

Property Acquisition

Summary

To agree to acquire Units 1-9 Trade City, Lyon Way, Frimley, to assist employment and economic development within the borough of Surrey Heath, and to provide long term income to assist in the ongoing provision of local authority services.

Portfolio and Date Signed off

Deputy Leader – 4 May 2018

Wards Affected

All

Recommendation

The Executive is recommended to RESOLVE that

- (i) the acquisition of Units 1-9 Trade City be approved on the basis that such acquisition will assist in the employment and economic development of the borough, as well as providing long term income to assist in the provision of public services and;
- (ii) the Chief Executive be authorised to complete the due diligence work currently being undertaken and thereafter be further authorised to complete the acquisition of Units 1-9 Trade City, including all necessary legal documentation required to achieve the transfer of ownership, after taking all appropriate legal, valuation and technical advice; and
- (iii) as an urgent decision, the Capital Programme be increased by £13,100,000 to reflect the estimated total costs of this acquisition.

1. Key Issues and Current Position

- 1.1 Members will recall the creation of the Property Acquisition Strategy in 2011 and the commitment to acquiring strategically important assets which either promote the delivery of our key priorities or are important in assisting the long term economic wellbeing of the borough, or for housing. As Members are aware, these types of acquisitions come up at short notice with relatively short timescales for submission of bids, and then completion of the legal formalities. Hence the necessity to report urgently to the Executive at this meeting.
- 1.2 The opportunity to acquire Units 1-9 Trade City, Frimley, has arisen and the details of the proposed transaction are set out in the Annex to this Report. The Council has carried out initial investigation and has identified this site as a potentially attractive investment property. It is considered to meet the

property acquisition requirements in terms of ability to positively influence economic regeneration within the borough, and appropriate return on investment.

- 1.3 The site has been offered to competitive bids, and the Council has successfully offered £12,225,000 subject to contract and due diligence. The total purchase price based on the offer of £12.225m including SDLT and other costs, is likely to be £13.1m and the Council will need to increase the Capital Programme accordingly. This is an urgent decision that the Executive may make in accordance with the Budget and Policy Framework Rules set out in the Constitution. This is because it is not practical to convene a full council meeting within the timescales of this transaction and the Chairman of Performance and Scrutiny has agreed to this in writing.
- 1.4 The Council has commenced detailed due diligence prior to exchange to ensure that the financial return indicated by the initial valuation advice is achievable. Professional advice and valuation services have been sought to advise on the current offer made, subject to contract.
- 1.5 As this is an urgent report, the matters which must be considered have been set out based upon what is known at the time of writing this report and Members will be updated verbally on the most up to date position at the meeting.
- 1.6 The Council has a good awareness of the light industrial market within the borough and reasonable confidence in the rental potential of these units based on demand for units at Albany Park and St Georges Industrial Estate. This is further supported by Hurst Warne in their report where they stated that demand remains active for industrial/warehouse units throughout the size range offered by this scheme. They go to say that within the Blackwater Valley Region, there is only a 3.5% vacancy rate within the Industrial/warehouse sector.

2. Resource Implications

- 2.1 The purchase of the available site at Units 1-9 Trade City represents a substantial investment for the Council. Whilst an initial purchase price of £12,225,000 has been agreed in principle, based on the advice of the agent Hurst Warne, this is subject to the outcome of the due diligence exercise as mentioned above. It is therefore possible that the final value may change before completion of this acquisition. However it should be noted that the Council cannot pay in excess of the independent “red book” valuation.
- 2.2 Based on the draft figures we have received so far, the purchase is estimated to make a gross return of 4.7% before interest and borrowing costs. Officers will need to decide how the purchase should be funded based on available rates at the time that the borrowing is required, having taken appropriate investment advice from our retained Treasury Management advisers,

Arlingclose. The borrowing requirement falls within the existing Prudential Limits agreed by Members in February 2018.

- 2.3 It should be noted that the Prudential Regulations stipulate that not only should the Council be able to cover the interest on any money it borrows but also has to make a “Minimum Revenue Payment” (MRP) against revenue for the capital repayment of the loan on an annual basis. This is to ensure that loans can be repaid and do not fall on future taxpayers. It is estimated that the total revenue cost of borrowing will be approximately £507,000 per annum.
- 2.4 As with all acquisitions of this nature, it will also be essential to maintain rental income, ensure that the property is managed in a commercial and professional manner, and to effectively manage rental reviews and lease negotiations. At this stage it has been assessed that a sum of £15,000 per annum will be sufficient for this purpose.
- 2.5 The initial rental income for the site is expected to be £616,000 per annum. If full occupancy is achieved, the annual revenue return after borrowing and other costs is anticipated to be £94,000, a net yield of 0.72%. This is likely to be the worst case scenario, as borrowing costs may be lower, as in other transactions.

