St Edmundsbury
BOROUGH COUNCIL

Z391

Cabinet
3 December 2008

Asset Management Plan: Haverhill Industrial Properties: Assessment and Options Appraisal (Dec08/01)

1. Summary and Reasons for Recommendation(s)

1.1 In accordance with the Asset Management Plan (AMP) Action Plan, all of the Council's property assets are being systematically assessed This report follows the adopted processes for the assessment of the Council's non-operational assets. Investment properties in Bury St Edmunds and Haverhill and low rent ground leases have already been subject to AMP reviews. It considers the industrial premises and nil rent ground leases located in Haverhill.

1.2 The assessment process includes assessing each property asset against the adopted property objectives, it explains the matters considered in order to score each property, including possible reasons for retaining or disposing of particular assets, then applies the decision tree of option appraisal, in order to arrive at an objective decision. The particular reasoning and scoring for each asset is contained in Exempt Appendix 3.

1.3 The reason for undertaking the AMP process, and in recommending rationalisation of the portfolio in some cases, is to make better use of property resources, in accordance with good asset management planning. The review is set in the context of the current difficult market, which has an impact on the consideration of the AMP options.

1.4 On 23 October 2008, Cabinet also approved, subject to the approval of full Council, that £445,000 be allocated towards the cost of repairs and improvements to the Haverhill employment units, subject to the AMP process. This report also takes into account the proposed expenditure.

2. Recommendation(s)

2.1 It is **RECOMMENDED** that the proposals identified in Exempt Appendix 3 to Report Z391, which relate to individual assets, be approved. These proposals include retain, and work more closely with partners to improve the service value of the assets, sell when opportunities arise and consider further as part of service reviews or in connection with other developments.

3. Corporate Objectives

3.1 The recommendation(s) meet the following, as contained within the Corporate Plan:-

(a) Corporate Priority: *'To raise standards and corporate efficiency'*; and
(b) Cabinet Commitments: *'Improving Efficiency and Value for Money'*.

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4. Key Issues

4.1 Assessment of Haverhill industrial properties

4.1.1 The Council has a diverse non-operational portfolio, which has been partly inherited and partly assembled over a period of decades in both an ad hoc and planned manner. Much of the property is owned as a result of the town development schemes, where substantial parcels of land were acquired by the former Haverhill Urban District (UDC) and Bury St Edmunds Borough Councils. Both Councils built starter units, which in the 1970s were standard units of around 2,500 sq ft.

4.1.2 Haverhill UDC was particularly active in this area, and constructed:-

(a) Group 1 units: 9 to 27 (odd nos.) Hollands Road, Haverhill in two blocks of five units (21 to 27 Hollands Road is the Enterprise Centre managed by the Mid-Anglian Enterprise Agency (MENTA) and is excluded from this review, as it was recently considered by the Cabinet on 23 October 2008 (Report Z304 refers);
(b) Group 2 units: 8 to 38 (even nos.) Hollands Road, in four blocks of four units, together with garage/stores 17A and B to 20A and B; and
(c) 2 Hollands Road: a stand alone factory and office building of 24,000 sq ft.

4.1.3 Other assets which are the subject of this review are:-

(a) 6 to 12 Piperell Way, Haverhill: four larger units (6,500 sq ft) were constructed by St Edmundsbury Borough Council in the 1970s; and
(b) Homefield Business Park ground leases: further investigation was required. This was considered by the Cabinet in the AMP review of ground leases on 2 August 2006 (Report X151 refers).

Other factory units and ground leases provided by Haverhill UDC have subsequently been sold, and the above assets are the only ones now owned by the Council in Haverhill.

4.1.4 There are 26 separate tenancies for the total of 35 premises (excluding Homefield Business Park ground leases), as some tenants occupy adjoining units, out of a total of around 260 leased land and buildings in the Council's non-operational portfolio. The market value of these assets, as at 1 April 2008, is approximately £2.8 million. Their annual rent roll for 2008/2009 is over £360,000, giving an average yield of 13%. In investment terms, this means the properties are treated as risky in terms of reliable and sustained income flow, the main criteria for assessing market capital value. Therefore, the Haverhill units represent 10% of all leased properties, and around 17% of the income. This compares against the best performing sector of the portfolio, the investment assets, which represents 9% of all leased properties, but 59% of the total income of the non-operational portfolio.

