

Agenda item:

**CABINET**

**On 26<sup>th</sup> January 2009**

Report Title - Commercial Property Portfolio Review

Report of **Director of Corporate Resources**

Signed : *J. Parker. 13/1/09.*

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Wards(s) affected: **ALL**

Report for: **Non-key decision**

**1. Purpose of the report (That is, the decision required)**

- 1.1. To report on the detailed review of the Council's Commercial Property portfolio to assess the suitability and performance of the portfolio in relation to the Borough's community strategy priorities.
- 1.2. To review the future retention and development strategy for the portfolio and consider options for future management.

**2. Introduction by Cabinet Member (if necessary)**

- 2.1. Following a review of the Council's Commercial Property portfolio, the report provides members with the outcome of the review and a number of options on the future management of the portfolio bearing in mind that further work is required to determine the most viable option to better deliver the Council's objectives.

### **3. State link(s) with Council Plan Priorities and actions and /or other Strategies:**

- 3.1. The outcomes of the review will contribute towards achieving the Council's five priorities through maintaining the financial performance of the Commercial Property Portfolio and improvements proposed for the management of the portfolio.
- 3.2. The commercial property review assesses the suitability of assets and performance in relation to the Borough's community strategy priorities.
- 3.3. The review undertaken by Drivers Jonas supports the CPA/CAA process in challenging the Council's use of assets, measuring performance, assessing value for money and considering alternative service delivery and management models.

### **4. Recommendations**

4.1 To note the outcome of the detailed property review carried out by specialist consultants Drivers. In summary the review concludes as follows:-

- 93% of the properties in the portfolio meet the Council's strategic objectives and can be continued to be managed on the current basis, 7% of the properties require further assessment as they may require additional investment to improve condition or performance or may be suitable for future disposal.
- the financial performance of the portfolio is above the industry benchmark.
- the current management of the portfolio needs improvement and a more pro-active approach is required.

4.2 To note the options appraisal set out in the report for the future ownership, investment and management of the commercial portfolio and in view of the portfolio assessment from the property review and recent developments in the management of the portfolio,

- To confirm the continued retention of the Commercial portfolio focussed on meeting service, regeneration and financial objectives subject to the development of a prioritised asset management plan.
- To confirm the continued in-house management of the commercial portfolio to focus on strategy, delivery and improved outcomes through a review of capacity and capability of the team and external consultants.

4.4 To note that further research and work be carried out to consider the opportunities that might accrue from a wider multi agency approach to property use and development as set out by central government, for example through the Homes and Communities Agency and the single conversation initiative.

## **5. Reason for recommendation(s)**

5.1. The report summary in paragraph 7 together with the other options in paragraph 6 sets out the reasons for the recommendations in the report.

## **6. Other options considered**

6.1. The Drivers Jonas review sets out an options appraisal model to consider both the future asset strategy (i.e. whether to continue retaining the portfolio or sell) and various management models (i.e. whether to continue to manage in-house or externalise). A summary in table form is included in Appendix 2 outlining six key options;

- Continuation of current arrangements i.e. retain, manage, no new investment
- Portfolio Improvement – retain, manage, Council funds new investment
- Externalise Management – as above but outsource management
- Strategic Contracting of Management – as above with external manager also acting as strategic adviser to identify site development opportunities and funding sources through development partners.
- Joint Venture – transfer asset to a special purpose joint venture with a partner who will introduce funding and capacity to develop and manage the portfolio.
- Sell the portfolio

### **Ownership and Control**

6.2. The review of the portfolio has confirmed the need for commercial properties to be made available within the borough for the economic regeneration objectives set by the Council.

6.3. Whilst continued ownership of the portfolio is the most direct method of assuring a supply of such assets within the borough it is not essential that the Council continues to own these. There are other methods of controlling and influencing future supply of commercial assets within the borough. The extent of market intervention required is a key factor in considering whether or not to continue to own the full extent of the commercial portfolio. Alternative options might include

- Reduce the size of the portfolio by disposing assets that are primarily held for financial returns or for longer term regeneration benefit.
- Sell (or lease) the portfolio with conditions to protect future use.

6.4. Neither of the above options is recommended at this stage as essentially this is a financial decision that should be considered in the context of the Council's budget strategy against other financing options. For example, if it is desired that additional capital resources are required for other Council priorities, divestment

can be considered as an alternative to prudential borrowing. Furthermore the current economic circumstances and property market does not present the best time for voluntary divestment of property assets.

### **Portfolio Management**

6.5. The portfolio is currently managed by an in-house property team supported by key service officers through the corporate steering group. Current arrangements for managing the property portfolio include additional capacity through contract staff and commissioning of specific property services from external consultants.

