Agenda Item No:	8
Report to:	Cabinet
Date:	12th September 2019
Report Title:	Corporate Property Performance Annual Report 2018/19
Report Author:	Philip Bond, Commercial, Development and Regeneration 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 2019 is shown in the Corporate Property Income Schedule attached at Appendix 1.

The Council is constantly exploring both ways to make the existing portfolio more profitable and additional investment opportunities. An update on the work done in this regard is provided in the report.

Key Decision:	No
Affected Wards:	None specifically
Recommendation:	That Cabinet is asked to;

i. note the revenue performance of the Council's corporate property portfolio during the previous twelve months as provided for in the Corporate Property Income Schedule attached at Appendix 1 and;

ii. note the work undertaken to increase profitability and investment activity during the previous twelve months and going forward.

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 considered in detail in the Corporate Property Income Schedule attached at Appendix 1.

Legal Implications:	There are none.
Other Material Implications:	There are none.
Risk Assessment	The portfolio is risk assessed on a regular basis, prior to any acquisition and during the budget monitoring updates. The risks relating to each property are assessed at the time of acquisition, as part of the insurance renewal process and where the tenants change.
Equalities Impact Assessment:	Not applicable.
Appendices:	**Appendix 1 – Corporate Property Income Schedule 2018/19**
Background Papers:	None.
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Report Title: Corporate Property Performance Annual Report 2018/19

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 the profitability of the portfolio and investment activity during past twelve months and going forward.

Background

2. In March 2015 the Government produced a four year financial settlement for Local Government, the net effect of which will be to reduce revenue support grant funding to zero by 2019/20. The Council, having been aware of the impending changes for some time, has been taking steps to mitigate against the impact of this to ensure the uninterrupted delivery of Council services. This approach includes the acquisition of property for investment purposes which can bring with it the additional benefits of borough wide regeneration.

Financial Implications

3. The income generated from the Council's corporate property portfolio during the period April 2018 to March 2019 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 £1,856,120 on a total income of approximately £3.83m.

4. The surplus for 2018-2019 is approximately £400k lower than 2017-2018. This has primarily been caused by a mixture of reduced income and increased costs and outgoings. The reduced income is focused on International House where there has been a reduction in rental income of approximately £200k. This was due to a rent free period and the fact that we had no tenant(s) for the eleventh floor. This situation should reverse for 2019-2020 as the rent free period has now ended and heads of terms have been agreed to lease approximately half of the eleventh floor to a new tenant.

5. The increased costs and outgoings relate to approximately £100k of rental costs for the leases the council has on the new Connect 38 building and approximately £100k of increased costs for Park Mall due to an insurance re-valuation and increased legal fees due the number of leases that were signed. As with the reduction in rent, the situation with the increased costs and outgoings will improve during 2019-2020 as we start to receive rent from tenants of Connect 38.

6. In 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. An example of this is the rent of £33,490 paid by Environmental Health for One You, the health and wellbeing unit at Park Mall. 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. In September 2018 the council appointed a Property and Asset Manager. This role provides support to the Head of Corporate Property and Projects in the provision and delivery of core objectives. The role has responsibility and leadership for the Council’s commercial investment portfolio, strategic asset management, building & design services and energy teams. The role contributes to the Council’s regeneration initiatives and provides input to all aspects of asset management proposals as well as leading on the preparation of the Council’s asset management plan and associated systems for the whole corporate estate.

Elwick Place

10. 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.

11. The development comprises of a hotel and cinema with the two anchor tenants of Travelodge and Picturehouse and 10 retail units. All the retail units are intended to be food and beverage units with the exception of one unit that is expected to be a gym.

12. Since the development was planned and designed there has been a significant change in the retail sector. The tough economic conditions that the sector now finds itself in have been epitomised by the collapse of national chains such as HMV, Maplin, Patisserie Valerie and Toys R Us. In addition other well-known national brands such as Debenhams and

House of Fraser have entered administration.

13. It is against this background, as well as the continuing uncertainty of Brexit, that securing tenants for the retail units has been slower than hoped for. However, recently the council and its development partner, Stanhope plc, was able to announce that it had reached agreement with the independent food and restaurant company, Macknade's, to lease the largest unit in the development, unit 1. It is anticipated that Macknade's will open in October/November this year. Terms have also been agreed with another company which is also aiming to open its restaurant before the end of the year. Additionally agreement is expected to be reached very shortly with Snap Fitness to open a gym in unit 8 of the development.

14. Discussions with a number of other potential tenants are also underway and it is hoped that the majority of the units will be let or have agreements in place to let in the next 12-18 months.

International House

15. International House continues to perform well even with a reduced level of income as detailed above. Occupancy for the site is currently slightly over 90% and if agreement is reached with a potential new tenant for approximately half of the eleventh floor this level will rise to above 95%.

16. During 2018-2019 the council undertook a major improvement in the street scene around Dover Place, the Commercial Quarter and International House. As part of these improvements the car park at International House was re-surfaced, significantly improving the visual amenity of the area.

17. Following a recommendation from Overview & Scrutiny Committee during 2018 officers have had a red book valuation of International House carried out. A red book valuation (based upon guidance from the Royal Institute of Chartered Surveyors) assesses the covenant strength of the tenant(s) in occupation in conjunction with various other commercial factors including the number of tenants in occupation and unexpired lease term(s) to expiry and/or break options.