4.1.5 The Haverhill industrial properties are significant assets, both in terms of the proportion of the portfolio and total income. However, the AMP assessment needs to challenge the service, financial or strategic reasons for owning them, particularly in the context of the Council's economic development role and in the current economic conditions. The adopted assessment process and options appraisal for the assets is complex and full details are attached as Appendix 2. The decision tree model, which is part of the process, is attached as Appendix 1.

4.2 Market analysis

4.2.1 Current and anticipated supply/demand of stock in Haverhill

According to a national database, there are a number of units of varying sizes available in Haverhill at this time, for example:-

(a) Maple Park, Falconer Road which has been on the market for approximately six months and is a development that consists of 18 units of between 1,017 sq ft and 20,000 sq ft;
(b) Tudor Rose Court, Hollands Road which consists of eight larger industrial units; and
(c) in addition, there are not only plans to extend Maple Park further but there remains a significant supply of land at Haverhill Business Park.

With regard to demand, Maple Park perhaps exemplifies the current economic climate in that since opening, only two units have been let. This obviously contrasts with St Edmundsbury's industrial units which are all occupied apart from one. Commercial unit supply is not, therefore, an issue at this time.

Further, statistics provided by the Suffolk Development Agency indicate that between April and October 2008, 34 companies were looking for premises in Haverhill of which 11 were actively seeking an industrial unit of some description, although only four companies selected to view the details of properties between approximately 2,000 to 5,000 sq ft.

4.2.2 State of manufacturing in Britain

According to the Chartered Institute of Purchasing and Supply (as reported by the BBC), the manufacturing sector in the UK shrank in September by the fastest rate for 17 years. This followed a sustained manufacturing slowdown throughout the summer months (Office for National Statistics).

In Haverhill, the impact of the global economic climate upon manufacturing in the UK has recently been evident by the decision of a large employer to close its manufacturing operation thereby laying off all its staff.

4.3 Maintenance and repair considerations

4.3.1 Unlike with the majority of the non-operational portfolio, the Council is responsible for external repairs, decorations and improvements to the Group 1 and 2 units, although the leases to individual tenants make them responsible for sharing these costs. The tenants are responsible for maintenance for the remaining industrial properties in this review.

4.3.2 Six Year Planned Maintenance Programme

Both the Group 1 and Group 2 units are now around 40 years old and major components are life expired. Costs have been identified, producing a total six year Planned Maintenance Programme of around £740,000. Details of the programme are contained in Appendix 2. If individual units are to be refurbished in periods of vacancy, the estimated cost per unit is £35-£40,000, excluding fees.

4.3.3 From an asset management perspective, consideration has to be given to the potential level of expenditure against the assessment criteria of service return, financial return and value for money. As a simple ‘pay back’ period, the cost of repairs per unit is equivalent to around four years’ total gross rent. However, it is unlikely that all of the units will become vacant sometime during the six year period, as a proportion of the tenants will renew their leases and retain occupation. Therefore, the refurbishment budget needs to be flexible enough to be dipped into when a tenant vacates. The best way to achieve this is to ring fence a guaranteed sum over a longer period.

4.3.4 <u>Property options to consider for potential expenditure</u>

Identified maintenance expenditure which could be spent at the Group 1 and 2 units is potentially very high. Cabinet has, subject to this review, proposed to ring fence £445,000 of these estimated costs. For asset management and decision-making purposes, the property options need to be considered in respect of this proposal. A summary of the options is detailed below; more details and considerations are included in Appendix 2:-