3. Legal Issues

- 3.1 The Council has the power to acquire land in accordance with section 120 of the Local Government Act 1972.

4. Risk Management

- 4.1 There are a number of potential risks associated with the proposed acquisition, both at the point of acquisition and in the longer term.

Purchase risks

- 4.2 An initial price has been agreed but this is subject to a formal valuation and the outcome of the due diligence. Costs of due diligence work including valuation will only be capitalised if the acquisition proceeds. These costs are estimated at £35,000 and included within the £13,100,000 budget. Therefore if the acquisition does not complete, these abortive costs must be funded from revenue.

Ongoing risks

- 4.3 As with all property investment there is a level of financial risk in relation to loss of tenants, bad debts, rents reductions etc which could impact the return the Council receives. The Council will need to ensure that it can repay its borrowing and if rentals fall, this could fall on the Council's finances and therefore impact services. However, the Council has researched demand for these types of units and the market continues to be strong and. In addition, the

Council holds adequate reserves to cover any short term financial short falls that may arise.

- 4.4 The capital value of the site may fluctuate over time. However it is the Council's intention to hold this property for the longer term in order to support the local economy through employment so it is unlikely that any valuation losses, if they arise, will be realised.
- 4.5 Property by its nature is relatively illiquid i.e. it is not easy to convert into cash if required. This is because there may not be a high number of ready buyers available and such a sale may take many months to complete. At the current time, the Council has adequate reserves which should cover its cashflow requirements.

5. Options

- 5.1 The Executive can either support the acquisition of Units 1-9 Trade City, Frimley; or
- 5.2 The Executive can decide not to invest in Units 1-9 Trade City, Frimley.

6. Proposals

It is proposed that the Executive resolve that:

- (i) the acquisition of Units 1-9 Trade City be approved on the basis that such acquisition will assist in the employment and economic development of the borough, as well as providing long term income to assist in the provision of public services and;
- (ii) the Chief Executive be authorised to complete the due diligence work currently being undertaken and thereafter be further authorised to complete the acquisition of Units 1-9 Trade City, including all necessary legal documentation required to achieve the transfer of ownership, after taking all appropriate legal, valuation and technical advice; and
- (iii) the Capital Programme be increased by up to £13,100,000 to reflect the estimated total costs of this acquisition.

7. Supporting Information

- 7.1 A Summary is set out at Annex A.

8. Corporate Objectives and Key Priorities

- 8.1 The purchase of this investment satisfies the Council's Key Priority 2 namely Prosperity – to support and promote the local economy as well as strengthening the Council's financial independence by generating income.

9. Governance

- 9.1 The property will be managed by managing agents together with the Council's internal corporate property team.

Annexes	Annex A - Financial Summary
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Consultations, Implications and Issues Addressed

Resources	Required	Consulted
Revenue	✓	
Capital	✓	
Human Resources		
Asset Management	✓	
IT		
Other Issues	Required	Consulted
Corporate Objectives & Key Priorities	✓	
Policy Framework		
Legal	✓	
Governance		
Sustainability		
Risk Management		
Equalities Impact Assessment		
Community Safety		
Human Rights		
Consultation		
P R & Marketing	✓	

Review Date:

Version:

Annex A - Summary of the proposed acquisition of Units 1-9 Trade City, Frimley

Property	Units 1-9 Trade City, Frimley
Address	Lyon Way, Frimley, Surrey Heath, GU16 7EX
Tenure	Freehold
Sector	Light Industrial/Warehouse
Purchase Price	£12.225m
Condition	The property comprises a modern multi-let industrial estate comprising nine units across three terraces and one detached unit, totalling approximately 56,621 sq ft (GEA). The individual unit sizes range between 2,790 sq ft and 19,895 sq ft. The estate was developed by Kier in 2015 and provides units of steel portal frame construction with full height metal clad elevations. The specification of the individual units varies across the estate.
Income	£616,000 pa
Tenancies	<p>The site has 9 units of which 7 are let. The vendor is offering 12 month rent guarantees on the vacant units. Average unexpired lease term (weighted by unit size) is 5.8 years to expiry, or 2.8 years to breaks.</p> <p>80% of contracted income is to tenants judged to be low or medium risk. Rent Deposits and a Parent Company Guarantee are in place against 49% of the contracted income, including that from tenants judged to be at higher risk of default.</p>