6.6. Alternative options that could be considered to improve management capacity and capability are;

- Develop capacity and capability of the in-house team to improve focus on strategy, delivery and outcomes
- Further outsource specific functions to provide additional capacity to enable in-house team to focus on strategy and outcomes.
- Externalise management of the portfolio, retaining a small in-house capacity to focus on strategy and outcomes.

6.7. Whilst the review highlighted a historical weakness in the management of the portfolio this is now being addressed through an appropriate management strategy. A major risk of externalisation, at least in the short term, is the less empathetic approach, whether in reality or perceived by tenants that a completely private landlord's agent would bring.

6.8. Furthermore with the current property market there is an improved scope for establishing a more stable in-house team and also there will be considerable interest from private agents wishing to work with the in-house team in any further commissioning.

6.9. For the above reasons it is not recommended at this stage to substantially externalise the management of the portfolio.

## **7. Summary**

### **Background**

7.1 The Council's commercial property portfolio (with a book value of approximately £30 million) has a key financial input to the Council's revenue budget (net income budget of approximately £4.9 million per annum) and aims to contribute to social and economic objectives through the provision of neighbourhood shop premises within housing estates and commercial & industrial premises to support the SME sector. A summary and breakdown of the portfolio is attached as Appendix 1.

7.2 Much of the existing commercial property portfolio was built through development

projects and funding initiatives to provide employment and appropriate buildings for the local business needs. The portfolio is mixed in terms of tenants and length of leases and predominantly supports local businesses with a small number of national employers.

7.3 The Council's commercial portfolio is managed by an in-house team of property surveyors located within Corporate Property Services. The commercial team is responsible for assessing rental values, marketing, negotiating lettings, dealing with all the day to day management and financial performance. The commercial team is supported by a range of other Council services for income collection, contractual, legislative, debt recovery (legal) and budget monitoring (finance). The commercial team also manages Technopark with a team based on site to deal with facilities management and tenant services.

7.4 In recent times the management of the portfolio has suffered due to difficulties in recruitment and lack of adequate management capacity. This resulted in an excessive backlog of rent reviews, lease renewals and generally a lack of active management resulting in deteriorating condition of the buildings and increased risk of loss of income due to difficulties in negotiating back rent increases.

### **Strategic Objectives**

7.5 The overriding policy aim for the is to only hold assets that are required for immediate service delivery or contribute to the achievement of corporate objectives and priorities in the longer term. This principle has been a focus for the recent improvements in the management of the portfolio and property review carried out by Drivers Jonas.

7.6 The portfolio has traditionally been managed with a focus on revenue income to the Council. More recently the focus was shifted towards supporting economic regeneration through provision of suitable accommodation to local businesses. The Council's Asset Management Plan now sets out the strategic objectives for the Commercial Property Portfolio as:-

- **Service** – the commercial estate should provide appropriate market intervention to encourage enterprise, promote the provision of local community and commercial facilities and complement the development of other public services.
- **Financial** – the commercial estate should provide sustainable income to support the Council's revenue budget in the short to medium term taking account of the scope for enhancing capital gains in the longer term.
- **Regeneration** – the portfolio should be directed to supporting community and strategic projects and ensure that the estates are maintained to enhance the local neighbourhoods thereby supporting the Council's priorities for the Borough.

### **Recent Developments & Improvement Plans**

7.7 A corporate officer steering group was set up to widen engagement, seek views on performance and address the objectives under the community, economic, social and

regeneration headings. This includes officers from Corporate Property Services, Regeneration, Community Services, Homes for Haringey, Housing, Finance and Planning. The terms of reference include the following:-

- Review Council strategy and link with commercial portfolio
- Identify key regeneration, housing and neighbourhood projects within Borough
- Link opportunities from the commercial portfolio review with key projects
- Funding opportunities – i.e. GAF, CIF etc
- Set priorities in terms of Council service needs
- Outputs identified from the commercial portfolio review related to service needs
- Development sites identified
- Specification for phase two of review agreed
- Management issues to be discussed and identified

7.8 Over the past two years there has been an investment in (contract) resources for the in-house team and external agents have been appointed to address the backlog. A strategy to improve the level of voids and outstanding rent reviews has had some success but the portfolio still suffers from a high level of both.

7.9 Permanent staff recruitment is currently in hand to provide adequate management capacity and continuity for the proactive management of the portfolio. The downturn in the economy will help with this recruitment process and create a more stable management team.

7.10 Management and recovery plans have been prepared and implemented to improve the performance of the commercial portfolio. These actions have been successful and produced results on rent reviews, lease renewals and voids. A level of voids in the portfolio is inevitable and a strategy is in place to deal with this. Within a week of becoming vacant the property is inspected, valued and advertised on Haringey website. There is a constant rolling programme of advertisement for empty properties. The properties are regularly inspected and monitored through this process. All vacant property is inspected weekly as required for insurance purposes.

