

Report of: Head of Land and Property

Report to: Director of City Development

Date: 24 March 2017

Subject: Acquisition of a Property for the Council's Investment Portfolio

Are specific electoral wards affected? If relevant, name(s) of ward(s):	<input type="checkbox"/> Yes	<input checked="" 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

1. The Council has an opportunity to further strengthen and improve the value and performance of its investment portfolio which is brought about from its leading role of stimulating development within the City.
2. One of the main aims of the Council is to bring about economic regeneration in Leeds. The Council has already been involved in bringing forward the development of commercial property at a time when the market was stalling. These proposed acquisitions 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. These are unique opportunities which have been offered to the Council to acquire strategic investments which will enhance the quality and performance of the Council's Investment Portfolio.
3. At the meeting on 8th February 2017 the Executive Board granted approval to the delegation of the future injections and 'authority to spend' of the acquisition of strategic assets in support of the Council's financial strategy, to the Director of City

Development and the Chief Finance Officer in consultation with the relevant Executive Board Member for Regeneration, Transport and Planning and Group Leaders of Executive Board.

4. A report was submitted to the Executive Board at the meeting which outlined the Initial Budget Strategy where part of the revenue to support this strategy would be created by the acquisition of further investment assets.
5. The targets contained within this strategy are to generate additional revenue over borrowings of £2m pa by 2017/18, a further £0.5m pa by 2018/19 and an additional £1m pa by 2019/20. The opportunity exists for the Council to continue its recent investment in commercial property opportunities and a number of other investment propositions have been brought forward for the Council to consider. The majority of these opportunities would enable the Council to acquire buildings that are let to tenants from which the Council will immediately receive a rental income. The level of rents that are being obtained are sufficient to cover the cost of borrowing to acquire the properties and provide a surplus to support the Council's budgets, to continue to improve services at a time when funding streams to the Council are declining.
6. The proposal also contributes to regenerating places, supporting businesses to grow and invest, creating quality places and spaces and backing innovators and entrepreneurs.
7. As such the Council is seeking to build an investment portfolio that supports the aims of the Best Council Plan to enhance and strengthen the economic growth and access to economic opportunities in Leeds. These opportunities can be unique and enable the Council to acquire strategic investments which will enhance the quality and performance of the Council's Investment Portfolio. Often these property transactions occur off the market and need to be completed in relatively short periods of time. As such the Council needs to ensure that it can respond quickly to these investment opportunities as they arise to meet the revenue targets that have been set.
8. To enable the Council to respond to the opportunities in a timely fashion the Executive Board at its meeting on 22 June 2016 approved that the Director of City Development continues 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. The confidential appendix sets out details of an investment property that the Council can acquire that would generate a net surplus revenue position after borrowing costs.

Recommendations

9. The Director of City Development City Development is recommended to:
 - i) Approve the acquisition of the Site and entering into a development agreement on the terms outlined in the confidential appendix;

- ii) Approve the injection into the Capital Programme, and give authority to spend, the sums detailed in the confidential appendix;
- iii) Authorise the Head of Land and Property to progress the transactions above as outlined in the confidential appendix.

1.0 Purpose of this report

- 1.1 The purpose of this report is to seek approval to the purchase of the development land that has been offered to the Council and subsequently build three industrial units upon the land. It is anticipated that once developed and let to commercial occupiers these units will generate additional income to support the revenue requirements of the Council as set out in the Initial Budget Strategy.
- 1.2 In addition it is considered that the acquisition of this land and subsequent creation of commercial business space will align with the Council's ambition for Leeds to have a strong economy and accelerate the economic progress the city is making whilst ensuring all people and communities in Leeds contribute and benefit from economic success.
- 1.3 At the same time 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 The Executive Board at its meeting on 22 June 2016 approved the acquisition of 3 Sovereign Square and 1 Logic Leeds. The acquisition of both these properties and the subsequent purchase of an office building at Thorpe Park Leeds approved the Executive Board in December 2016 have added to the Council's investment portfolio by creating a surplus of income over the borrowing costs and therefore supporting the Council's revenue budgets. 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 At the meeting on 22 June 2016 the Executive Board further authorised 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.
- 2.3 Since the June Executive Board meeting the Council has been presented with a number of investment opportunities. These have been assessed in terms of revenue return and also the regeneration benefits through the investment that the Council might be making in that part of the city. The opportunity presented in the confidential appendix will bring forward the construction of new industrial units which will attract further businesses to the area, create new employment opportunities for residents and provide the Council with a rental return that will contribute to the Council's budgets.

- 2.4 The Council has already brought forward development opportunities in Leeds such as Sovereign Street in the city centre. By purchasing the subject plots of land the Council will accelerate development activity within the Enterprise Zone.
- 2.5 The Council also promoted development in the Enterprise Zone by awarding grants to land owners for site preparation and infrastructure delivery, and underwriting development risk by agreeing to purchase vacant warehousing if it was not let following construction. From its acquisition of unit 1 at Logic Leeds the Council has already been successful in bringing forward development and creating employment opportunities whilst at the same time generating an income surplus after borrowing which contributes to the Council's budgets.
- 2.6 Through connections with the LEP, Officers have been actively pursuing opportunities to make further investment in the Enterprise Zone and it is considered that this land purchase opportunity provides further investment for regeneration of the city for the Council to consider.

