

**Report of: Director of City Development and Deputy Chief Executive**

**Report to: Executive Board**

**Date: 22 June 2016**

**Subject: Design & Cost Report for Acquisition of Properties for the Council's Investment Portfolio**

Are specific electoral wards affected? If relevant, name(s) of ward(s): Temple Newsam and City & Hunslet	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
Are there implications for equality and diversity and cohesion and integration?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Is the decision eligible for call-In?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Does the report contain confidential or exempt information? If relevant, access to information procedure rule number: 10.4(3) Appendix number: 1	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No

### Summary of main issues

- On 21 October 2015 Executive Board considered a report from the Chief Executive entitled 'Strong Economy, Compassionate City' which was a response to the White Paper motion passed at July Council on sharing economic success in the city. The report advised how the Council had played a pivotal role in the economic recovery of Leeds having intervened proactively to kick-start development and regeneration projects, support businesses to grow and invest, and to help people to work. The Council had used its powers for land assembly at the Trinity and Victoria Gate schemes; brought forward its land at Sovereign Street; constructed the First Direct Arena; and pump primed the delivery of manufacturing and logistics space in the Leeds Enterprise Zone, amongst a few. The ambition for Leeds to have a strong economy and to be a compassionate city has now been set out in the Best Council Plan 2016/17, with a council priority being to support economic growth and access to economic opportunities.
- The subject of this Design and Cost report relating to the Council's investment portfolio builds on the Council's activities and role as major regeneration body within the city. It further demonstrates how the Council's early intervention in poor economic conditions has resulted in investment opportunities yielding significant returns for the benefit of the citizens of Leeds.
- Following the Council's intervention it now has the opportunity to acquire two buildings to add to its property investment portfolio. This arises as a direct result of

investing at a time when others would not, and releasing land into an otherwise stagnant market to stimulate development. The buildings would be acquired with tenants from which the Council will immediately receive a rental income. The level of rents are sufficient to cover the cost of borrowing to acquire the properties and provide a substantial surplus to support the Council's budgets, to continue to improve services at a time when funding streams to the Council are declining. The buildings are 3 Sovereign Square, Sovereign Street / Swinegate, LS1 (City and Hunslet Ward) and Unit 1 Logic Leeds, Skelton Moor Way, LS15 (Temple Newsam Ward)

4. One of the main aims of the Council is to bring about economic regeneration in Leeds. The Council has been involved in bringing forward the development of both of these buildings at a time when the market was stalling and their acquisition will further the Council's involvement and financial benefits. With the Council's ambition to become the best city in the UK, with an economy that is both prosperous and sustainable, these acquisitions offer the opportunity to further boost the performance of the Council's property investment portfolio with substantial rental income. The acquisitions align with the approved Asset Management Plan which includes enhancing the value of the Council's Investment Portfolio in order to produce further revenue to support the Council's budget position. The proposal also contributes to regenerating places, supporting businesses to grow and invest, creating quality places and spaces and backing innovators and entrepreneurs.
5. These are unique opportunities offered by the owners for the Council to acquire strategic investments which will enhance the quality and performance of the Council's Investment Portfolio.

## **Recommendations**

6. Executive Board is recommended to:
  - i) Approve the acquisitions of 3 Sovereign Square as an investment on the terms detailed in the confidential appendix.
  - ii) Approve the acquisitions of Unit 1 Logic Leeds as an investment on the terms detailed in the confidential appendix.
  - iii) Approve the injection into the Capital Programme, and give authority to spend, the sums detailed in the confidential appendix.
  - iv) Authorise the Director of City Development under the scheme of delegation to approve any changes to the recommended terms which may be necessary prior the acquisitions being completed, and to authorise the Director of City Development to complete the acquisitions.
  - v) Authorise the Director of City Development to investigate the acquisition of additional investment opportunities which will further enhance the strength and performance of the Council's investment portfolio in supporting the Council's budget and stimulating economic regeneration and confidence as part of a strategic investment fund.

