

# Extraordinary Joint Executive (Cabinet) Committee

Forest Heath & St Edmundsbury councils

**West Suffolk**  
working together

<b>Title of Report:</b>	<b>Investing in our Commercial Asset Portfolio</b>	
<b>Report No:</b>	<b>EXEMPTION REMOVED CAB/JT/19/006</b>	
<b>Report to and dates:</b>	<b>Extraordinary Joint Executive (Cabinet) Committee</b>	5 February 2019
	<b>SEBC Council</b>	19 February 2019
<b>Portfolio holder:</b>	John Griffiths Leader of St Edmundsbury Borough Council <b>Tel:</b> 07958700434 <b>Email:</b> john.griffiths@stedsbc.gov.uk	
<b>Lead officer:</b>	Ian Gallin Chief Executive <b>Tel:</b> 01284 757009 <b>Email:</b> ian.gallin@westsuffolk.gov.uk	
<b>Purpose of report:</b>	To advise Cabinet of the opportunity to acquire a commercial property investment in Bury St Edmunds using the £40m Investing in Growth Fund and to seek Council approval to purchase the property.	
<b>Recommendation:</b>	<p><b>It is <u>RECOMMENDED</u> that Cabinet submits an urgent proposal to Council which:</b></p> <p>(1) <b>endorses the proposal to purchase the property at Vicon House, Western Way, Bury St Edmunds for a sum of £3,266,000 (Three Million Two Hundred and Sixty Six Thousand Pounds) excluding VAT, fees and Stamp Duty Land Tax, to be funded from the Investing in the Growth Agenda fund; and;</b></p> <p>(2) <b>establishes a capital budget of £3,503,480 to be made available to facilitate the purchase, including fees and Stamp Duty</b></p>	

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	<p><b>Land Tax, to be funded from the Investing in our Growth Agenda Fund; and</b></p> <p><b>(3) notes that should the purchase be made, the Council's Section 151 Officer will make the necessary changes to the Council's prudential indicators as a result of Recommendation (1).</b></p>
<p><b>Key Decision:</b></p> <p><i>(Check the appropriate box and delete all those that <b>do not</b> apply.)</i></p>	<p><i>Is this a Key Decision and, if so, under which definition?</i></p> <p>Yes, it is a Key Decision - <input type="checkbox"/></p> <p>No, it is not a Key Decision - <input checked="" type="checkbox"/></p> <p>As it's a decision of Council</p>
<p><i>The decisions made as a result of this report will usually be published within <b>48 hours</b> and cannot be actioned until <b>five clear working days of the publication of the decision</b> have elapsed. This item is included on the Decisions Plan (as contained in a General Exception Notice published on 25 January 2019.)</i></p>	
<p><b>Consultation:</b></p>	<p>Cabinet members were briefed about this opportunity informally on 22 January 2019. A briefing will be provided to all councillors before any formal decisions are taken.</p>
<p><b>Alternative option(s):</b></p>	<p>The Council does not purchase this property investment and does not deliver strategic improvements. Another investor may bring forward a scheme that does not bring the wider highways and appropriate uses to match the Council's ambitions for the area.</p>
<p><b>Implications:</b></p>	
<p>Are there any <b>financial</b> implications? If yes, please give details</p>	<p>Yes <input checked="" type="checkbox"/> No <input type="checkbox"/></p> <ul style="list-style-type: none"> <li>A capital budget of <b>£3,503,480</b> would be funded from the Council's Investing in our Growth Agenda Fund</li> </ul>
<p>Are there any <b>staffing</b> implications? If yes, please give details</p>	<p>Yes <input type="checkbox"/> No <input checked="" type="checkbox"/></p> <ul style="list-style-type: none"> <li></li> </ul>
<p>Are there any <b>ICT</b> implications? If yes, please give details</p>	<p>Yes <input type="checkbox"/> No <input checked="" type="checkbox"/></p> <ul style="list-style-type: none"> <li></li> </ul>
<p>Are there any <b>legal and/or policy</b> implications? If yes, please give details</p>	<p>Yes <input checked="" type="checkbox"/> No <input type="checkbox"/></p> <ul style="list-style-type: none"> <li>If a purchase is approved, the Legal Team will be instructed to take forward the conveyancing and undertake due diligence.</li> </ul>
<p>Are there any <b>equality</b> implications? If yes, please give details</p>	<p>Yes <input type="checkbox"/> No <input checked="" type="checkbox"/></p> <ul style="list-style-type: none"> <li></li> </ul>
<p><b>Risk/opportunity assessment:</b></p>	<p><i>(potential hazards or opportunities affecting corporate, service or project objectives)</i></p>

