Norwich City Council

SCRUTINY COMMITTEE

Item No 7

REPORT for meeting to be held on 26 January 2012

Asset Management Strategy

Summary:	To provide an overview of the council's investment strategy with regard to commercial assets.
Conclusions:	The adopted asset management strategy provides a framework for the development of an investment strategy for the investment portfolio. The main purpose of this commercial property holding is to generate income for the council. This income will be sustained by adopting a process of asset challenge (to determine whether or not the asset should be retained or released) backed up by robust asset management practices and an investment strategy that allows for the acquisition of new assets.
Recommendation:	To note the proposal to include in the 2012/13 capital plan an allocation for the acquisition of new investment assets to be funded from the receipts arising from asset disposals.
Key Documents:	Non housing asset management strategy July 2011.
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1.0 General Background

1.1 The Scrutiny Committee have identified a need to consider the investment strategy for commercial assets. This report provides an overview of the issue and uses a number of case examples to illustrate the challenges the council is facing,

1.2 The corporate asset management strategy, adopted by Cabinet in July 2011 identified that the council has a diverse property portfolio of which a significant proportion is the commercial or investment portfolio. Attached as appendix A is an extract from the strategy that provides a summary of the key metrics of the non-housing portfolio.

1.3 The main purpose of the investment portfolio is to provide revenue income that is invested in service provision. Members will note from the summary (appendix A) that the commercial assets are split between two main portfolio holdings:

- <u>Norwich Airport Industrial Estate</u> comprises over 80 lettings covering a total area of 105 acres mainly developed between 1967 and 1979. There are two further sites at Horsford Manor and Harts Hill detached from the main estate. The land is owned freehold by Norwich City Council, but is held on express trust for Norfolk County Council, effectively joint ownership. Under this agreement income derived is divided 60% for the County Council and 40% to the City Council with neither Council able to sell its share without the other parties consent. Gross income from the estate for 2010/11 is approx £1.2 million (Norwich City Council 40% equates to nearly £500,000).
- <u>An investment portfolio</u> of over 400 properties held with the prime objective of generating revenue income for the Council comprising let property (shops, offices and industrial units). Gross income produced is over £2m.

1.4 These commercial assets have been acquired over a number of years based on a range of separate decisions (e.g. perceived need to protect properties with a heritage value, opportunistic purchases, economic development initiatives etc). Few acquisitions have been made in the past 10/20 years and the ageing investment portfolio has experienced limited financial growth, has an increasing number of void properties (some of which are at the end of their economic life), has a high proportion of low income assets and can be characterized in general terms as a stock dominated with assets that have a legacy of underinvestment. For a number of years the council has implemented a policy of asset disposal to support capital investment.

2.0 Portfolio Review Process

2.1 The asset management strategy identified that the council should seek to optimize the investment portfolio through an asset management challenge process which seeks to categorise assets as ‘retain’ or ‘release’. In some cases it may be appropriate to make further investment prior to either retention or disposal. The retained properties are more likely to be those of a reasonable condition, fit for purpose and likely to fulfill the expectations of rental growth. Released property will provide capital that could be reinvested in properties that have potential to provide sustainable rental income.

2.2 This challenge process should be supported by a process for allocating capital to either invest in the retained assets or acquire new assets with the intent of maximizing income. It is important to note that the objectives for other elements of the portfolio (such as car parking, office accommodation, open spaces, heritage assets etc) will be different and are outside the scope of this review.

2.3 Under the direction of NPS the council has developed a robust asset challenge process that uses a matrix approach with 20 criteria to help advise on the question of ‘retain’ or ‘release’. A copy of the matrix is attached as Appendix B for each of the case studies listed below. The matrix is a used as a guide for decision making. It is not an end in-itself and not an exclusive list of issues to consider. It is part of the process of re-engineering the portfolio to reduce liabilities and improve the financial return in the short to medium term. The following four case studies help to illustrate how the review process works:

2.4 **Case study 1 – Asset release for immediate disposal**
Workshop and offices to the West of the City

The property is located to the west of the City just off Dereham Road. The premises are an infill workshop and offices located in a row of terraced houses. The area suffers from old chalk workings and this site has two underground shafts passing under it. This is why the original houses built on site were demolished. The premises themselves show signs of subsidence as evidenced by the slope of the front window sill of the offices. The premises are in a poor state of repair. The buildings have reached the end of their useful life and will need extensive financial input to get it into a lettable condition which may not be justified by the rental return. Being located in the middle of a residential terrace, informal planning advice has indicated that a residential use would be an acceptable alternative use.

