which was to reduce revenue support grant funding to zero by 2019/20. The Council, having been aware of the impending changes for some time, had taken steps to mitigate against the impact of this to ensure the uninterrupted delivery of Council services. This approach included the acquisition of property for investment purposes which can bring with it the additional benefits of borough wide regeneration. Disposals of assets have always been a part of the strategy but will now have a greater focus in assisting to replenish capital reserves.

Financial Implications

3. The income generated from the Council's corporate property portfolio during the period April 2019 to March 2020 is shown in the Corporate Property Income Schedule attached at Appendix 1 and has been reported previously in the council's end of year outturn. The return is calculated in respect of the historical cost of the asset (the purchase price). The surplus for this period (before internal recharges) is approximately £2.41m on a total income of approximately £5.0m.
4. The surplus for 2019-2020 is approximately £550k higher than 2018/2019. This increase has primarily been caused by an increase in income from more recently acquired assets and reduced liabilities in older assets.
5. The increases in income have predominantly been created through increased rent from Elwick Place as 2019/2020 saw the first full year of operation and the acquisition of the Matalan site on Brookfield Road.
6. Contained within the Corporate Property Income Schedule attached at Appendix 1 "rent income from general fund" distinguishes the rents collected from third parties to those rents charged to other Council services. Internal recharges are overheads and expenses apportioned

pro-rata to each asset. The inclusion of internal recharges results in a more accurate calculation of return on investment.

7. It should also be borne in mind when considering the income generated by the Park Mall shopping centre, that it was not acquired as an investment but rather for regeneration purposes and to reinvigorate the town centre.

Performance & Asset Update

8. Over the previous twelve months a number of activities and initiatives have been undertaken with a view to improving the management and profitability of the real estate portfolio including the purchase of a number of new assets. Further details are provided below.

Asset Management

9. The Corporate Property Service have recently started to develop an asset management system that will allow the council to establish and maintain a shared central corporate property asset database. This will assist with identifying asset specific compliance and risk assessments and will help with efficient and consistent property management and reporting.
10. The system being used is the Asset Management module on the council's ABAVUS system. ABAVUS is a multi-channel, modular and fully configurable platform used by other services. This system, once built out, will provide readily accessible information on assets such as basic property data and attributes, safety related information such as statutory compliance data as well as documentation and plans related to assets .

Elwick Place

11. In December 2018 the council took possession of Elwick Place, a new retail and leisure development on Elwick Road. Built on the site of the old Ashford market the development is intended to grow the night time economy in Ashford and become a destination in its own right.
12. The development comprises of a hotel and cinema with the two anchor tenants of Travelodge and Picturehouse and 10 retail units.
13. The 2019/2020 financial year has seen the first full year of operation since the council took possession. Travelodge saw a strong uptake of rooms during the financial year and Picturehouse saw an encouraging increase in customers during the same period. During this period Macknade opened in unit 1 of the development and they had a strong start to trading although the impact of the coronavirus pandemic (to be discussed later in this report) significantly curtailed their operations. During the year Snap Fitness also opened a gym in the development.
14. As reported last year since the development was planned and designed there has been a significant change in the retail sector. The impact of the coronavirus pandemic has only exacerbated the situation in the retail and

leisure sector. The impact of how we leave Europe is also unknown at this time as is the the impact it will have.

15. However, against this background, the council and its development partner, Stanhope plc, has been in negotiations with a number of parties interested in taking up leases within the development. At the time of writing this report we are at an advanced stage in lease negotiation for four of the units and have received proposals for a further three units. Whilst there is still uncertainty in the retail and leisure market, if the four leases that are being negotiated are signed, it is possible that the majority of the development may be let by Christmas or the New Year.

International House

16. International House continues to perform well and is currently operating with an occupancy level of approximately 94%, an increase of around 4% on the previous year.
17. During 2019/2020 we successfully let over half of the 11th floor which has led to both an increase in rent and a reduction in service charge and business rates liability. We also secured a long term lease for the 5th floor and extended a number of existing leases covering approximately 12,000 square feet of office space.
18. It is expected that the significant changes that the pandemic have caused will have a negative impact going forwards and this will be discussed later in this report.

