DECISION-MAKER:	CABINET
SUBJECT:	RE-CATEGORISATION OF INVESTMENT PROPERTIES
DATE OF DECISION:	19 DECEMBER 2011
REPORT OF:	CABINET MEMBER FOR RESOURCES, LEISURE AND CULTURE

STATEMENT OF CONFIDENTIALITY
Confidential Appendix 2 to this report contains information deemed to be exempt from general publication based on Category 3 of Paragraph 10.4 of the Council's Access to Information Procedure Rules. The appendix includes a table showing the rental income and values of property which, if disclosed prior to entering into any contracts, could put the Council at a commercial disadvantage. In applying the public interest test it is not considered appropriate to publish this information as it could influence bids for a property which may be to the Council's financial detriment.

BRIEF SUMMARY

Following a challenge to the "strategic status" of properties within the investment portfolio, a number of properties are recommended for re-categorisation, which will enable them to be reviewed for possible disposal.

This approach is a means of updating strategy but may also provide the means to realise significant capital receipts that in turn reduces debt and means the Council can divert revenue away from servicing debt and into front line services.

RECOMMENDATIONS:

(i) To approve the re-categorisation of Investment Property into 'Strategic Investment Property' and 'Managed Investment Property' as set out in Confidential Appendix 2 to this report.

(ii) To increase the delegated authority to the Head of Property and Procurement to approve any potential disposals from the current limit of £50,000 to £300,000.

(iii) To increase the delegated authority to the Head of Property and Procurement, following consultation with the Cabinet Member for Resources, Leisure and Culture, to approve any potential disposals from the current limits of £50,000 - £500,000, to new limits of £300,000 - £1,000,000.

REASONS FOR REPORT RECOMMENDATIONS

1. To re-align the Councils' Strategic Investment property portfolio to current needs, and dispose of properties that are no longer required for strategic purposes where it is financially advantageous to do so.
2. To realise significant capital receipts in the next 5 years.
3. To save management costs.

ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

4. Do nothing. This would not achieve the benefits given above.

DETAIL (Including consultation carried out)

Introduction

5. The Council owns a substantial property portfolio which supports all of its activities. Whilst there has been a disposal programme operating since 2000, this report recommends a major initiative to promote a new strategy towards selling significantly more property assets. The current property disposal programme has raised £45 million of capital receipts as at March 31st 2011. There is a further £9.5 million forecast for the current year, of which £4 million has already been received

6. Investment Property is property owned by the Council and let to third parties producing a rental income. There are 3 sub-groups of investment property:-

   - Strategic
   - Managed
   - Infrastructure

   ‘Infrastructure’ is part of owning a large and complex estate and there will be very few opportunities to rationalise here. Examples are leases of Gas Governor stations or electricity sub-stations, or wayleaves created over parks. There is very little ‘realisable value’ to this part of the portfolio but very little management cost either.

7. ‘Managed Property’ is investment property whose original purpose for acquisition (mainly planning/redevelopment) is now much less significant than when the property was acquired and is retained mainly to produce a rental income. It is managed on a commercial basis much as any private sector landlord. Where the performance of this property is low (compared to the Public Works Loan Board Rate) consideration is given to disposal, depending on the financial case of each. The total asset value of this sub-category of property is in the order of £8,000,000 producing a rental income of £535,000 per annum.

8. ‘Strategic’ Investment Property is held for long term strategic or planning reasons, to support redevelopment/regeneration initiatives in the short, medium or long term, and to underpin economic development objectives. It produces a rental income in the order of £5,758,345 p.a. The capital asset value of strategic investment property is £106,000,000.

9. This report is focused solely on the Strategic Investment properties and sets out why every property is currently classed as strategic, as opposed to managed, and highlights the main issues associated with a change of category and potential disposal.

10. Much of the property owned by the Council, especially investment property is a legacy. Some property has been held for hundreds of years, whilst much of it (especially in the city centre) was acquired after the second world war to promote re-development. Long leases were granted to developers who re-built damaged parts of the City.

11. Each group of property has been reviewed in detail to assess whether it is still required, and if so whether it should be classed as managed or strategic. In the past strategic property was not considered suitable for disposal as it was held to promote longer term re-development or regeneration. A fundamental review of this type of property has taken place and unless the strategic reasons for retention are critical, a re-categorisation to managed is recommended.

12. Many properties formerly in the strategic category have in fact served their strategic purpose, and in other cases the benefit gained by the Council in continuing to hold these properties is small compared to the potential sale value. In addition owning property does not always guarantee development, in certain market conditions, especially those we are now experiencing, if the development is fundamentally unviable (i.e. the cost of the land and the building costs exceed any final sale values) then it will not happen unless the Council 'pump primes' the development by subsidy, which is usually a significant cost, does not happen very often and may have State Aid complications.

