

CABINET

18 June 2019

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| Title: Purchase of 44-52 River Road, Barking, IG11 0DP | |
| Report of the Cabinet Member for Finance, Performance and Core Services | |
| Open Report with Exempt Appendix 2 (relevant legislation: paragraph 3 of Part I of Schedule 12A of the Local Government Act 1972 as amended) | For Decision |
| Wards Affected: Thames | Key Decision: Yes |
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| Accountable Director: Ed Skeates, Development Director, Be First | |
| Accountable Strategic Leadership Director: Claire Symonds, Chief Operating Officer | |
| Summary | |
| <p>The area around River Road is a key employment site within the Borough and is allocated as Strategic Industrial Land (SIL). An opportunity has arisen for the Council to purchase the 4.37 acre site of 44-52 River Road (shown in appendix 1) as an investment asset. The building has a remaining term of 10.8 years to Restore PLC with an overriding guarantee (Authorised Guarantee Arrangement) provided by the previous tenant (Wincanton PLC) which provides a strong covenant. The passing (existing) rent at £7.30 psf is considered reversionary (below the market rate) and the rent review in 2022 is likely to yield a significant uplift (c.£10psf).</p> <p>Given the changing nature of industrial areas in the sub region it is expected this will result in increases in occupational rent and industrial land prices in the locality.</p> <p>Acquisition of the property would meet a number of key objectives for the Council:</p> <ol style="list-style-type: none">1. The acquisition of well let commercial property within the borough, in good condition on Full Repairing and Insuring (FRI) lease, providing a satisfactory return with potential for improving returns through rental growth post 2022 that meets the minimum investment criteria of the Council.2. The acquisition of a large site in an established industrial area which provides the medium-term opportunity (post 10 years) to relocate/decant existing business occupiers on sites which have been identified for redevelopment for residential use to minimise the need for businesses to leave the borough. <p>Restores PLC use the building as a commercial document/archive store.</p> | |

The necessary due diligence has been undertaken and the acquisition has been reviewed and approved by the Investment Panel on the basis the purchase price does not exceed the figure set out in Appendix 2 below which it meets the Council's investment criteria.

Recommendation(s)

The Cabinet is recommended to:

- (i) Approve the acquisition of the site at 44-52 River Road, as shown edged red in the plan at Appendix 1 to the report, via borrowing within the General Fund on the terms set out in Appendix 2 to the report;
- (ii) Delegate authority to the Chief Operating Officer, in consultation with the Cabinet Member for Finance, Performance and Core Services, the Cabinet Member for Regeneration and Social Housing and the Director of Law and Governance, to agree the final terms for completion and retain the asset as an investment on the completion of all due diligence; and
- (iii) Authorise the Director of Law and Governance to enter into all necessary agreements, contracts and other documents to complete the freehold purchase .

Reason(s)

- Acquire a well let commercial property within the borough, in good condition on a FRI lease, providing rental income with potential for improving returns through rental growth that meets the Council's investment criteria.
- Secure a strategic parcel of land which offers the medium term opportunity (post 10 years) to relocate/decant existing occupiers from sites which have been identified for redevelopment for residential use to minimise the need for businesses to leave the borough.

1. Introduction and Background

- 1.1 44-52 River Road, Barking IG11 0DP (the Property) is a 4.37 acre site that contains a large warehouse, a separate two storey office building, small gate house and small facilities building (no longer in use), with a total floorspace of 82,296 sq ft. The warehouse is currently used as a commercial document/archive store. The office building is used by the staff as break out space and administrative staff although much of the space is unused and is in a poor condition. A title plan can be found in Appendix 2 of this report.
- 1.2 The Property is bounded by the River Roding to the west and River Road to the east. The site is elevated from the roadside level and is rectangular in shape with a 43% site coverage. The main building construction is of steel portal frame with brick/profile metal clad elevations beneath and profile steel roof with an eaves height of approximately 8 metres.
- 1.3 The lease falls within the Landlord and Tenant Act so at expiry the current tenant would be entitled to a lease extension under similar terms. There is no break in the lease until expiry which adds to the security of income.

- 1.4 A building survey has been undertaken which shows that it is generally in good repair. The current tenant is liable for all costs of repair, maintenance and insurance so there is no cost to the landlord. The survey suggests that the office element is dated and effectively obsolete. While the current tenant is liable to leave the property and the office element in good condition at the end of the lease it is recognised that this space might be surplus to the requirements of a future occupier.
- 1.5 The site has power lines crossing the site which limits redevelopment opportunities however the site is not being purchased for redevelopment potential.
- 1.6 An independent agent's opinion of value has been procured which justifies the proposed purchase price with reference to current market transactions in the outer London area. Moreover, it confirms that the current rent is revisionary and that the lack of office element would not prejudice the re letting of the accommodation at lease expiry. Therefore, it is considered that the purchase represents a secure investment with the potential for improved returns following a rent review in 2022.