- vi) Agree that this report is made exempt from Call In for the reasons set out in paragraph 4.5.3 above.
- vii) Agree that the Director of City Development is authorised to undertake the recommendation contained in the confidential appendix.

## **1 Purpose of this report**

- 1.1 The purpose of this report is to recommend the terms for the acquisition of two newly constructed buildings in Leeds (3 Sovereign Square and Unit 1 Logic Leeds) which can be added to the Council's property investment portfolio. Both properties will immediately produce new rental income for the Council which will fund the cost of the borrowing required to acquire them and a surplus to support Council budgets. The acquisitions align with the Council's ambition for Leeds to have a strong economy and be a compassionate city with the aim to sustain and accelerate the economic progress the city is making whilst ensuring all people and communities in Leeds contribute and benefit from economic success. The value and strength of the Council's property investment portfolio will be enhanced and make the Council's financial position stronger and more resilient.

## **2 Background information**

- 2.1 Leeds was hit hard by the recession, with major retail, office and industrial schemes being stalled. The city has, however, bounced back from the recession strongly and the private sector is growing quickly. This economic success is a result of the resilience, entrepreneurship, innovation and investment by the private sector, and also the Council playing a pivotal role. The Council has intervened proactively to kick-start development and regeneration projects, support businesses to grow and invest, and to help people to work.
- 2.2 The Council used its powers to help assemble the sites for the Trinity and Victoria Gate schemes, unlocking over £0.5bn of retail investment. The Council brought forward its land at Sovereign Street to enable the development of 160,000sqft of Grade A offices and a new public square. The Council's First Direct arena has attracted over a million visitors, and a huge amount of additional spending to Leeds. Work has been undertaken with developers to pump prime the delivery of more than 300,000sqft of modern manufacturing and logistics employment space in the Enterprise Zone. The Council has funded a new railway station at Kirkstall Forge helping bring forward a major brownfield development project with 1,000 new homes. Grants have been made to businesses which levered in private sector investment and created new jobs and thousands of people have been helped into work. The Council's actions clearly demonstrate the city is open for business.
- 2.3 One particular example of the Council's intervention to stimulate development in poor economic conditions is at Sovereign Street in the city centre. The Council's high income producing pay and display car park was packaged in lots sufficient to

accommodate appropriately sized buildings where specific requirements for relocations in the city, or inward investment to Leeds, were known. The Council lost valuable income from the car park, but economic regeneration and investment took place successfully and capital receipts were realised from the sale of plots which were reinvested in the construction of new public realm. The Council's promotion of development at Sovereign Street links to the South Bank, one of Europe's largest regeneration projects. The Council has used its unique position as custodian of the city to unlock development opportunities and create jobs within the South Bank, strengthening infrastructure and connectivity between the rest of the city and surrounding neighbourhoods. One plot at the former car park accommodates the newly constructed 3 Sovereign Square.

- 2.4 The Council also intervened in the Leeds Enterprise Zone by awarding grants to land owners for site reclamation, and underwriting development risk by agreeing to purchase vacant warehousing if it was not let following construction. The Enterprise Zone development has only been possible due to the Council's intervention when the economic climate deterred others. Unit 1 Logic Leeds is situated in the Enterprise Zone. For major development sites the Council's preference is now to engage with end users directly rather than generally marketing sites. It is now possible for the Council to benefit from those early interventions, rather than the developers and land owners securing all the financial rewards.
- 2.5 Two developers of 3 Sovereign Square and Unit 1 Logic Leeds have approached the Council offering the opportunity for the Council to acquire newly constructed buildings. The Council had been directly involved in the early stages of the proposed developments to encourage construction by offering packages of assistance. Details of the opportunities are contained in the confidential appendix to this report.