Current Categorisation and Changes

13. The Council owns 248 investment properties categorised as strategic. There are a number of standard reasons which can be applied to each property, and these are as below:-

A two stage approach has been taken in analysing the categorisation of a strategic property:

a) Determine whether a property is considered as a group of properties, or on an individual basis.
b) An appraisal is undertaken on a "yes / no" basis of the following categories:
    - Influence – Does the council wish to control an outcome through property ownership?
    - Financial – Significant income i.e. over £200,000, or future sales subject to clawback of grant funding
    - Support regeneration or redevelopment
    - Retain provision – Where the Council, through land ownership wishes to ensure the provision of a specific output or use.
    - Part of a property or infrastructure – i.e. shop units below residential blocks.
    - Long term retention

For the majority of the sites there is more than one reason why they should be categorised as strategic; however it the grouping that is the most important consideration. Another key factor for each site will also be the level of revenue generated, please see financial comments below.

14. A thorough challenge has now taken place to each of these groups to see whether

a) It is appropriate that the property is still retained as strategic, and if not if it can be classed as 'managed' in which case it could be considered for disposal, subject to the usual case by case evaluation, and assessment of impact on revenue.
b) the *reason* for retention needs to be changed.

15. In addition, the properties that remain as strategic are challenged and the implications given, in regeneration and planning terms, as well as financial, if they were to be sold.

16. In undertaking this appraisal it became very clear that properties formed natural groups and in many cases had to be considered together. Once grouped each property was appraised against the strategic considerations set out above.

17. Appendix 1 sets out the various groups of properties, with a brief rationale as to why they are currently assessed as strategic. The categorisation has been arrived at as a consensus between relevant council functions.

18. Having undertaken the first challenge the appraisal of every property within each group was further challenged. For example, the first group in Appendix 1 is Belgrave Industrial Estate. This property had been considered strategic, yet once tested there were no reasons why it should remain strategic, and therefore it is recommended for change.

19. Confidential Appendix 2 sets out the potential changes in the strategic category, and if appropriate what may be achieved by way of capital receipt. The proposed changes to both the strategic and managed category are set out in the table below:

	Current		Proposed	
	Rent	Asset Value	Rent	Asset Value
Strategic	£5,758,345	£106,500,000	£1,647,623	£28,207,338
Managed	£535,000	£8,000,000	£4,655,555	£85,860,378

Note: There is a variation when the columns are totalled as some properties will be move to other categories not included in the table. The data use to compile this report was taken in July 2011. Since that time some properties may have been sold, and rents and values may have varied.

20. Whilst property is categorised as "Remain Strategic", this does not mean that the Council will not dispose of it at some point in the future. There may be some property which should be retained long term, but some could be retained for only a few years in order to remove or reduce development risk (by securing planning permission or similar) and thus significantly increase the value. There is significant financial advantage to the Council in these cases in waiting to sell at some point in the future rather than now.

21. Property ownership can help the Council achieve many of its objectives. The City Centre Masterplan identifies many regeneration projects. Where the City Council is a landowner it can promote development in its own right, having already commenced the land assembly through its ownership. Different models of delivery need to be considered for development, whether it be for city centre regeneration or Estates Regeneration. If an Asset Backed Vehicle is required to stimulate development, then the Council will need to ensure there are sufficient valuable assets to include in any vehicle to make it a realistic option.

22. If a property is reclassified as managed from strategic, whether to retain or dispose becomes a financial decision, based on performance, rather than taking any strategic considerations into account. If managed property is performing well it may be better financially to retain, however if there is an imperative to increase capital receipts, notwithstanding the revenue loss, then the property can be disposed of anyway. Every potential disposal can be looked at on a case by case basis and recommendations made depending on the financial balance in each case, and the overall level of receipts required.

23. It should be noted that the Asset values given are those that are prepared for bookkeeping purposes only, as they need to appear in the Council's accounts, they have not been calculated in preparation for a disposal. Although investment property is valued largely on a market value basis (as opposed to a replacement cost basis for many service properties), they make high level assumptions which will need to be looked at and refined on a case by case basis prior to any disposals. These properties are valued on a 5 year rolling programme, but are subject to an annual desktop review and update. They can therefore be considered as giving a reasonable guide to anticipated levels of capital receipts. However the values used are last figures for the last financial year. This year's valuations are nearing conclusion.

Managing property whilst held as Strategic

24. As a general principle the Council has been restructuring leases since the 1980's. This is where a long lease (usually 99 years) was granted by the Council in the 1950's or 1960's at a fixed rent with no rent reviews, as the concept of rent reviews did not exist at that time. As time passes, and the end of the lease approaches, the tenant often wishes to surrender the old lease in exchange for a new 125 year lease, but at a modern rent with rent reviews built in.