2. Proposal and Issues

Opportunity

- 2.1 Industrial investments provide potential for increased returns driven by a scarcity of stock and the potential to aid residential led regeneration by providing mid to long term decant opportunities. This is an opportunity for the Council to acquire an investment within Borough that will provide acceptable returns at purchase with the potential for improved returns following a rent review in 2022. In the mid to longer-term ownership (i.e. beyond 10 years) the site would assist the Council in accommodating either the existing tenant for a further term or other business occupiers potentially decanted from former industrial sites which are now allocated for residential regeneration.
- 2.2 The purchase offers a sound investment which meets the Council's minimum investment criteria, with an opportunity to benefit from rising land values in the area in the future. The site is not being acquired as a redevelopment site for alternative uses, given the proximity of other traditional employment uses and the SIL status of the land the current use is intended to be retained. The site is allocated as Strategic Industrial Land in the adopted Local Plan where there is a presumption in favour of retaining industrial uses in the B1/ B2/ B8 and sui generis use class.

Heads of Terms

- 2.3 The structure of the transaction has been agreed between the Vendor and Be First as the Council's agent. It is proposed that this purchase is made by a Council in its General Fund given the long term nature of the hold. The Council intends to access Public Works Loan Board (PWLB) borrowing to fund the purchase.

3. Options Appraisal

3.1 Option One – Acquire the Site

Acquisition of the property would meet a number of key objectives for the Council:

- The acquisition of well let commercial property within the borough, in good condition on a FRI lease, providing a rental income with potential for improving returns through rental growth that meets the Council's minimum investment criteria.
- The acquisition of a key strategic site which provides the medium-term opportunity to relocate/decant existing employment occupiers.
- The long-term opportunity to benefit from rising land values in the area in the future.

3.2 Option Two – Do not acquire the Site

- If the Site is not acquired by the Council, it is likely that the property will be sold in the open market to the highest bidder at a level similar to the proposed purchase price;
- It is likely it will be to an investor looking to hold the property in the medium term and benefit from the uplift in rental income at the next rent review and the general upturn in land/property values in the borough over the coming years;
- The Council will have missed the opportunity in the medium to longer term to provide future decant space for local businesses that may be blocking the regeneration of sites elsewhere in the borough such as Castle Green and Thames Road;
- The Council will not benefit from the likely improvement in rental levels/investment values or the long term land value increases.

4. Consultation

4.1 There has been no public consultation on the Property purchase as there are no immediate plans to redevelop.

4.2 The initial proposal was discussed by the Be First Board on 14th January 2019, which supported the recommendation to proceed with the purchase.

4.3 The proposal was discussed by the Investment Panel on 22nd May 2019 on the basis of a lower purchase price, which supported the recommendation to proceed with the purchase.

5. Financial Implications

Implications completed by: David Dickinson, Investment Fund Manager

- 5.1 The investment proposal put forward is not part of the current business plan and will therefore require additional borrowing. The cost of borrowing is 3.25% and this will be covered by the rental return providing a net of interest return each per year.
- 5.2 River Road will be held for investment purposes and will be managed on a fully commercial basis. The purchase will be treated as capital expenditure and will increase the Council's Capital Financing Requirement. The Council will hold River Road for investment purposes, with the option to sell the asset or redevelop it. The property will be leased on a fully repairing basis, with no additional costs outside of the 0.8% set aside for management of the asset.
- 5.3 If the Council intended to buy and develop or buy and sell River Road then no debt repayment, called Minimum Revenue Provision (MRP) would need to be set aside to repay the debt liability. As the asset is going to be held to provide an annual return and possibly re-let and not redeveloped or sold, then MRP will need to be set aside, which will significantly reduce the net income generated.
- 5.4 It is recommended that, prior to the Council purchasing this site, a report containing the full terms of the deal, confirmation of the net return, recommendations for the equitable split of the net return and an independent s123 report, is provided.
- 5.5 Issues have been identified around the constraints inherent with the investment, especially around the Pylons on the property. The impact both on the value of the purchase costs but also on future development and sales value needs to be fully investigated and reported on prior to any deal being agreed.
- 5.6 Clarification is required from Be First over the use of a draft opinion of value from Lambert Smith Hampton to support the development as Lambert Smith Hampton introduced the investment to Be First.