(a) recharge the tenants a share of the cost: making such a demand may deter an ingoing tenant from proceeding;
(b) recharge the tenants a share of the cost through an increased annual rent: the Haverhill units have a niche in the market and are able to attract a range of tenants who can afford to pay the current level of rent. There is a balance between retaining tenants, re-letting at acceptable levels or experiencing vacancies and voids;
(c) recharge the tenants a share of the cost through an annual service charge: the same effects as increasing rent;
(d) do not recharge the tenants: if the Council has a strong commitment to economic development, this option may be justified. The main reason for the Council holding the units is to provide industrial and commercial space at a price that small and growing businesses can afford;
(e) undertake refurbishment in partnership: investigations can be made to see if grants are available;
(f) do not undertake refurbishment: there is a danger that if refurbishment is not carried out as units become vacant, re-letting will be more difficult and longer voids experienced, or rents will have to be reduced to achieve lettings. The Council may be in breach of legislative requirements; and
(g) redeploy the £445,000: the money does not have to be spent on these units, it could be put to more pressing needs in the capital programme or for the refurbishment of other assets in the non-operational portfolio.

4.3.5 These options are considered further in Exempt Appendix 3.

5. Other Options considered

5.1 The process for assessing the Haverhill industrial properties includes option appraisal. The agreed options are to retain, to consider the feasibility of alternative uses or with partners, to better meet the Council’s property objectives, or to sell and reallocate capital to better achieve corporate objectives.

5.2 All the options and proposed recommendations for each asset considered are contained in Exempt Appendix 3.

6. Community impact *(including Section 17 of the Crime and Disorder Act 1998 and diversity issues)*

6.1 General

6.1.1 There are unlikely to be any adverse community impact or implications for the Crime and Disorder Act 1998 in making the decisions for individual property assets contained in Exempt Appendix 3.

6.2 Diversity

6.2.1 There are no diversity implications.

7. Consultation

7.1 The Portfolio Holder for Economic Development and Asset Management has been consulted.

8. Resource implications *(including asset management implications)*

8.1 There are no immediate resource implications in approving the recommendations proposed for each asset considered.

8.2 The income received through rents from the Haverhill industrial properties is significant. In implementing some of the options proposed for particular assets, a balance needs to be achieved where sales are considered: the equivalent amount of revenue that can be raised from any ensuing capital receipts and the risks of sustaining income from rents. Any impact on the Five Year Programme needs to be identified at the appropriate time.

8.2 The Council has established a self-financing Property Fund for acquisition of key strategic or investment property. It is unlikely that this facility will be necessary in implementing the options proposed for the Haverhill industrial properties.

9. Risk Assessment *(including Health & Safety, potential hazards or opportunities affecting corporate, service or project objectives)*

9.1 Risk assessment is part of the AMP process. There are no health and safety risks.

Risk area	**Inherent level of Risk** (before controls)	**Controls**	**Residual Risk** (after controls)
The economic climate adversely affects businesses in Haverhill, which impacts on rental income	High	The proposed recommendations for each asset will be implemented at the appropriate time	Medium