### **3 Main issues**

- 3.1 The construction of 3 Sovereign Square is nearing completion. It is an office building, the majority of which has been pre-let to a national law firm which provides a good covenant. The owner / developer is currently in discussion with potential occupiers for the vacant parts. Construction should be completed shortly and the main occupier will sign its lease shortly thereafter. The owner / developer has requested the Council completes the acquisition following the completion of the main occupational lease. This may leave the Council with certain parts of the building vacant, but the owner / developer will undertake to pay the Council the lost rent for the vacant parts, and any other associated costs, such as business rates, for a period of two years.
- 3.2 Unit 1 Logic Leeds has been constructed and a lease agreed to a national company with a strong covenant. Completion of this lease is conditional on certain matters being satisfied, which is expected to happen shortly. The owner / developer of this building has requested the Council takes a 250 year lease of this building before the end of June 2016.
- 3.3 Both buildings are let at market rents, and the risk of the vacant parts of the Sovereign Square building remaining vacant for any length of time is considered

low. Acquisition of the buildings provides the opportunity to increase and improve the quality and diversity of the Council's Investment Portfolio. This principle is one of the ten key proposed actions in the Asset Management Plan; to support the Council's revenues. Should the buildings be acquired they will sit well alongside other major key investments such as the Arena, the redeveloped Merrion House, and the Harper Street (Markets) multi-storey car park.

- 3.4 These are unique opportunities to acquire strategic investments improving areas of the city which will give the Council continued presence in these quickly evolving and development regeneration areas. At the same time the acquisitions will enhance the quality of the Council's Investment Portfolio. The buildings are let to tenants with strong covenants and the Council will immediately receive a substantial rental income (details in the confidential appendix).

## **4 Corporate considerations**

### **4.1 Consultation and engagement**

- 4.1.1 The Executive Member for Regeneration, Transport and Planning has been briefed and is supportive of the acquisitions.

### **4.2 Equality and diversity / cohesion and integration**

- 4.2.1 Equality, Diversity, Cohesion and Integration screening has taken place indicating there are no implications and, therefore, further assessment is not required. The EDCI screening document is attached at Appendix 2.

### **4.3 Council Policies and Best Council Plan**

- 4.3.1 The ambition for Leeds to have a strong economy and be a compassionate city is set out in the Best Council Plan. The proposals in this report support this ambition and the council's Best Council Plan 2016/17 priorities around supporting economic growth and access to economic opportunities and the associated breakthrough projects on 'more job, better jobs,' 'strong communities benefiting from a strong city' and 'housing growth and high standards in all sectors'
- 4.3.2 The proposed acquisitions support the Best Council Plan ambition for the authority to continue to be an efficient and enterprising organisation by seeking to optimise the council's Investment Portfolio and generating income to support the council's revenue budget. Not only would the acquisitions provide a net surplus income at a time when there is unprecedented pressure on the Council's revenue budget, but they would also put strategically located properties in Council ownership.
- 4.3.3 The approved Asset Management Plan 2013 – 17 has, as one of its ten areas of focus, 'making the Council's portfolio work better' undertaking to improve the scale and quality of the Investment Portfolio to assist and support the Council's revenue budget, including strategic acquisition where there is a strong financial case to do so.

#### **4.4 Resources and value for money**

4.4.1 The proposed acquisitions would provide the Council with a net surplus annual income as detailed in the confidential appendix after allowing for borrowing costs.

#### **4.4.2 Capital funding and cash flow**

4.4.3 See attached confidential appendix.

#### **4.5 Legal Implications, access to information and call In**

4.5.1 Section 120(1) of the Local Government Act 1972 authorises local authorities to acquire any land for their functions, and for the 'benefit, improvement or development of their area.' Leading Counsel has advised that the Council can safely rely on this power given that the acquisition of the Properties will be for the "benefit" of the Council's area by improving the Council's financial position generally, and for the "improvement" and "development" of the Council's area by facilitating and enabling regeneration projects, in that the surplus generated will contribute to the funding of the Economic and Regeneration Service and its activities, to support economic growth and regeneration in the area.