6. Legal Implications

Implications completed by: Paul Field, Legal Practice

- 6.1 This report proposes the freehold acquisition of land known as 44-52 River Road being a 4.37 acre site with a tenanted 82,296 sq.ft warehouse let to Restore PLC for the maximum price set out in Appendix 2. The report notes that in the short to mid-term the site is being acquired as an industrial investment opportunity deemed to yield acceptable returns, with the potential to support future housing led regeneration objectives by providing decant space for businesses relocated from other regeneration sites. The intention is to retain industrial uses on the site which is consistent with its designation of the site in the SIL, and not to redevelop for residential uses. As such the rationale for the acquisition is both investment and regeneration led. Gowling LLP have been retained to advise in respect of the acquisition/terms and are carrying out appropriate due diligence into potential risks, liabilities and relevant Landlord and Tenant Act 1964 matters. The presence of two pylons and their impact on development potential

- 6.2 The purpose for which land is acquired is relevant to the powers to be relied upon. Officers have identified the site as an investment opportunity, with the potential to support further regeneration in the area by providing decant space for displaced businesses from housing led regeneration sites. The Council has the power to acquire the freehold interest in the land by virtue of Section 120 of the Local Government Act 1972. and to carry out the proposed acquisition under the general power of competence, section 1 of the Localism Act 2011 (GPC). Under the GPC power the Council can do anything that individuals generally may do provided that there is no prohibition against it elsewhere. Section 1(5) of the Localism Act provides that the general power of competence under section 1 is not limited by the existence of any other power of the authority which (to any extent) overlaps with the general power of competence. The use of the power in section 1 of the Localism Act 2011 is, akin to the use of any other powers, subject to Wednesbury reasonableness constraints and must be used for a proper purpose.
- 6.3 The general power is also subject to the limitation under section 4 of the Localism Act 2011, to the effect that if it is used for a commercial purpose then the Council must do the activity through a company or registered society. Officers and decision makers must be satisfied that the Council would not be acting predominantly for a commercial purpose in pursuing this investment acquisition. The mid to long term regeneration arguments in favour of the acquisition suggest the purpose is not purely commercial.
- 6.4 Further support for the transaction is available under Section 111 of the Local Government Act 1972 which enables the Council to do anything which is calculated to facilitate, or is conducive to or incidental to, the discharge of any of its functions, whether or not involving expenditure, borrowing or lending money, or the acquisition or disposal of any rights or property.

Investment Power

- 6.5 The short to mid-term and requires borrowing from PWLB to fund it. The Council's power to invest (Section 12, Local Government Act 2003) is relevant and can be exercised for any purpose relevant to its functions or for the purposes of the prudent management of its financial affairs. In exercising this power, the Council would rely on the second limb, namely that the proposals aid prudent financial management and should have regard to relevant statutory guidance. The financial implications consider how the proposals assist the prudent management of the Council finances.
- 6.6 The Ministry of Housing Communities and Local Government (MHCLG) issued revised statutory guidance under section 15 of the Local Government Act 2003 on local authority investments on 1 April 2018 (the Guidance). In approving the proposals both officers and decision makes should have regard to relevant aspects of the MHCLG Guidance.
- 6.7 Local Authorities are required to have an updated investment strategy as is required in the Guidance. The Council's Investment Strategy contains provision for commercial investments albeit it is pending revisions. The investment metrics are deemed acceptable in line with the current Investment Strategy. The report and any accompanying financial or legal due diligence reports (which are confidential

and exempt) should address how the proposals are aligned with the investment parameters for the commercial asset class.

- 6.8 The Guidance references 'non-financial assets' which includes certain property portfolios: 'non-financial assets that the organisation holds primarily or partially to generate a profit; for example, investment property'. There are specific requirements for non-financial investments, and property portfolios, set out in paragraphs 37 to 40 of the Guidance. The Guidance requires local authorities to consider whether the asset retains enough value to provide security of investment using the fair value model in International Accounting Standard 40: Investment Property as adapted by proper practices.
- 6.9 In taking forward the proposals finance and legal officers should discuss the impact of MHCLG's guidance and whether the arrangements qualify as 'non-financial assets' under it. Consideration of the financial implications should include the extent to which the proposals amount to fair value and any proposed mitigation of risks.

7. Other Implications

- 7.1 **Risk Management** – The land purchase risk has been mitigated via the independent market appraisal undertaken by Lambert Smith Hampton and due diligence to date. Extensive legal due diligence work has taken place regarding the acquisition. Be First has been advised by Gowlings who produced a report on title. A desktop environmental study has been prepared and the vendors have shared a previous intrusive survey. The survey confirms that the site is made ground which will require enhanced foundation design on any redevelopment if this is proposed. The site lies in an area of heavy industry and there is a strong likelihood of contamination in the site and adjacent land. However, if the current use is retained the risk of contamination presenting a danger or leaving the site is limited. It is not considered necessary to purchase environmental insurance at this stage as the current tenant is liable for any activities undertaken on the site.
- 7.2 **Contractual Issues** - The proposal is for the Council to hold the asset in its General Fund. An application to elect for tax has been made so the purchase can progress as a TOGC. It is proposed that the asset would be managed by the Council Property Services Department in My Place and it organise for updates to the buildings insurance policy and the recovery of any costs from the tenant.
- 7.3 **Property / Asset Issues** - The proposal involves a freehold purchase providing an additional asset for the Council. My Place would take the Landlord role collecting rent.

Public Background Papers Used in the Preparation of the Report: None

List of appendices:

- Appendix 1: Title Plan
- Appendix 2: Financial Information (P&C)