The fact that this asset had a high maintenance liability, and a low rental value, prompted officers to review its status. The outcome of the review process was to release the asset through sale by auction. The property achieved a sale value of £80,000 which was above estimate and was sold to 2 individuals wishing to operate a business from the premises. The income received will help support the 2012/13 Capital Programme.

2.5 **Case study 2 – asset let with conditions**
Redundant pumping station

This grade II listed property, which spans the river Wensum, is the redundant pumping station that was previously used as an integral part of the sewerage system for Norwich. Located at the highest extent of tidal flow, this building was ideally sited to extract Hydro power, and the main generating hall still retains the various generating machinery, which is deemed to be of high industrial historical interest. Initially a "friends of NMY" group were undertaking refurbishment of the facility with a view to opening it as a visitor attraction. However work had stalled for several years due to lack of funds and volunteers.

It was determined that due to the specialist nature and contents of the building, and the presence of the historic generating equipment, the property was not fit for commercial rental in its current state. However, the review process highlighted the opportunity to let out sufficient space beneath the building for the provision of a HEP generating station. This area has now been let on a 22 year lease, on a minimum rent basis, with the addition of a 'turnover' element, through which the rent received by the council is topped up by a percentage of the net income received through the generation of electricity.

In addition, the tenant is pursuing the possibility of converting the main generating hall into office accommodation, and a further agreement is in place to cover rent for this option, should the appropriate permissions be forthcoming. If these plans prove to be unviable, then arrangements are in place for this part of the building to be handed back to the council.

2.6 **Case study 3 – asset retain**
Industrial units

The property is located on the South side of the city with good access to the A47, and comprises three warehouse units each of 300 sq m. Built in 2008 as part of a larger industrial park, these units have been built to institutional standard with steel clad portal frames and 6.8 m eaves. Each unit is in good decorative order, and has the benefit of five parking spaces to the front and a shared access area.

As part of the review of this asset it was noted that whilst disposal would enable the council to benefit from a substantial capital receipt, it would also result in the loss of a newly built industrial facility, with no repair issues, and a regular income of £44,375 per annum. The decision was taken to retain this asset.

2.7 **Case study 4 – Short term asset retention but pro-active asset management to secure residential use on vacant possession. Commercial property in the City Centre**

Located on the periphery of the City Centre, this grade 2 listed, historic and former residential property is currently let to a company for office/training purposes on a lease that has less than 3 years to run.

In view of the fact that the tenant is holding over under an old lease, which means there is no certainty of income, it was decided to review this asset. This review highlighted the fact that, due to the nature of the building's layout and size, lack of any car parking and limited demand by alternative commercial users, should the asset become vacant, it was unlikely that there would be significant interest from a new tenant in the property in it's current configuration. However the review also concluded that the capital value of the asset with planning consent for residential use would increase from £250,000 to £350,000. Therefore it was decided to retain this asset, work with the existing tenant to encourage them to complete a new lease, but should this not be forthcoming, then officers seek planning consent for conversion to residential use to enable the property to be disposed of.

3 Investment strategy

3.1 The disposal of assets provides a capital income for the council. In addition to asset disposal, other sources of capital include developer funding (currently section 106 income), lottery funding and government grants including HCA funding. This resource is then invested in capital works and the programme is approved by Council on an annual basis as part of the budget setting process. In recent years the programme has financed a range of projects including the refurbishment/repair works to the Memorial Gardens and Guildhall; the repair and maintenance of other assets (including river walls, community centres, office accommodation) and new play and open space provision. The programme is always oversubscribed and this is one of the reasons why there is a legacy of underinvestment in council assets. This is a situation that is not unique to the city council and it is one that many local authorities, and public bodies in general face.

3.2 In relation to this report, the Council has adopted a pragmatic approach to an investment strategy for commercial assets. In view of the limited scope for council funded investment in repairing and improving existing assets the current approach is almost entirely reactive (rather than programmed). It normally seeks to require existing tenants to undertake this investment (via full repairing leases and robust enforcement of dilapidation payments on cessation of a lease) or by offering incentives to existing and new tenants that offset rental payments against repair costs. Some aspects of this approach have worked well and there are a number of examples where private sector funding has been used to secure the repair and enhancement of important assets.