4.5.2 In addition, Leading Counsel has advised that in these circumstances, the power to borrow for any purpose relevant to its statutory functions under Section 1(a) of the Local Government Act 2003, is available to the Council, given that "functions" embraces all powers and duties of the Council, including the power to acquire property mentioned above.

4.5.3 The Council is purchasing 3 Sovereign Square under the provision of an option agreement which requires the transaction to be exchanged within 20 days of notice being served by the vendor. By variation the vendors have agreed to extend this to a long-stop date of the 27 June to exchange. Accordingly, if the Council does not exchange by that date it will lose its special position afforded by the option agreement. This situation would place the purchase under significant risk and for that reason this report has been made exempt from Call-in.

4.5.4 Similarly, with respect to Unit 1 Logic Leeds, the price negotiated has been concluded on the basis that the sale completes by 30 June 2016 to be before the end of the vendor's financial year. Should the sale not complete to that timescale the Council would be at risk of the sale and the purchase price being re-opened for negotiation in open competition with other parties. For this reason it is proposed that this purchase is exempt from Call-in.

4.5.5 The information contained in Appendices 1 is exempt under Access to Information Rule 10.4(3) as it contains information relating to the financial or business affairs of a particular organisation and of the Council. It is considered that the public interest in maintaining the content of the appendix as exempt outweighs the public interest in disclosing the information due to the impact that disclosing the information would have on the Council and third parties.

## **4.6 Risk management**

- 4.6.1 The Council will borrow to fund the acquisitions. Currently, interest rates remain at historically low levels and rental income will more than adequately cover the borrowing costs, and provide a substantial surplus to assist other revenue budgets. Interest rates would have to increase substantially before the rental income was fully exhausted covering the borrowing costs. The Council has the opportunity to fix long term borrowing at significantly low interest rates.
- 4.6.2 There may be times in the future when the buildings, or parts of them, become vacant. Should this be the case then the Council is likely to have been given lengthy notice of a proposed vacation which will provide time in which a new tenant could be sought. The Council's property investment portfolio contains many letting properties and it is quite normal to experience void periods and to seek new tenants.

## **5 Conclusions**

- 5.1 In conclusion, the Council has an opportunity to strengthen and improve the value and performance of its investment portfolio which is brought about from its leading role in stimulating development during the recession. The Council is being offered attractive investment opportunities and terms for the acquisitions are recommended for approval. The Council will benefit from its early intervention in the developments at times when it may have not been considered prudent to dispose of land interests and make financial commitments. The Council will continue to be involved in the economic regeneration of Leeds through the opportunities it took to secure longer term interests in the developments.

## **6 Recommendations**

- 6.1 Executive Board is recommended to:
- i) Approve the acquisition of 3 Sovereign Square as an investment on the terms detailed in this confidential appendix.
  - ii) Approve the acquisition of Unit 1 Logic Leeds as an investment on the terms detailed in this confidential appendix.
  - iii) Approve the injection into the Capital Programme, and give authority to spend, the sums detailed in the confidential appendix.
  - iv) Authorise the Director of City Development under the scheme of delegation to approve any changes to the recommended terms which may be necessary prior to completion, and to authorise the Director of City Development to complete the acquisitions.
  - v) Authorise the Director of City Development to investigate the acquisition of additional investment opportunities which will further enhance the strength and performance of the Council's investment portfolio in supporting the Council's budget and stimulating economic regeneration and confidence as part of a strategic investment fund.

- vi) Agree that this report is made exempt to Call-In for the reasons set out in paragraph 4.5.3 above.
- vii) Agree that the Director of City Development is authorised to undertake the recommendation contained in the confidential appendix.

## **7 Background documents<sup>1</sup>**

7.1 There are none.

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<sup>1</sup> The background documents listed in this section are available to download from the Council's website, unless they contain confidential or exempt information. The list of background documents does not include published works.