10. Legal or policy implications

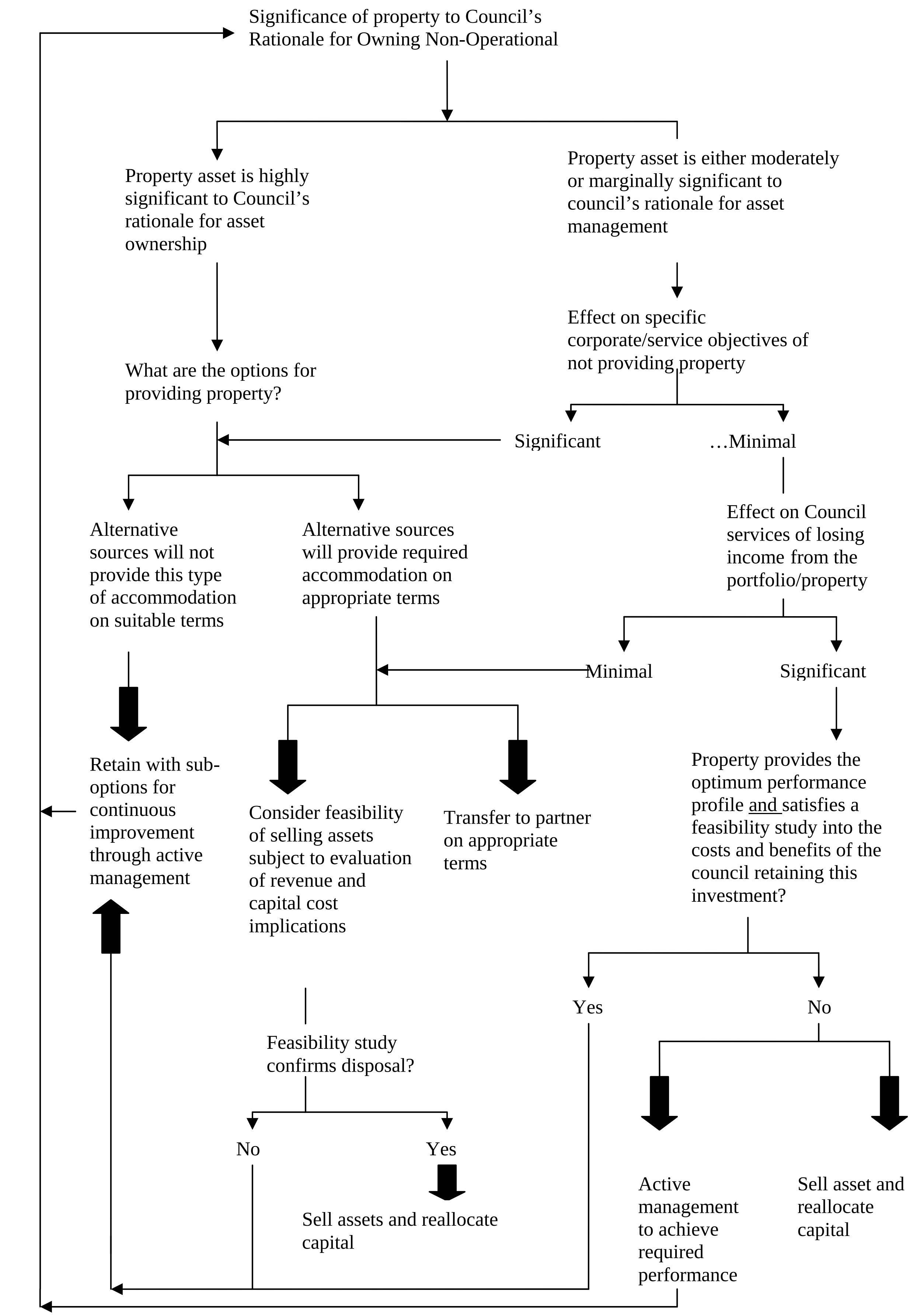
10.1 There are no legal or policy implications. Strategic property decisions are made in compliance of Section 123 of the Local Government Act 1972.

Ward(s) affected	All	**Portfolio Holder(s)**	Economy and Asset Management; and Resources and Efficiency
Background Papers	**Cabinet 2 August 2006 (Report X151); Cabinet 23 October 2008 (Report Z304)**	**Subject Area** Property Management	

APPENDIX 1

HAVERHILL INDUSTRIAL PROPERTIES

DECISION TREE FOR REVIEW AND CHALLENGE



APPENDIX 2

ASSESSMENT AND OPTIONS APPRAISAL OF HAVERHILL INDUSTRIAL PROPERTIES

Overview

Best Value Committee on 21st January 2002 adopted the objectives for non-operational property and the assessment framework. The model was amended in 2008 to align it to the new corporate asset management plan and capital management strategy, which incorporates the current corporate objectives.

Property Objectives

The 3 adopted property objectives for all non-operational asset reviews are:

Service return:
To achieve or support the achievement by others of Corporate and Community Plan aims and objectives, and to ensure that any properties leased to other organisations do likewise;

To increase the Council's influence in land use, vitality and viability and to influence the quality of design and construction, and, by example, to act as a catalyst in driving forward change.

Financial return:
To ensure that the financial return from investment and surplus properties is maximised where consistent with meeting the Council's corporate requirements.

Value for money:
To obtain value for money by the efficient, effective, economic and sustainable use of assets to achieve financial and service return.