3.3 There are risks associated with this pragmatic approach and they can include potentially non-compliance with statutory regulations and constrained income growth. Furthermore an aging portfolio (like that held by the city council) will, without a sufficient repair and maintenance programme, have an increasing risk of voids and depressed rental growth over time.

3.4 The general aim for an investment asset holder is to have a portfolio that attracts long term secure tenants with good covenants/rental income. For the council to achieve this it will need to reshape the portfolio over a 5 to 10 year period by proactive estate management and the acquisition of a more modern investment portfolio. As shown above there have been a number of reasons why the council has not been able to develop this approach, but looking forward there are two ways this could change.

3.5 Firstly the Council is committed to a joint venture with NPS (to be known as NPS Norwich). One of the reasons for progressing this arrangement is to provide a greater focus on (and resource for) the proactive asset management of the investment portfolio. This approach would seek to maintain and re-engineer the investment portfolio to ensure that the following outcomes are secured:

- Secure and maximise revenue income/curb rent roll decline
- Reduce council funded repair liabilities
- Identify assets for disposal
- Identify development opportunities
- Stimulate economic regeneration and encourage employment opportunities
- Enhance possibility of windfall capital receipts
- Improve infrastructure and presentation of the estate
- Reduce voids
- Mitigate Council expenditure on held let property

3.6 Secondly, linked to the delivery of these outcomes is the replacement of the portfolio process by new assets with more secure income and reduced maintenance. The acquisition of new commercial assets will require capital funding and this is most likely to be financed from capital receipts received from the disposal of property. As part of the 2012/13 capital planning process members will have the opportunity to consider allocating funds from asset disposals to reinvest in the investment portfolio. It is recognized that in a period of economic uncertainty and with a wide range of demands on the capital programme, considerable care is required in agreeing any new investment. For this reason each proposal will be supported by a business case and would require cabinet approval.

Appendix A

Size & Mix

No. of Assets	1091

Basic Dimensions

Value (£00s)	Cost (£000s)	Income (£000s)	Condition (£000s)
£193.692M	£6.283M	£9.317M	£10.06M
(For capital accounting purposes)		From lettings	Estimated repair backlog

Summary

Value

Operational	
Land & buildings	£99.630M
Community	£9.023M
Non-operational	
Investment	£56.544M
Surplus	£28.495M

Cost

Rates	£0.855M
Water & Sewerage	£1.336M
Energy	£0.555M
Rent	£0.234M
Buildings maintenance	£1.227M
Grounds maintenance	£2.225M
Security & cleaning	£0.789M
Insurance	£0.254M

Income

Car Parks	£4.608M
Investment Portfolio	£2.134M
Provision Market	£0.811M
Norwich Airport Estate	£0.493M
Allotments & Parks/Play Areas	£0.269M
Others	£1.002M

Condition

Urgent	£2.27M	Good	£0.44M
Good	£4.30M	Satisfactory	£1.86M
Desirable	£2.79M	Bad	£4.76M
Longer	£0.80M	Poor	£3.1M

Detail

Investment

Investment Portfolio	413
Norwich Airport Estate	85
Provision Market	8
Economic Development	54
Assets Used by Others	7

Community

Mile Cross & Other Depots	5
Community Centres	18
Other Services Buildings & Land	10
Stewardship	118

Land & buildings

City Hall, Admin buildings	3
Area Housing Offices	5
Car Parks	17
Public Conveniences	11
Cemeteries	3
Allotments & Parks / Play Areas	324
Norman Centre	1

<u>Note:</u> These figures are indicative figures only as they draw on a range of data sources from different time periods. They should not be taken as a definitive statement but are are intended to indicate the broad dimensions of the portfolio. All financial figures are in £000s

Appendix B

Property matrix scoring sheet

To help achieve a level of consistency in our approach to reviewing our assets, an assessment tool has been developed, to attach a score to each asset (or group of assets).