18. The council purchased International House in 2014 for £7.8m. The valuation for International House returned as of March 21st 2019 is approximately £9m.

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. Against the back drop of a

significant decline in the retail high street shopping market the council has been able to bring new traders into the shopping centre, increase the variety of shops trading within the centre and improve the vibrancy of Park Mall.

21. Currently every unit except one is now tenanted and heads of terms have been agreed with a new tenant for the vacant unit. Whilst churn is inevitable, particularly in the current retail conditions, Park Mall is at its most stable position for a number of years and the council will be looking to increase the level of rent that the centre achieves in the next 2 to 3 years.

Commercial Quarter

22. In 2016 the council reached agreement with Quinn Estates to lease 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.

23. In 2018 the council entered into a lease with a tenant for the council's interest in the fourth floor and subsequent to this the council has signed leases with a further two tenants for space on the third floor. At the time of writing this report the council has let approximately 11,000 sq. ft. of its 18,000 sq. ft. interest in the Connect 38 building.

Garages

24. The Council's garage holding of approximately 1500 garages makes a significant contribution towards the Council's income each year. Since late 2017 the council has been looking to improve upon the management and profitability of our garage sites that were viable and to look for alternative uses for those sites which are not.

25. The once paper-based application and lettings process has been digitised so that the system is fully automated. This new working practice has both improved customer service and resulted in efficiencies and savings.

26. In addition structural and asbestos surveys are being carried out on the garage stock which will lead to a detailed planned maintenance strategy being developed. Work is also being undertaken with a planning consultancy to consider garage sites that may be suitable for development and other uses rather than being retained for garages.

Carlton Road Business Park

27. In September 2017 Cabinet approved the purchase of a development of light industrial units on land at Carlton Road by Gallagher's. The development was completed and passed into council ownership towards the end of 2018.

28. Two units have been let internally, including one to Aspire the council's landscape services team. Terms have now been agreed with two companies for units on the site with one of these expected to reach lease completion in the next couple of weeks.

29. Lettings of the units have been slower than originally anticipated due to a mixture of concerns surrounding Brexit and the sites operating hours. However the council is looking to amend the operating hours of the site and we expect to see significant growth in tenancy levels over the next 12-18 months.

Risk Assessment and Management

30. The portfolio is risk assessed on a regular basis through internal monthly reviews and the quarterly budget monitoring cycle.

31. The risks relating to each property are assessed at the point of acquisition, as part of the insurance renewal process and where the tenants change.

32. In order to manage the risk of voids, the property management undertaken internally ensures that tenancies are monitored and either re-marketed or negotiation with existing tenants commenced no later than six months prior to the end of any lease term.

Other Options Considered

33. The purpose of this report is to advise on the revenue performance of the Council's corporate property portfolio during the previous twelve months and of opportunities being explored to increase profitability and investment activity. As such, it is not appropriate to consider alternative options at this time.

Conclusion

34. The Council is continuing to make good progress with its commercialisation agenda resulting in improved management practices and improving the overall efficiency of the real estate portfolio. New investment opportunities are continuing to be explored in accordance with the criteria identified in the Corporate Property Management Strategy 2018 to 2021.

Portfolio Holder's Views

35. Will be given at the meeting.

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Appendix 1 - Corporate Property Income Schedule 2018/19

	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	*Civic Centre	Tenterden Gateway	Sustainable Energy Project	*Minor Holdings	Total
Total income	22,203	16,665	446,386	577,605	0	125,313	97,702	314,000	589,860	34,526	44,549	1,240,441	116,689	51,847	20,492	131,856	3,830,135
Total expenditure	(134,951)	0	(31,573)	(85,760)	(7,464)	(55,185)	(11,376)	(4,101)	(667,235)	(5,138)	(11,831)	(769,218)	(107,252)	(72,853)	0	(10,078)	(1,974,015)
Surplus/Deficit	**(112,748)**	**16,665**	**414,813**	**491,846**	**(7,464)**	**70,128**	**86,325**	**309,899**	**(77,375)**	**29,388**	**32,719**	**471,222**	**9,437**	**(21,006)**	**20,492**	**121,779**	**1,856,120**
Historical Cost	0	0	2,780,000	2,820,200	0	0	1,032,000	3,560,000	823,500	217,000	467,200	7,900,000	202,900	0	185,000	1,045,700	
Return	0.0%	0.0%	14.9%	17.4%	0.0%	0.0%	8.4%	8.7%	(9.4%)	13.5%	7.0%	6.0%	4.7%	0.0%	11.1%	11.6%	
Less internal recharges	0	(551)	(123,772)	(5,746)	0	(81)	(81)	0	(61,250)	(4,268)	(8,799)	(70,547)	0	(6,133)	0	(54,272)	(335,500)
Rent income form GF	0	0	0	0	0	0	0	0	33,490	0	0	0	0	27,139	0	0	60,629
Net income after recharges	**(112,748)**	**16,114**	**291,041**	**486,100**	**(7,464)**	**70,047**	**86,244**	**309,899**	**(105,134)**	**25,119**	**23,920**	**400,675**	**9,437**	**(0)**	**20,492**	**67,506**	**1,581,249**
Return on investment including recharges	0.0%	0.0%	10.5%	17.2%	0.0%	0.0%	8.4%	8.7%	(12.8%)	11.6%	5.1%	5.1%	4.7%	0.0%	11.1%	6.5%	
* Based on 2007 Historical value																	