Title: The Council’s Commercial Property Portfolio 2015

Report of the Chief Finance Officer

Open Report

Wards Affected: All

Key Decision: No

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Accountable Director: Jonathan Bunt, Chief Finance Officer

Summary

In reviewing the work programme at the meeting of PAASC on 24 June 2015, Members asked for a report to be presented detailing information about the Council’s Commercial Property Portfolio following its return to the Council from Elevate in April 2015.

Recommendation(s)

That Members note the update regarding the Council’s Property Portfolio.

Reason(s)

This report was requested at the last meeting of the Public Accounts and Audit Select Committee on 24 June 2015.

1. Introduction and Background

1.1 The Council’s Commercial Portfolio currently comprises 428 property assets for which a commercial agreement (usually a lease) is currently in place. These comprise a mix of short and long leasehold arrangements. The table below summarises the asset classes and property types held in the Portfolio:

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Property Type</th>
<th>No of Units</th>
<th>Gross Rent</th>
<th>Gross Value (based on 10% of rent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Community</td>
<td>• health centres</td>
<td>77</td>
<td>£1.02m</td>
<td>£10.2m</td>
</tr>
<tr>
<td></td>
<td>• social &amp; sports clubs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• children’s nurseries</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• allotments</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industrial</td>
<td>• light industrial</td>
<td>99</td>
<td>£1.2m</td>
<td>£12m</td>
</tr>
<tr>
<td></td>
<td>• long leaseholds</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• advertising hoardings</td>
<td></td>
<td></td>
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<td>-----</td>
<td></td>
</tr>
<tr>
<td>• substations</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retail</td>
<td>252</td>
<td>£1.95m</td>
<td>£19.5m</td>
<td></td>
</tr>
<tr>
<td>• shops</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>428</td>
<td>£4.17m</td>
<td>£41.7m</td>
<td></td>
</tr>
</tbody>
</table>

1.2 The Commercial Portfolio is managed by the Property Service Team. This was transferred to Elevate in April 2012 with rental income and client oversight retained by the Council. The Property Services Team was transferred back to the Council from Elevate in April 2015, which included three permanent staff members. The team is now managed by the Strategic Asset Management and Funding Team within Finance.

2. About the Commercial Estate Team and Portfolio

2.1 The Commercial Estates element of the Property Services Team currently comprises two Senior and one Estate Surveyor. The objective of the team is to maximise rental income, manage all new lettings, rent reviews, lease renewals, property inspections and undertake all landlord and tenant matters in conjunction with the Council’s Legal Services and Elevate Income Team. The team act as the Council’s principal advisors.

2.2 The Commercial Property Portfolio is varied and diverse, with a range of both investment properties (held for their level of income) or those held for their social and community value (most of which still generate an income for the Council). A number of properties are long leasehold and properties that are managed in conjunction with Service Departments (such as the community centre management agreements and buildings where part of the areas sub-let to third party e.g. – Children’s Centres etc).

2.3 Since transferring back to the Council, the financial structure of the Portfolio is being amended so it can be managed on a profit and loss account basis. This establishes clarity and transparency on both the income and costs associated with managing the Portfolio and will enable performance benchmarking to be undertaken to demonstrate that the team is managing the stock effectively. This process will also highlight under-performing properties that will be considered for dispose or redevelopment.

2.4 In 2014/15 the portfolio generated £3.99m in income; an increase of 8.5% on the 2013/14 income. This was mainly due to three major factors, a rising market; the portfolio being largely fully let (2% vacant units) and the completion of backdated rent reviews and lease renewals.

2.5 The previous Housing Revenue Account (HRA) element of the portfolio was transferred to the General Fund (GF) in 2014/15 following legal advice and approval from the Council’s external auditors.

2.6 The commercial units previously accounted for within the HRA were initially provided under housing powers to provide amenity to Council housing in the area. As a consequence of changes in ownership of the surrounding Council housing, largely due to right to buy, the shops no longer provided benefit solely or predominantly to Council tenants. Furthermore, Government policy is that the HRA remains a ring-fenced account and should primarily be a landlord account arising from a housing authority’s landlord functions rather than as a commercial landlord. All associated income and running costs of these properties now fall to the General Fund.
2.7 On the basis that the shops were not being provided or used for housing linked purposes and are on commercial leases, the properties therefore should correctly be accounted for in the General Fund. It should be noted that the HRA self-financing settlement excluded commercial properties held within any HRA and therefore no debt is attached to these properties as a consequence of the HRA self-financing settlement. As such no adjustment was required to the respective Capital Financing Requirements (CFR’s) of the General Fund and HRA.

2.8 In 2015/16, management costs (salaries, valuations, lettings, repairs, vacant unit costs etc) will amount to £315,000, which represents a management fee of around 7.8% of the income. Industry standards within the private sector would typically expect a management fee of around 10%.

3. **Marketing & New Lettings**

3.1 Demand for the Council’s commercial shops is particularly strong with many new businesses choosing to set up in the Borough. As a result there were only 8 vacant units currently not under offer and available for lease as at the end of July 2015. This represents a vacancy factor of 2% of the portfolio, which is a level of performance above expectations for a diverse Local Authority portfolio. Comparisons with other London Borough’s in August 2015, suggests vacancy factors of between 4-6%.