Park Mall

19. The council purchased the long term leasehold of Park Mall in 2015. The purchase was made to support the council's long term aspirations to develop and regenerate the town centre and, as such, was not made as a commercial investment. At the time of purchase approximately 30% of the units were vacant with those that were occupied being predominately charity shops.
20. Since the purchase the council has worked hard to develop the shopping centre and encourage traders to move to it. There is only one charity shop now in the centre and the occupancy rate for Park Mall is approximately 88%. Whilst the centre lost 3 tenants during the financial year we are currently in discussions with a couple of potential new tenants that would boost occupancy.
21. Members are reminded the Council acquired the facilities principally for regeneration purposes as such the facilities are now starting to require substantial repairs, these costs were reflected in the price paid at the time of the acquisition. Consideration should now be given to looking at the options for the facilities and how these may be brought forward in the current financial climate.
22. However, it must be noted that since the end of last financial year the retail sector has been significantly affected by the coronavirus pandemic

which led to most of the units to close due to the Government lockdown. The potential impact on trading at Park Mall will be discussed later in this report.

Commercial Quarter

23. In 2016 the council reached agreement with Quinn Estates to lease approximately 18,000 square feet of office space across two floors in the new Connect 38 office development on Dover Place. The lease of the two floors helped improve the viability of the scheme and helped ensure the delivery of the first phase of the council's ambitious plans to develop a commercial quarter near to the International Station, one of the council's big 8 projects.
24. During the financial year 2019/2020 the council successfully entered into two new long term leases for approximately 5,200 square feet of the vacant floors leading to increased rent and a reduction in service charge and business rate liability. At the end of the last financial year we had successfully let approximately 14,200 square feet leaving just 3,800 square feet left available to let.

Garages

25. The Council's garage holding of approximately 1500 garages makes a significant contribution towards the Council's income each year. As part of the garage commercialisation strategy the council has been undertaking structural and asbestos surveys to feed into the planned maintenance strategy that is being implemented.
26. As a result of this the council has been able to introduce more targeted maintenance interventions focused on extending the life of the better performing garage areas which should secure longer term revenue.
27. The council continues to improve upon the management and profitability of our garage sites that are viable and to look for alternative uses for those sites which are not. Later on in this report the disposal of lower value assets will be considered

Carlton Road Business Park

28. In September 2017 Cabinet approved the purchase of a development of light industrial units being constructed on land at Carlton Road by Gallagher Properties Limited. The development was completed and passed into council ownership towards the end of 2018.
29. Lettings of the units had been slower than originally anticipated due to a mixture of concerns surrounding Brexit and the sites operating hours. However since the election in December 2019 and the confirmation that the UK would be leaving the EU there has been a significant rise in market interest and resulting leases. In addition the Council has recently been successful in a submission to the Local Planning Authority and the operational hours are now in line with the market demands for these types

of facilities

30. During the financial year 2019/2020 two new leases were completed to add to the two units already occupied. Since then a further lease has been completed and Heads of Terms have been agreed on a further two units and are currently going through the legal team for completion. A further two units have terms agreed in principle and discussions on a further three units are progressing well. If this current trajectory of interest and completions continues it would be hoped that the level of occupancy at Carlton Road Business Park should exceed 33% by the end of the current financial year.
31. Further to the increased commercial interest in the site, it has played a major role in the council's response to the coronavirus pandemic. The council used some of the larger units to act as the storage and distribution hub for the council's emergency food distribution response to the pandemic providing food and supplies to the most vulnerable in the borough.
32. In addition to the council's usage of the site we were able to work closely with and support the Ashford Vineyard and Fare Share charities who used the site to base their food distribution network. This co-location of hubs meant that the logistics for the distribution of food and goods was greatly simplified and Fare Share have been highly complementary about the support the council was able to provide.

Matalan

33. In April 2019 the council completed its purchase of the freehold of the Matalan site in Brookfield Road, Ashford. The opportunity presented itself when the existing owners brought the site to the market in February 2019.
34. The site is a key strategic site and as such forms one of the gateways into the town marking the change from rural Ashford to town centre Ashford located on the approach into the town centre on the A28.
35. The investment provides an income stream to the Council as well as being a long term strategically important site as there are a number of options available to the Council for the longer term occupation or development of the site, should the current leaseholder vacate.