The Property Strategy is directed to optimising the benefits of owning non-operational property to achieve these property objectives. In respect of the non-operational portfolio, the properties are to be assessed in order to rationalise existing holdings, to improve upon the performance of retained assets and to meet future requirements. This is to:
a) facilitate the development of key strategic sites in support of the Council's corporate and/or service objectives; and
b) secure revenue and/or capital returns that compare favourably with alternative means of investment return.

The Assessment Framework

The criteria for scoring (range -1 to 3 per criteria) against the property objectives are:
Service return – direct link with one or more of the Corporate Priorities;

Financial return - short-term rental growth prospects, internal rate of return (commercial measure and benchmark of income and capital performance over time) and level of risk.
Value for money - justifiable need for the asset, management costs, property condition and property service performance.

As well as scoring the properties, the assessment framework uses a **Decision Tree.** This allows the user to consider if there is a justifiable need for each property. This questions the rationale for owning the ground lease portfolio, then leads through questions on the impact of ownership, considers alternative investments and the impact of losing each property. In some cases, it may not be a simple decision and further feasibility studies may be necessary before deciding on one of the options. The options are:

Retain – active management to achieve required performance;
Retain – consider feasibility of property in alternative use or with partners, which better meet the Council's property objectives;
Sell – reallocate capital to better achieve corporate objectives and priorities.

<u>Assessment of Haverhill Industrial Properties</u>

The Council has a diverse non-operational portfolio, which has been partly inherited and partly assembled over a period of decades in both an ad hoc and planned manner. Much of the property is owned as a result of the town development schemes, where substantial parcels of land were acquired by the former Haverhill Urban District and Bury St Edmunds Borough Councils. Both councils built starter units, which in the 1970s were standard units of around 2,500 sq ft.

Haverhill UDC was particularly active in this area, and constructed:

- Group 1 units – 9 to 27 (odd nos.) Hollands Road, in 2 blocks of 5 units (21 to 27 Hollands Road is the Enterprise Centre managed by MENTA and is excluded from this review, as it was recently considered by Cabinet (Paper XXXX refers))
- Group 2 units – 8 to 38 (even nos.) Hollands Road in 4 blocks of 4 units, together with garage/stores 17A & B to 20A & B
- 2 Hollands Road – a stand alone factory and office building of 24,000 sq ft.

Other assets which are the subject of this review are:

- 6-12 Piperell Way - 4 larger units (6,500 sq ft) were constructed by St Edmundsbury Borough Council in the 1970s
- Homefield Business Park ground leases – further investigation (considered by Cabinet in the AMP review of ground leases in August 2006 (Paper XXX refers)

Other factory units and ground leases provided by Haverhill UDC have subsequently been sold, and the above assets are the only ones now owned by the Council in Haverhill.

There are 26 separate tenancies for the total of 35 premises (excluding Homefield Business Park ground leases), as some tenants occupy adjoining units, out of a total of around 260 leased land and buildings in the Council's non-operational portfolio. The market value of these assets, as at 1st April 2008, is £2,759,000. Their annual rent roll for 2008/09 is £361,000, giving an average yield of 13%. Therefore the Haverhill units represent 10% of all leased properties, and around 17% of the income. This compares against the best performing sector of the portfolio, the investment assets, which represents 9% of all leased properties, but 59% of the total income of the non-operational portfolio.

Therefore they are significant assets, both in terms of the proportion of the portfolio and total income. However, these statistics need to be considered in more detail by considering performance of the individual groups and units within each group. The AMP assessment therefore needs to challenge if there are service, financial or strategic reasons to retain them, particularly in the context of the Council's economic development role.

The 5 groups of assets considered in this review are shown in the matrix at the end of Exempt Appendix 3. The properties were revalued in 2008, to ensure that the review is based on current market information. The review is set in the context of the current difficult market, which influences the consideration of AMP options.

Considerations for the Assessment

Some of the factors taken into account in assessing the assets against the adopted property objectives are:

Service return – The prime corporate aims for holding industrial units are: Improving efficiency and value for money; Managing future development of the Borough; Future development of Haverhill. There may be compelling arguments for owning the units in delivering the Council's economic development policies. Ownership of the units in Haverhill has no influence on the commitments to Bury St Edmunds town centre and rural services.