<b>Risk area</b>	<b>Inherent level of risk (before controls)</b>	<b>Controls</b>	<b>Residual risk (after controls)</b>
Council does not achieve assumed returns from Investing in the Growth Agenda Fund.	High	Bring forward investment proposals as they become available in the local market.	High
Strategic opportunity from purchasing the site is missed.	High	Well-evidenced case to purchase the property is presented through this and the Council report.	Medium
Price offered is in excess of market value.	Low	Market assessed by Asset Surveyors from Strategic Property team. To be supported by Red Book valuation from an external consultant.	Low
Purchase price is agreed but professional fees could vary beyond budgetary provision.	Low	Use of the Council in-house solicitors. External property professional advice (Red Book valuation) already accounted for.	Low
The property was built in the 1960s and therefore has a limited remaining life. The fabric of the building could deteriorate over the next ten years which could affect tenant occupation levels and marketability.	Medium	Building surveyors from the Council's Estates Management team will inspect the property and set out mitigations. The property is subject to a Service Charge which should cover ongoing maintenance.	Low
The national investment market is experiencing instability due to uncertainty surrounding Brexit. Further turmoil in the markets could result in a fall in capital values. This could result in a loss if the property is sold.	High	The local market is stable and less susceptible to national trends and this purchase is seen as a long term investment which should avoid the effects of short term market forces. An exit strategy is set out in this report.	Low

The development value of the site could diminish as a result of highways requirements which are likely to reduce the size of the site available for development.	High	The site is located in an emerging area and therefore should command adequate demand even if the site is reduced in size. Any future development will be supported by a feasibility study and a development appraisal to help deliver a scheme that will achieve a return on investment along with strategic improvements.	Medium
<b>Ward(s) affected:</b>		All St Edmundsbury Wards	
<b>Background papers:</b> <i>(all background papers are to be published on the website and a link included)</i>		West Suffolk Growth Investment Strategy – Executive Summary	
<b>Documents attached:</b>		<b>Appendix A</b> - Location plan <b>Appendix B</b> – Photographs <b>Appendix C</b> – Site layout plans	

## **1. Key issues and reasons for recommendations**

### **1.1 The Opportunity**

- 1.1.1 The Council has the opportunity to purchase the freehold interest of an office/light industrial complex known as Viccon House on Western Way in Bury St Edmunds.
- 1.1.2 Ownership of this property interest can deliver strategic, place-shaping and revenue potential for the Council. The purchase would be made from the Investing in Growth Fund and would help toward achieving the aspiration of a 1% (after borrowing costs) return across the whole fund. It would deliver a net income of £88,950 per annum (a 2.54% return after borrowing) to support Council services and the Council's agreed investment strategy.
- 1.1.3 The property is currently fully let to six commercial tenants and offers long term potential to ultimately re-develop the site, complementary to the Western Way Development and West Suffolk College expansion. It also offers the opportunity to alleviate traffic issues in this area as highlighted previously as a concern by members. The supporting cases for this are set out under **3. Strategic Case**.

## **2. The Property**

- 2.1.1 The site comprises a mix of office space and light industrial workshops over two floors and a further retail unit of 3,625 sq ft (t/a World of Beds). The buildings consist of one large building with three additional detached workshops to the side and rear. The accommodation is split into seven units providing 2,888 sq m (31,087 sq ft) of office accommodation and 2,027 sq m (21,821 sq ft) of industrial space and benefits from 140 parking spaces.
- 2.1.2 Location plans are provided in **Appendix A** and site layout plans are attached in **Appendix C**.

### **2.2 Property Condition**

- 2.2.1 The Council's surveyors will inspect the property and their findings will be provided in an addendum before Council makes any decision.
- 2.2.2 The properties were built in the 1960s and are primarily of brick, concrete and steel frame construction with steel profile wall cladding in parts. The buildings are generally in reasonable condition throughout. The tenant at unit 2 and 3, Servest Group Limited, recently spent approximately £500,000 refurbishing their units.
- 2.2.3 Photographs of the property exterior are attached in **Appendix B**.

### **2.3 Offer and Valuation**

- 2.3.1 The development firm, Bream Real Estate, introduced the opportunity to the Council. The property will be purchased as part of a package from the vendor, Citygate, where Bream will purchase a property in Ipswich and the Council purchase Viccon House from the same vendor at a fixed price on an

open book basis. This will protect the Council's position and will avoid any conflict of interest between the parties. Bream will receive a finder's fee of 2% of the purchase price for the off market introduction.