Risk Assessment: Retail

36. The portfolio is risk assessed on a regular basis through internal monthly reviews and the quarterly budget monitoring cycle. However, as has been mentioned throughout the report, the council could face significant pressures during the current financial year due the impact of the coronavirus pandemic and the Government's lockdown in response.
37. The retail sector had already been facing significant pressure in the run up to the pandemic primarily caused by a shift in shopping habits from town

based to on-line shopping. With the enforced closure of most retail and leisure establishments for at least three months the impact on the retail and leisure sectors has been immense even with significant levels of support provided by the Government.

38. The list of chains to have gone into administration is extensive and includes the likes of Monsoon, Oasis, Oak Furniture Land, Go Outdoors, Harveys, DW Sports and Debenhams. Whilst many of these were already struggling prior to the pandemic the forced closures were the final straw for many of these chains.
39. Whilst none of the above chains are tenants of the council, the council has not been immune to the impact of the pandemic. Both Travelodge and Poundstretcher, council tenants at Elwick Place and Park Mall respectively have entered into Company Voluntary Arrangements.
40. A Company Voluntary Arrangement (CVA) allows an insolvent limited company to pay creditors over a fixed period. If creditors agree to the CVA then the company can continue trading. As a result of these CVAs, whilst the council will see a reduction in rental income, it benefits from still receiving a reduced income that it would not have received in the event the companies had collapsed.
41. In addition to the well-known brands smaller independent retailers have also been heavily impacted over the course of lockdown, in particular our tenants at Park Mall. Whilst all of our smaller tenants have re-opened we appreciate that they may struggle for some time particularly if there is a second wave of the pandemic that leads to a further national or local lockdown. The reductions in the revenue income in this current financial year have been reported to Cabinet as part of the Council's budget monitoring.
42. In order to support our tenants throughout the Council's Property Portfolio, the Economic, Regeneration and Investment Board ("ERIB") agreed that officers should consider how the council could support tenants facing financial difficulties due the pandemic. The council has received a number of request from tenants for support and these will be considered by ERIB in the future.

Risk Assessment: Office and Industrial

40. Whilst the main impact to date of the pandemic been focused on the retail and leisure sectors the office and industrial sectors have not been immune. Although far less affected we have had a number of office and industrial sector tenants facing significant impacts to their business.
41. These have primarily been businesses that service the retail and leisure sectors or else those that provide services in a 'face to face' manner that have not been possible during lockdown. We have received a number of requests for support from these sectors and due consideration will be given the requests as detailed above through ERIB.

42. However, perhaps the most concerning impact that the council may face in the future is in the changing use of office accommodation. As has been demonstrated the ability for companies who traditionally have an office based culture to let staff work from home successfully has been significant. Indeed, the council itself was one of these organisations that was able to successfully manage the transition to home working.
43. This successful transition has already led many businesses to review or to start to review their working practises, especially in relation to home working. The impact on office rental values has already started to be seen in major working hubs such as London although this has partially been caused by the concern of company staff having to travel on public transport.
44. Whilst the first impacts on rental values and office usage will be seen in London, business areas further outside of London, such as Ashford, will still be affected. Indeed we are already aware of some tenants reviewing their office usage. At the moment however, we do not expect to see a sudden reduction in office rental values and the option for existing tenants to change their current office usage is limited to when their leases come up for expiry.
45. At this time is not possible to predict the potential impact this may have on council revenues, particularly from International House, however this will be monitored closely and any clear trends that develop both nationally and locally will be taken into account when accessing the risk to income.

Disposal of Assets

46. In January 2014 the Council approved the Property Acquisition Investment and Disposal Strategy (“PAIDS”). This strategy led to the introduction of a Member Panel (now known as ERIB) which would assist in the purchase and disposal of properties and whereby decisions would be made in a timely and efficient manner following the criteria as outlined in the strategy.
47. Under the strategy ERIB is able to approve expenditure up to £2 million per annum financed by prudential borrowing (if necessary), for acquiring and, where required, to carry out adaptations to investments.
48. Whilst the strategy was clear on considerations that must be given to the disposal of assets it did not set any financial constraints on what ERIB could approve.
49. Asset disposal is an important tool in the overall asset management function. Assets currently being considered for disposal include residential properties held by the General Fund which are not now required for regeneration nor required by the Housing service.
50. One of the key roles of ERIB is to act in a timely and efficient manner. However there are no financial limits set out in the disposal section of PAIDS so the financial value of asset disposals that ERIB can give an

opinion on is not clear and transparent. It is therefore proposed to limit this value to £2 million per annum to match the ERIB approval level for acquisition and investment expenditure.