3 Main issues

- 3.1 In order to continue to acquire investment opportunities an Investment Strategy has been devised that seeks to acquire additional investment opportunities that either provide a strong rental income and/or add to the investment and regeneration of parts of the City. A major element of the strategy is the identification of the suitable property investment properties.
- 3.2 Whilst the main aim of the investment strategy concentrates on the identification of opportunities that are let or pre let to strong financial covenants with secure income flow on full repairing and insuring leases with lengthy unexpired terms, there is also a desire to assist in the regeneration of the City and to invest in employment generation opportunities. This principle is one of the ten key proposed actions in the Asset Management Plan; to promote business, support employment creation and at the same time add to the Council's revenue stream.
- 3.3 Leeds City Council has agreed to purchase three high-quality industrial units at Muse Developments 110 acre Logic Leeds site. Construction of the units will begin in summer 2017 and is scheduled to complete late spring 2018. The three units comprise internal areas of 33,000 sq.ft 32,000 sq.ft and 37,000 sq.ft respectively. Logic Leeds, which also houses a John Lewis distribution hub, is in the Leeds City Region Enterprise Zone by Junction 45 of the M1.
- 3.4 This purchase detailed in the confidential appendix will therefore complement the Council's investment portfolio and sit well alongside other major key investments recently made. The land acquisition and the development opportunity that it brings will also enhance the range and diversity of the Council's Investment Portfolio.

4 Corporate considerations

4.1 Consultation and engagement

- 4.1.1 The Executive Member for Regeneration, Transport and Planning and the Executive Member for Resources and Strategy have been briefed and are

supportive of the acquisition. The Leader of the Conservative Group has been consulted and supports the proposal. The Leader of the Liberal Democrat Group has also been consulted.

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 acquisition supports 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 by generating income to support the council's revenue budget.
- 4.3.3 It is proposed to build 3 individual units on the subject land. Once these units are built, potential occupiers will be subject to vetting to ensure that the businesses they plan to operate are consistent with the Council's aim to provide employment opportunities that are fair, sustainable and inclusive to all parts of our community.
- 4.3.4 It is envisaged when let and income producing that the acquisition will provide a net surplus income at a time when there is unprecedented pressure on the Council's revenue budget, but will also put strategically located properties in Council ownership.
- 4.3.5 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 acquisition 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 terms provisionally agreed for the subject land are contained within the attached confidential appendix. The terms for the purchase have been agreed on an exclusive basis with the vendor in a very competitive market therefore are considered to be highly confidential. Should approval not be granted to the proposal it is likely that the seller will offer the land to other parties. For this reason it is proposed that this purchase is exempt from Call-in.
- 4.5.4 The information contained in Appendix 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. The property has been offered to the Council to acquire on a one to one basis off the market rather than being put to the open market. 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 acquisition. Currently, interest rates remain at historically low levels and the projected 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 This opportunity is a development and therefore there is a risk that it may not be fully income producing upon completion. Provisions are to be agreed with the developer for a marketing campaign to be put in place during the construction period so that suitable tenants are found. However provision has been made in the financial appraisal for void periods and this risk is reflected in the price the Council is paying.

- 4.6.3 There may also be times in the future when the buildings to be constructed 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. It is considered that the size of the proposed units and their location will make them attractive to the market.
- 4.6.4 As part of the acquisition of an investment property the Council will seek external advice from a leading firm of Chartered Surveyors. This external expertise will provide the Council with a level of due diligence that ensures that the acquisition represents value for money ensuring that the Council will obtain a good rate of return. During the build period external consultants will be engaged to monitor the construction and upon practical completion a full condition survey will be undertaken of each building prior to accepting final handover of the property.
- 4.6.5 Separately prior to the acquisition of the land, a comprehensive financial development appraisal has been undertaken based on the rental levels that could be achieved set against the Council medium/long term borrowing costs. Due diligence has also undertaken based on the lettability of the units and expected covenant strength of the individual tenants who may eventually occupy the buildings. This has included carrying out research into the strength of the industrial letting market. The advice received from commercial property agents active in the market is that demand for units of the sizes proposed in the location is currently very good with few competing new build opportunities.
- 4.6.6 Once the development and acquisition of these properties is completed they will be proactively managed by the Council and where appropriate the Council will secure external property advice.

5 Conclusions

- 5.1 In conclusion, the Council has an opportunity to strengthen and improve the value and performance of its investment portfolio. The Council is being offered a number of investment opportunities and in order to meet the additional revenue targets needs to acquire further investments. The terms for the acquisition of this particular property are recommended for approval and detailed in the confidential appendix.

6 Recommendations

- 6.1 The Director of City Development is recommended to:
- i) Approve the acquisition of the Site and entering into a development agreement on the terms outlined in the confidential appendix;
 - ii) Approve the injection into the Capital Programme, and give authority to spend, the sums detailed in the confidential appendix;
 - iii) Authorise the Head of Land and Property to progress the transactions above as outlined in the confidential appendix.

7 Background documents¹

7.1 There are none.

¹ 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.