- 2.3.2 We understand that Citygate want to combine these two properties in one sale as they are keen to dispose of some of their assets within this financial year. Therefore, it would not be appropriate for the Council to approach Citygate directly at this stage with Bream having introduced the opportunity and the deal being an off-market one. This could potentially damage the Council's reputation in the investment market going forward.
- 2.3.3 Officers have negotiated a purchase of the property, subject to contract and Council approval, in the sum of £3,266,000 (Three Million Two Hundred and Sixty Six Thousand Pounds) exclusive of VAT, SDLT and fees. At this price the finder's fee payable to Bream equates to £65,320. Bream have indicated that they are content with this proposal, but it has yet to be agreed by Citygate.
- 2.3.4 The offer was based on advice from the Council's in-house chartered surveyors and finance officers and takes account of the current market value of the interest including the revenue and borrowing implications.
- 2.3.5 To support the offer a RICS Red Book valuation is being prepared. Once we have obtained this advice, it will be presented to Members in the form of an addendum to this report.

## **2.4     *The Purchase process***

- 2.4.1 We will seek for Heads of Terms to be agreed between the parties and, subject to Council approval, in-house solicitors will undertake the conveyancing and due diligence.
- 2.4.2 If there are no unforeseen legal or property issues arising from the due diligence process, we could exchange contracts and complete the acquisition by the end of March 2019, which aligns with Citygate's aspirations to realise the asset value during this current financial year.

## **3.     Strategic Case**

- 3.1 A purchase of the site provides an opportunity for the Council to hold ownership influence in an area in which the Council already has a presence and is investing significantly in the future shape of the area.
- 3.2 The design and procurement of any future development is expected to be over a five to ten year timeframe during which the Council will continue to hold and manage the property as a revenue-generating investment.

### **3.3     *Western Way***

- 3.3.1 Given the close proximity of the site to West Suffolk House, the Council's Western Way Development site and ongoing developments by West Suffolk College in the area, this purchase provides potential for the Council to

develop complementary uses on the site and will protect its vision for the area.

### **3.4 Highways**

- 3.4.1 Crucially, ownership of the site could allow the Council to use the north western corner of the site to assist the Highways authority to implement road improvements to alleviate current traffic congestion on the tight corner on Western Way between ASDA and the Newmarket Road traffic lights. This is an issue that has been highlighted previously by councillors.
- 3.4.2 Redevelopment of the site could reduce the number of exits from the site onto Western Way (currently three) in line with Highways proposals.
- 3.4.3 The Council could consider the impact of a new development on overall traffic volumes on Western Way and lower volume uses could be sought. However, more importantly, retaining the current uses (the most likely scenario in the timeframe of the Western Way planning application) gives certainty over traffic movements in the local network, as these are linked predominantly to office use. In contrast, commercial developers are likely to consider retail uses which offer a higher development value, but could increase traffic volumes significantly.

### **3.5 Supporting existing businesses on the site**

- 3.5.1 Existing tenants, such as Servest and Green Duck, are major employers in Bury St Edmunds and the Council, as landlord, could enable existing tenants to retain operations in the area by offering flexible leases or secure tenure. The Council's redevelopment timeframe may be longer than that of any commercial developer purchasing the site, and we would consider the retention of those businesses when assessing scheme feasibility.
- 3.5.2 This investment in West Suffolk will support the Council's strategic priority of "Growth in the West Suffolk economy" by maintaining property for local employment and encouraging major employers to remain in the area.

### **3.6 Protecting the High Street**

- 3.6.1 Should the site be purchased by a commercial developer, their ambitions could potentially involve retail to mirror the Western Way Retail Park (B&M and The Range). This could have an adverse impact on the health of the town centre by encouraging a greater number of shoppers to an out of town location.

## **4. Financial Case**

### **4.1 Investing in Growth Fund**

- 4.1.1 The principle of the Council's Investing in Growth Fund is to support delivery of the West Suffolk Strategic Priorities and produce revenue to support the ongoing delivery of services. The fund aims to provide a blended return with a target to achieve 1% above borrowing across the whole fund.

4.1.2 So far the fund has invested in the following:

- Developing Cornhill Post Office, Bury St Edmunds
- Acquisition of 20 High Street, Haverhill
- Acquisition of 113 High Street/1 The Avenue, Newmarket
- *In the process of acquiring 33-35 High Street, Haverhill (approved by SEBC Council on 19/12/18)*

4.1.3 Collectively these investments provide a gross revenue income of £328,925, with a return on capital invested to date, after borrowing, of 0.26% (against a blended return target of 1%). Therefore the current net revenue return is £14,600, against the MTFS revenue requirement of £400,000.