To enable this the Cabinet is therefore asked to approve the addition of the words, "Such disposals shall be limited to £2million per annum in line with the limits in this Strategy relating to acquisition and/or investment." to clause 6 of the Property Disposal Process of PAIDS as set out in Appendix 2. Opinions recommended by ERIB are referred to the next available Cabinet meeting for information/decision as per the terms of reference.

Conclusion

51. The Council continues to achieve significant income from its commercial property portfolio that helps to support the council's budget and the services it provides. However, as has been noted in this report, the future impact of the coronavirus pandemic could have a material impact on council revenues from its commercial assets in the future.

Portfolio Holder's Views

52. 'We have to accept that because of Covid the Council will face rental income reductions, however Officers are working hard to reduce the potential impact on the Council's finances.'

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Appendix 1 - Corporate Property Income Schedule 2019/2020

	Commercial Quarter	Court Wurtin	*Industrial Estates	*Garages	Carlton Road	Elwick Place	Stanhope Shops	Wilkinson 1 Park Mall	Park Mall	*Bockhanger Com Props & Centre	*Brookfield Com Prop	International House	Matalan	*Civic Centre	Tenterden Gateway	Sustainable Energy Project	*Minor Holdings	Total
Total income	192,853	22,220	452,669	527,243	3,474	411,751	113,025	314,000	652,095	29,400	46,476	1,599,253	331,750	117,607	49,470	91,138	67,535	5,021,958
Total expenditure	(516,254)	0	(18,200)	(112,183)	(80,069)	(240,902)	(1,440)	0	(644,846)	(5,240)	(710)	(800,479)	(606)	(87,923)	(59,104)	0	(42,822)	(2,610,779)
Surplus/Deficit	(323,401)	22,220	434,469	415,061	(76,596)	170,849	111,585	314,000	7,249	24,160	45,766	798,773	331,144	29,684	(9,634)	91,138	24,714	2,411,179
Historical Cost	0	0	2,780,000	2,820,200	7,128,954	36,950,639	1,032,000	3,560,000	823,500	217,000	467,200	7,900,000	5,030,939	202,900	0	185,000	1,045,700	
Return	0.0%	0.0%	15.6%	14.7%	0.0%	0.0%	10.8%	8.8%	0.9%	11.1%	9.8%	10.1%		14.6%	0.0%	49.3%	2.4%	
Less internal recharges	0	0	(78,370)	(16,414)	(1,528)	(1,082)	(3,755)	0	(63,130)	(1,643)	(8,427)	(62,072)	(38)	(90,490)	(26,211)	(19)	(15,935)	(369,115)
Rent income form GF	0	0	0	0	0	0	0	0	23,510	0	0	0		0	0	0	0	23,510
Net income after recharges	(323,401)	22,220	356,099	398,646	(78,124)	169,767	107,830	314,000	(32,371)	22,517	37,339	736,701	331,106	(60,807)	(35,845)	91,119	8,779	2,065,575
Return on investment including recharges	0.0%	0.0%	12.8%	14.1%	(1.1%)	0.5%	10.4%	8.8%	(3.9%)	10.4%	8.0%	9.3%	6.6%	(30.0%)	0.0%	49.3%	0.8%	

* Based on 2007 Historical value

Civic Centre costs based on 15% of overall costs

Appendix 2 – Updated Property Acquisition, Investment and Disposal Strategy

Property Disposal Process

1. Definition of Surplus/Under-used:-

Property or land is deemed to be surplus to the Council's requirements if:-:

(a) it makes no contribution to the delivery of the Council's services or Corporate priorities nor generates any income, and it has no potential for future service delivery or strategic or regeneration and /redevelopment purposes, or

(b) Property or land site has been identified which would achieve a more cost effective service delivery and the existing site has no potential for future alternative service delivery or strategic or regeneration/redevelopment purposes.