Financial return – It is important that the non-operational portfolio generates growth in annual income and it could be questioned that if the Haverhill units do not generate growth, then why retain them? There are other financial criteria, such as the degree of risk of receiving the income and the amount (if any) of latent capital growth, which must also be considered. In some cases, the potential for future gains may outweigh short-term rental growth prospects. Or, there may be over-riding service return reasons for holding the assets, notwithstanding poor financial performance.

Value for money – The third criteria is value for money, where factors include property condition and management and professional costs. The most important indicator here is the Decision Tree (illustrated in Appendix 1).

In many cases, the decision to sell or retain will be easy to judge, supported by the matrix scores and ranks. For other assets, it will be harder to judge and further feasibility studies may be needed. Considerations are:

- If sold, can an equivalent amount of income be raised from alternative investments (property or otherwise)? Costs of sale, acquisition, Stamp Duty and management also have to be taken into account.
- Are there any contractual obligations which have to be taken into account, such as lease covenants, grants, etc, which will affect value?
- Does the property fulfil a community need, which may be lost if the property is sold?
- Does the property have unique characteristics which are important for the Council to protect?
- Is there potential, with surrounding land, to improve the investment, by combining sites or changing their use, which may mean additional investment?
- Are there long-term strategic reasons for holding the property, which outweigh the current under-performance?
- Is there a more pressing need for alternative capital investment which would justify sacrificing current income (particularly if the capital value has increased more than rental value)?
- Could the property be retained by the Council and used for direct service delivery?

Cabinet on 11th January 2006 approved the establishment of a self-financing Property Fund for acquisition of key strategic or investment property (Paper W487 refers). It may be appropriate to use this facility to improve the performance of some existing assets, if opportunities arise.

Cabinet also approved on 23 October 2008, subject to the approval of full Council, that £445,000 be allocated towards the cost of repairs and improvements to the Haverhill employment units, subject to the AMP process (Paper Z304 refers).

Maintenance and Repair Considerations

Unlike with the majority of the non-operational portfolio, the Council is responsible for external repairs, decorations and improvements to the Group 1 and 2 units. Although the leases to individual tenants make them responsible for sharing these costs, because there is a frequent turnover of tenancies, new tenants are reluctant to contribute, which they say are not fairly imposed on a new lease of, typically, 3 years. Additionally, expenditure results when one tenant vacates and basic works are required to make the premises suitable for a new tenant, such as subdividing adjacent units previously occupied by one tenant or making them more environmentally efficient.

The Council was able to attract grant funding from the East of England Development Agency (EEDA) in 2005/06 (£30,000) and 2006/07 (£30,240). The money was used to erect perimeter fencing and improvements to the external appearance of both Group 1 and Group 2 units.

Costs are only incurred at the Piperell Way units when vacancies arise and dilapidations and improvements need addressing before the units can be relet. The leases pass full repairing liabilities to the tenants.

These costs and staff costs for managing units which have a high turnover rate are relevant factors to include in the AMP assessment.

6 Year Planned Maintenance Programme

Both the Group 1 and Group 2 units are now around 40 years old and major components are life expired. Costs have been identified, producing a total 6 year Planned Maintenance Programme of around £740,000.

The units, including Haverhill Enterprise Centre, could benefit from the following investment (by priority):

- Replacement rooflights, doors and windows: a piecemeal programme of replacements is being undertaken, but an investment will help bring the units up to a uniform standard of repair and will increase their energy efficiency;
- Underground drainage repairs and car park surfacing: there are a number of defects in the drainage and car park/ loading area surfacing, especially in the Group I units. This work would also raise the aesthetic quality of the general area;
- Fencing to site perimeter especially between the units backing onto the Hamlet Croft Football ground: this space has been subject to ongoing vandalism/arson and dumped cars. The neighbourhood community team is keen to see a security fence erected to control the problems;
- Complete roof renewal and internal refurbishment, including meeting Disability Discrimination Act (DDA) requirements: because the work would be extremely disruptive to occupying tenants, it is proposed that refurbishment and renewal works be undertaken as the units become vacant. There are 20 units remaining to be improved, at an estimated coat of £35-£40,000 per unit, excluding fees.