## 4.2 Capital Implications

4.2.1 The provisionally negotiated price (subject to Heads of Terms being agreed) represents a total cost to the Council of £3,503,480, which includes SDLT and fees. Any VAT would be reclaimed by the Council.

4.2.2 The table below details the breakdown of the total capital cost of £3,503,480.

Capital Implications of Purchase of Vicon House, Bury St Edmunds	
Purchase Cost of building	3,266,000
Stamp Duty (SDLT)	139,500
Finder's fee - 2% of purchase price	65,320
Purchaser's costs - 1% of purchase price	32,660
<b>Total Capital Cost</b>	<b>3,503,480</b>

## 4.3 Revenue Returns

4.3.1 The property is expected to produce an annual rental income of £276,450 per annum once one outstanding rent review is completed (current rent passing is £266,450).

4.3.2 As this purchase will be part of the Investing in our Growth Agenda fund, it has been assessed on the basis of the Council borrowing to fund the purchase. This is consistent with all investments made from this fund. The table below details the revenue implications of this investment:

<b>Revenue Implications of Purchase of Vicon House, Bury St Edmunds</b>	
Rental Income from development	276,450.00
Less: Management Fees	( 36,000.00)
<b>Total income per annum</b>	<b>240,450.00</b>
<b>Overall (surplus)/deficit per annum before borrowing</b>	<b>240,450.00</b>
Borrowing - Interest	( 105,000.00)
Borrowing - MRP	( 46,500.00)
<b>Overall (surplus)/deficit per annum after borrowing</b>	<b>88,950.00</b>

- 4.3.3 Based on an expected annual surplus income of £88,950, and a total capital cost of £3,503,480, the net revenue return would be approximately 2.54% which would help meet the current Investing in Growth Fund requirement. This in turn helps support the delivery of wider council services.
- 4.3.4 The table above includes the full cost of prudential borrowing, however actual borrowing would only take place when the council's treasury management activities identify such a need. For example, this could be when the council's cash flow management activities anticipate that an external cash injection is required to maintain the appropriate level of cash balances for the council to operate and fulfil its budget and service delivery requirements.

#### **4.4 Investment Risk management**

- 4.4.1 The existing tenancies extend to an average unexpired lease term of 6 years which represents good income security in the medium term.
- 4.4.2 Due diligence is being undertaken on existing tenants to provide comfort on tenant covenant strength.
- 4.4.3 A service charge is currently levied on tenants which will help to offset maintenance costs on existing structures.
- 4.4.4 There is risk associated with retail in the current market, but retail only forms a small element of the existing site with World of Beds in Unit 1 accounting for 10% of total rental income. The remaining tenants operate under office/light industrial uses.
- 4.4.5 Mixed use developments spread the risk of tenant failure. If one market collapses, retail for example, the other uses on the site should continue to produce income. The presence of six separate tenancies on site will further spread the risk of rental default. Commercial re-development of the site is a clear alternative should returns from the current investment start to fall away.

#### **4.5     *Exit Strategy***

- 4.5.1     In the long term the site could be sold as an investment. Value could be added by re-gearing leases and gaining outline planning consent for a commercially viable re-development.

#### **5.       **Legal Considerations****

- 5.1       We will be obtaining copies of the Land Registry title documents and title plans and as part of the due diligence process will ensure that the vendors' personal covenants have been complied with. These will need to be confirmed by personal inspection.
- 5.1.1     The normal due diligence appropriate for a purchase of this nature will also be undertaken, including on planning and on the covenant strengths of the individual tenants.
- 5.1.2     Further legal commentary will be provided in the addendum.

#### **6.       **Resource Considerations****

- 6.1       If purchased, the property will be managed using the existing resources within the Councils in-house Estates team.

#### **7.       **Governance Considerations****

- 7.1       The timing of this proposal is not of the Council's making, as we are reacting to a market opportunity and need to act quickly in order to consider it.
- 7.2       In that context, while the information in this report is correct at time of writing, it may evolve before the extraordinary Joint Executive (Cabinet) Committee meeting and/or, if agreed by the Cabinets, before the Council meeting at which approval will ultimately be sought. Therefore, it may be necessary to revise the Joint Executive (Cabinet) Committee recommendation before either meeting.