2. Property or Land is deemed to be under-used if either:-

(a) the income being generated from the property/land is below that which could be achieved from:

- (i) an alternative use
- (ii) disposing of the property/land and investing the income
- (iii) intensifying the existing use, or

(b) part of the Property/landsite is vacant and is likely to remain vacant for the foreseeable future.

3. Site Identification

Sites for possible disposal may be identified in the following ways-

- a) By application from a proposed purchaser.
- b) Through Local Plan designation.
- c) Through Service Units declaring specific sites as being surplus to requirements*
- e) Through identifying previously unidentified surplus land from the land realisation programme review which was undertaken by an independent consultant together with information gathered from the Terriers or Land Registry searches.
- f) Ward members

(*where an under-used asset is generating an income, a Cost/Benefit analysis should be carried out, in consultation with the Finance Manager, to establish whether it is in the Council's best interest's to dispose of the Property/land).

4. Site investigations

Once a potential site has been identified, the Strategic Housing and Property Manager will consult with the Statutory Authorities, Portfolio Holder for Resource Management along with the relevant Portfolio Holder for the Service if appropriate and Ward Member as well as internal Council departments, to establish whether there are any development constraints on the site. Ground investigation works, and desk studies into previous land use history, will also be carried out where appropriate.

The local ward member will be consulted to ascertain the views of the local community.

5. Land Use

Unless a site is already designated for a specific use in the Local Plan, the above consultations will indicate the preferred type of development for the site. This will be either:

- a) Housing - Social
- b) Housing - Private
- c) Industrial/Commercial
- d) Leisure/Community

If a site is identified for (a) to (c), then it will be referred to the Head of Community and Housing for further consideration.

If a site is identified for (d), then further consultations should be undertaken with the Head of Culture and the Environment. If any other use is identified, the possibility of development by the Council is to be considered first. If development by the Council is not required for investment purposes or social provision, then the site may be brought forward for disposal.

6. Independent Valuation

All sites will be sold at not less than market value unless the Council decides that a figure below market value is appropriate. Where the disposal of a site is being considered which is outside the delegated authority of the Head of Community and Housing or considered

necessary due to the particular circumstances of the Property/Land (eg. a requirement of a funding body), then independent valuation advice will be sought from the District Valuer or from a suitably qualified valuer.

7. Method of Disposal

The Strategic Housing and Property Manager, following advice from a suitably qualified valuer, will recommend a method of disposal e.g. Auction, Private Treaty etc., for acceptance by the Member led group put in place under the Property Acquisition Investment and Disposals Strategy. Unless a “special purchaser” has been identified i.e. one who is prepared to pay a premium for the site (over and above market value), all potential purchasers are to be given an opportunity to tender/submit an offer.

Where the disposal is to be by way of a long lease, the Financial Manager will be consulted to assess the implications regarding VAT, Capital Controls and Treasury Management.

8. Marketing Strategy

The Strategic Housing and Property Manager, following advice from a suitably qualified valuer, will recommend a marketing strategy, either in-house or through the Council’s retained agents, for acceptance by the Member-led group referred to in 7 above. All staff costs, legal costs, marketing costs, consultants costs etc. associated with any potential disposal of an asset (even where such costs do not lead to an actual disposal) are to be re-charged to the cost centre for asset management.

9. Timing

The timing of any marketing/disposals will need to be considered against the background of the Council’s budgetary requirements, together with the current state of the market. Before recommending that a disposal is to proceed, the following factors are to be taken into consideration:

- Management Team to be advised of pending disposal
- Current market conditions
- Potential for the Property/land value to increase in the future
- Regional Planning Guidance and the Local Plan process - this will influence decisions on the
- Disposal (and acquisition) of Property/land, as well as the future use of individual sites.

10. Marketing

If no objections are received, the marketing strategy is to be commenced, with a view to identifying a purchaser.

11. Negotiations

The return from any disposal is to be maximised unless there are over-riding factors identified within the Corporate Plan which take precedence over the receipt of capital. Where a site is sold at a price below open market value, the matter is to be reported to the Executive as part of the next budget monitoring report. A sale of land at a price below open market value may require the consent of the Secretary of State under the provisions of the Local Government Act 1972 unless it falls under the General Disposal Consents.