3.2 The number of properties and income levels within the Portfolio is dynamic. The Portfolio changes reflecting the loss and acquisition of new units through demolition and redevelopment, such as the shops at Althorne Way, the shops demolished as part of the Goresbrook Village development (replaced by a new shop unit) and the new units created as part of the Abbey Road regeneration scheme.

3.3 The advertising and marketing of vacant units is currently outsourced to Dobbin and Sullivan, a firm of chartered surveyors and commercial property consultants who were appointed in 2012, and this arrangement will be market tested later in 2016. The marketing process is overseen by the Property Services Team to ensure efficiency.

3.4 Ward Members are notified of all new applications, which are assessed on a mix of rent offered; the user class required; the proposed use and the financial viability of the applicant to ensure a sustainable mix of units within a parade. Whilst healthy competition is welcome, too many of the same retail type within a single parade can reduce the chances of commercial survival within the parade. The Council’s Planning Team are also consulted to ensure that the necessary planning approval is sought where appropriate.

4. **Rent Reviews & Lease Renewals**

4.1 Over 95% of rent reviews and lease renewals are carried out by the team using market evidence and comparable data. Details of the rent reviews and lease renewals are drawn from the records held within the Asset Management System (see below) to ensure that the necessary legal notices are issued. Negotiations are concluded by the team with support from Legal Services and expert external advice is procured when required, on specialist areas (eg - industrial, sports & social clubs) where there is a less comparable evidence available within the Council.
4.2 The work of the Property Services Team is planned using reports generated from the Council’s Asset Management System. This enables work to be planned to efficiently manage expected rent reviews and lease renewals. This allows the Property Services Team to proactively engage with lessees several months in advance of the actual renewal date and negotiate a new lease and rents based on comparable evidence within the market to minimise void periods and maximise income.

5. Data Management

5.1 All property data is held electronically on the Council’s Corporate Asset Management System, this includes electronic copies of leases, site plans and photographs for much of the estate as well as lease information and tenant’s details.

5.2 A detailed exercise was undertaken in 2014 to cross check electronic records with manual files and data held by Legal Services to ensure the dates and details of rent reviews and lease renewals were current and these details feed into the work programme of the team.

6. Property Inspections

6.1 Vacant units are inspected fortnightly, as part of the Council’s insurance requirements and to ensure they remain secure and undamaged.

6.2 A series of annual property inspections commenced in April 2015 to ensure each occupied property is inspected at least once a year and a number of properties are inspected each month. This has proved particularly useful in engaging with our tenants and identifying and resolving management issues early.

7. Rent Collection and Arrears

7.1 The invoice and rent collection process is managed through the Elevate Income Section. The Income Service is notified of any changes to the portfolio (rent reviews etc) in order for revised invoices to be issued.

7.2 Management reports on rent collection are sent to the Property Services Team so that a process of reconciliation can be undertaken to cross check income with rent levels. The income collection rate for 2014/15 was 93% with several cases currently being pursued via the legal process in order to collect the outstanding arrears and key performance indicator are being developed with Elevate that specifically looks at the collection of commercial property debt outside of the wider general income target.

7.3 Tenants with unpaid invoices are sent a reminder, following which action to recover the money is generally initiated. In circumstances where significant rent arrears have built-up and the tenant has been unable to agree a plan for settling these arrears, legal proceedings are commenced, which can lead to the property being repossessed.
8. Reviewing the Portfolio and Disposals

8.1 Since 2013, capital receipts in excess of £700k have been generated either through actively disposing of units deemed to have little future value / opportunity for regeneration or through planned regeneration initiatives. A further £280k is anticipated in 2015/16 through sales agreed at Cabinet on 27 January 2015.

8.2 The portfolio generates a positive net income for the Council and has historically been managed passively with the Council not having sought to actively grow the portfolio through a pro-active programme of disposals, acquisitions and development. However, given the Council’s financial challenges and growth agenda, there is an opportunity to review this approach and to adopt a positive strategy to grow the portfolio. There is also an opportunity to review the lower performing/yielding units to consider alternative future provision or disposal.

8.3 A review of all Council property assets is currently being undertaken. Properties have been mapped on a ward by ward basis and this work supports the property asset review which will culminate in a new Corporate Asset Management Strategy, which will be bought to Cabinet for approval.

9. Financial Implications – Completed by Carl Tomlinson, Group Manager (Finance)

9.1 The report provides PAASC with an update on the commercial property portfolio. There are no financial implications arising as a result of this report.

10. Legal Implications – Completed by Evonne Obasuyi, Senior Lawyer

10.1 The report provides an update on the management and operation of the Council’s commercial portfolio. The Council is required to comply with its statutory obligations in regard to asset management and in the delivery of its landlord functions. There are no legal implications identified in this report.

11. Other Implications

11.1 Risk Management - No specific implications.

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

13. List of appendices: None.