From an asset management perspective, consideration has to be given to the potential level of expenditure against the assessment criteria of service return, financial return and value for money. As a simple ‘pay back’ period, the cost of repairs per unit is equivalent to around 4 years’ total gross rent. However, it is unlikely that all of the units will become vacant sometime during the 6 year period, as a proportion of the tenants will renew their leases and retain occupation. Therefore the refurbishment budget needs to be flexible enough to be dipped into when a tenant vacates. The best way to achieve this is to ring fence a guaranteed sum over a longer period.

Property options to consider for potential expenditure

Identified maintenance expenditure which could be spent at the Group 1 and 2 units is potentially very high. Cabinet has, subject to this review, proposed to ring fence £445,000 of these estimated costs. For asset management and decision-making purposes, the property options need to be considered in respect of this proposal.

- Recharge the tenants a share of the cost – when a tenant vacates premises, a schedule of dilapidations is prepared. The outgoing tenant may chose to undertake the dilapidations or pay the Council an estimated sum which can be put towards the more extensive refurbishment. The ingoing tenant will be reluctant to contribute unless there is a compensatory rent free period. Making such a demand may deter an ingoing tenant from proceeding;

- Recharge the tenants a share of the cost through an increased annual rent – this is a difficult option to implement. The Haverhill units have a niche in the market and are able to attract a range of tenants who can afford to pay the current level of rent. If the rents are increased to reflect the costs of refurbishment, assuming a payback period of 5 years, the rents would roughly have to double. This is not tenable, although a small increase in rents over a period may be possible, depending on the wider market conditions. There is a balance between retaining tenants, reletting at acceptable levels or experiencing vacancies and voids;
- Recharge the tenants a share of the cost through an annual service charge – because of the potential level of recharge (service charge at the same level as the rent), this is also not tenable;
- Do not recharge the tenants. If the Council has a strong commitment to economic development, this option may be justified, but it may be difficult to measure performance. Additionally, the Council must be careful not to assist its tenants, to the detriment of other businesses occupying privately owned space. There are also State Aid considerations if 'subsidies' are significant. The statutory duty for obtaining best price is relaxed for leases of less than 7 years. The main reason for the Council holding the units is to provide industrial and commercial space at a price that small and growing businesses can afford;
- Undertake refurbishment in partnership – the Council was able to secure a grant from EEDA in 2005 and 2006. Investigations can be made to see if further grants are available. Alternatively, LABGI (Local Authority Business Growth Incentive Scheme) allocations could be made to the refurbishment programme (Paper Z304) in subsequent years, if the Council continues to perform strongly in economic development;
- Do not undertake refurbishment – major components of the units are becoming life expired and do not meet modern environmental standards. There is a danger that if refurbishment is not carried out as units become vacant, reletting will be more difficult and longer voids experienced, or rents will have to be reduced to achieve lettings. Additionally, the Council may be in breach of legislative requirements such as DDA, asbestos and energy use;
- Redeploy the £445,000 – The money does not have to be spent on these units – it could be put to more pressing needs in the capital programme or in the refurbishment of other non-operational assets. Paper Z304 identified a range of investment proposals for the LABGI grant over the next 2 years and the proposed application of this money complements this programme. It is unlikely that funds will be available for refurbishing the Haverhill units from this source in the foreseeable future. Alternatively, the Council has established a self-financing Property Fund for acquisition of key strategic or investment property. Some of this Fund could be used instead of the £445,000. There is no advantage in doing this.

These options are considered further in Exempt Appendix 3.

Assessment for Haverhill Industrial Properties

The matrix at the end of Exempt Appendix 3 lists the assets which form the Haverhill industrial portfolio. It scores and ranks each criterion and gives a total score and rank for each property. This enables performance to be compared for different criteria and against other properties. Poor and strong overall performers can be identified and then considered in broad terms whether to keep, vary or sell.

By comparison, the average score for the units is just over 10, whereas the average score for an investment property was 17. The highest scoring unit is 14, which is below the poorest scoring investment assets.