Assets are assessed against a set of twenty property specific criteria and the resulting score is used as a matrix, to put each of the assets in an agreed category. This score and categorization together with other assessment criteria referred to in this report determines whether:

1. There is a clear presumption in favour of disposal
2. There is a clear indication that an asset requires specific work in order to decide whether to retain or dispose
3. There is a clear indication that work in required immediately to ensure an asset continues to perform

The lowest score achievable under the matrix assessment is 16, which indicates an asset let on favourable terms, with regular rental reviews to a good covenant, without substantial management costs. The highest matrix score achievable is 72 and this indicates that an asset does not meet some or all of these criteria.

The score banding for the three categories referred to at 1-3 above highlights:

- A score over 45 – a presumption in favour of disposal
- A score between 38 and 45 – further investigation is required to identify whether a property can be retained
- A score under 38 – presumption in favour of retention

The twenty criteria fit broadly under the following headings:

- Title – ownership and title restrictions
- Letting details – income and growth
- Letting issues – voids and arrears
- Repairs and condition
- Redevelopment potential – site assembly, marriage value, planning

Opinion on all of these issues is informed by the relevant sections in the *Asset Review Form.*

Property matrix – case studies:

Address	Case study 1		
Property Type	Workshop & premises		
UPRN	1000		
No	Criterion	Value	Weighting
1	Occupation	Vacant	2
2	Length of Letting	Vacant	4
3	Rent Review Pattern	None	4
4	Lease Expiry		4
5	Number of Voids Over Last 5 Years	None	2
6	Average Length of Voids Over Period	None	4
7	Repairing Responsibility	Landlord	1
8	Condition	Poor	4
9	Cost of Repairs - Revenue	Less than 5% of rent	4
10	Cost of Repairs - Capital	Less than 5% of 17 (below)	4
11	Type of Tenant	vacant	4
12	Rent Receivable	Poor against comparables	3
13	Current Rental Value	As 12 (above)	4
14	Rental Arrears Over Period	None	4
15	Management Time/Cost	Low	1
16	Location	tertiary	4
17	Capital Value	Over12 YP	4
18	Adjustment Factor	Adjust1	1
19	Planning	Adjust 2	2
20	Market Conditions	Adjust 2	2
		Matrix Value	62

Address		Case study 2	
Property Type			
UPRN			
No	Criterion	Value	Weighting
1	Occupation	Vacant	2
2	Length of Letting	Under 5 years	4
3	Rent Review Pattern	None	4
4	Lease Expiry	Under 3 years	4
5	Number of Voids Over Last 5 Years	1 - 2	2
6	Average Length of Voids Over Period	None	1
7	Repairing Responsibility	Landlord	4
8	Condition	Good	1
9	Cost of Repairs - Revenue	Less than 5% of rent	1
10	Cost of Repairs - Capital	Less than 5% of 17 (below)	1
11	Type of Tenant	Poor	4
12	Rent Receivable	Poor against comparables	3
13	Current Rental Value	Lower than 12 (above)	0
14	Rental Arrears Over Period	None	1
15	Management Time/Cost	Low	1
16	Location	Tertiary	4
17	Capital Value	Over 12 YP	1
18	Adjustment Factor	Adjust 4	4
19	Planning	Adjust 4	4
20	Market Conditions	Adjust 4	4
		Matrix Value	50

Address	Case study 3.
Property Type	Offices

No	Criterion	Value	Weighting
1	Occupation	Let	1
2	Length of Letting	Under 10 years	3
3	Rent Review Pattern	3 - 5 years	2
4	Lease Expiry	3 - 9 years	3
5	Number of Voids Over Last 5 Years	1 - 2	2
6	Average Length of Voids Over Period	Over 5 months	4
7	Repairing Responsibility	Tenant	1
8	Condition	Good	1
9	Cost of Repairs - Revenue	Less than 5% of rent	1
10	Cost of Repairs - Capital	Less than 5% of 17 (below)	1
11	Type of Tenant	Good	2
12	Rent Receivable	Fair against comparables	2
13	Current Rental Value	As 12 (above)	1
14	Rental Arrears Over Period	None	1
15	Management Time/Cost	Low	1
16	Location	Secondary (rising)	2
17	Capital Value	Under 10 YP	3
18	Adjustment Factor	Adjust 1	1
19	Planning	Adjust 1	1
20	Market Conditions	Adjust 2	2
		Matrix Value	35