25. This also releases significant 'marriage value' which arises from the merger of two interests, that is then shared between the landlord and the tenant. This results in either a much higher rental income for the council, or a capital receipt, or a combination of both. It has been the Council's policy to take as much value as revenue as possible, however by changing this to take a greater up front capital payment, and reduce the rental received, capital receipts can be generated. Although revenue is lost, this may be less than the costs of borrowing which could be removed, although this would need to be looked at on a case by case basis.

26. Restructuring leases in this way, or simply changing the incidence of capital to revenue received within the lease (known as re-gearing), has the advantage of generating a capital receipt and also allowing the Council to retain an asset if there are good strategic reasons to do so. Leases can be restructured in this way whether they are classified as strategic or managed, and opportunities to do this will be actively explored as part of implementing the disposal programme. This would have the advantage of achieving a capital receipt whilst still holding the property for strategic reasons.

27. In implementing the previous programmes the Council have already received a number of wins. A major caveat, however, is that this can only happen where a tenant is willing to do this, it cannot be a unilateral decision by the Council. In the current economic climate some tenants do not wish to consider this.

28. In order to progress the strategy as quickly as possible, it is recommended that the powers delegated to the Head of Property and Procurement are increased as set out in the recommendations to this report.

RESOURCE IMPLICATIONS

Capital/Revenue

29. Following the update of the capital programme in February the position reported to Council and approved was a deficit of £9.2M due largely to the loss of capital receipts (the re-phasing programme will reduce this to £8.1 million). This was compared to a £10.5M deficit reported in September 2010. The deficit represented 4.2% of the overall capital programme which was within the limit of 5% set in the Medium Term Financial Strategy and approved on the 13 May 2009.

30. Any sales realised as a result of the strategy in this paper will contribute to closing the deficit in the capital programme and any further proceeds will be available to reduce borrowing.

31. Any potential capital receipts arising from the proposals in this paper will not be included in forthcoming capital programme updates as this paper gives an overall assessment of property that could be moved from strategic to managed, and each property re-categorised will need assessment on a case by case basis, as already referred to, before a definite decision is made on disposal, and the level of capital receipt likely to be realised.

32. Forecast values and the timing of capital receipts can vary significantly due to many factors and it would therefore be prudent not to base decisions on estimates of receipts until their accuracy and certainty can be verified. As a result any receipts will not be included within the capital programme until they are received.

33. The revenue implications of disposals, such as loss of income, demolition, security, legal etc need to be fully assessed before a decision to sell is made and then budgeted for. The revenue implications of an individual property sale may not seem material but the cumulative effect of many such decisions can have a large effect on the revenue position and again this needs to be reflected in the budget forecast. As properties are removed from the Strategic list the approach to be taken would be similar to the approach taken with the disposal of Millbrook Trading Estate i.e. the financial model used demonstrated that it made more financial sense to sell the site rather than to retain the revenue stream. Once it has been agreed that properties are no longer strategic they would then need to be put through the same financial modelling to identify whether it is best to dispose of the site (and the cost of borrowing) where the cost of borrowing is greater than the revenue received.

Property/Other

34. Covered in report.

LEGAL IMPLICATIONS

<u>Statutory power to undertake proposals in the report</u>:

35. This report does not propose any specific proposals at this stage, each will be presented for approval to the relevant decision maker in the usual way. Should sales take place the criteria in Section 123 Local Government Act 1972 will be applied ie “best consideration ordinarily attainable”

<u>Other Legal Implications</u>:

36. There are practical resource issues in embarking on such a significant property disposal programme. The limited, and reducing, resources within Legal Services are such that it could not accommodate any instructions in the foreseeable future. Accordingly external legal support will need to be instructed with the associated costs falling to the portfolio. Alternatively, in may be more cost effective to employ a property lawyer on a fixed term contract to undertake this work.

POLICY FRAMEWORK IMPLICATIONS

37. The proposals set out in this report are not contrary to any policy implications. The disposal of council property for capital receipts supports the Councils capital programme.

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KEY DECISION? Yes

WARDS/COMMUNITIES AFFECTED:	None

<u>SUPPORTING DOCUMENTATION</u>

Non-confidential appendices are in the Members’ Rooms and can be accessed on-line

Appendices

1.	Appendix 1
2.	Confidential Appendix 2

Documents In Members’ Rooms

1.	None

Integrated Impact Assessment

Do the implications/subject of the report require an Integrated Impact Assessment (IIA) to be carried out.	No

Other Background Documents

Title of Background Paper(s)	Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)