7.11 The current in-house team manage the portfolio through constant contact with tenants and ensuring that their lease obligations are met. On the larger industrial estates they ensure that the landlord's obligations are met and that health and safety requirements are complied with. In the current economic climate a supportive approach is being undertaken towards tenants through constant contact in order to anticipate financial issues and limit further voids in the portfolio.

7.12 Some initiatives have been undertaken to improve the management of some Industrial estates. These include working with the Council's Regeneration team on the Rangemoor Estate. A capital budget bid has been made to refurbish the estates as part of the Council's Business Planning process.

### **Detailed Review by External Consultant**

7.13 Following a high level assessment of the Property Portfolio in discussion with the Officer Steering Group, Drivers Jonas was appointed to undertake a review of the Commercial property Portfolio in April 2008.

7.14 A summary of the report is set out in Appendix 2. Key headlines from this review are as follows:-

- Only 2 out of 1,175 properties in the portfolio are considered to be surplus to requirements and therefore the majority of the portfolio has been assessed to be meeting either the financial or regeneration objectives.
- 92.93% of the portfolio (1,092 out of 1,175 properties) has been assessed as relevant for continued investment i.e. retention in current use as it meets the Council's strategic objectives.
- 6.89% of the portfolio (81 out of 1,175 properties) has been assessed as requiring investment to improve condition and performance or could be considered surplus (where uneconomic to invest).
- The internal rate of return appraisal undertaken by Drivers Jonas confirms that the financial performance of the portfolio is above the industry benchmark.
- The current management of the portfolio needs improvement and a more proactive approach is required.

### **Future Opportunities**

7.15 The recent corporate engagement in the management of the commercial portfolio and the external review carried out by Drivers Jonas has highlighted the opportunity for considering a wider multi agency and collaborative approach to future provision and management.

7.16 This is consistent with government initiatives relating to use of resources, value for money and community led initiatives. The recent formation of the Housing and Communities Agency and the Local Authority role in leading the "single conversation" that is designed to bring various sectors and agencies together to address community needs also presents an opportunity to consider wider are based approaches consistent with the Council's role as a "place shaper".

7.17 It is proposed to explore these further as part of the forthcoming review of the Asset Management Plan.

## **8. Chief Financial Officer Comments**

8.1 The Chief Financial Officer has been consulted on the report and notes that at this stage Cabinet are being asked to consider and provide comments on the strategic direction being proposed for the Commercial Portfolio which has significant value for the Council as well as contributing significant revenue to the Council. This review is closely aligned to the wider Government agendas of improved asset management and sustainability as well as understanding costs, performance and value for money within the CPA and more importantly within the CAA. The review aims ensure that apart from generating income, the portfolio also effectively supports Council regeneration objectives and its role as place shaper.

8.2 Once the detailed property proposals are available a clearer view will be possible on the financial implications behind the proposals both in terms of maintaining revenue levels from a revised portfolio but also the implications of proposed service delivery options.

## **9. Head of Legal Services Comments**

9.1 There is nothing in this report that would prevent members from making the recommendations. However, the recommendations will raise a number of legal issues which cannot be dealt with in detail until further information has been provided.

9.2 Once the asset management plan has been finalised legal comments can be provided on the Council's power to dispose under any disposal programme and any works to be carried out under any investment programme.

9.3 Should management options set out in the review be considered in the future there will be a number of legal issues that will need to be addressed at an early stage. Advice should be sought as to how best to deal with the various legal requirements imposed by various legislations. Issues that may need to be address include the Council's powers under various Local Government legislations, disposal powers, company law, partnership law, employment law, procurement and general contracts law.

## **10. Equalities &Community Cohesion Comments**

10.1. The aim of the commercial property portfolio is to support social and economic regeneration and therefore this project will contribute to the development of sustainable communities and provide opportunities for individuals.



**11. Consultation**

11.1. The Commercial Property Portfolio Steering Group (officers from Housing, Regeneration, Property, Finance, Planning, and Community) has been closely involved with the review process. This includes influencing the property review model set up by Drivers Jonas.

**12. Service Financial Comments**

12.1. There are no financial implications arising from this report.

12.2. There will be a future need to identify funding for investment in improving the condition of buildings, increasing management capacity and marketing. There will also be opportunities to raise revenue and capital income through asset improvements. These financial implications will be covered as part of the existing commercial portfolio budget or through appropriate budget bids as part of the Council's Business Planning process.

**13. Use of appendices /Tables and photographs**

13.1. Appendix 1 – Summary of Commercial Portfolio

13.2. Appendix 2 - Summary of Property Review undertaken by Drivers Jonas

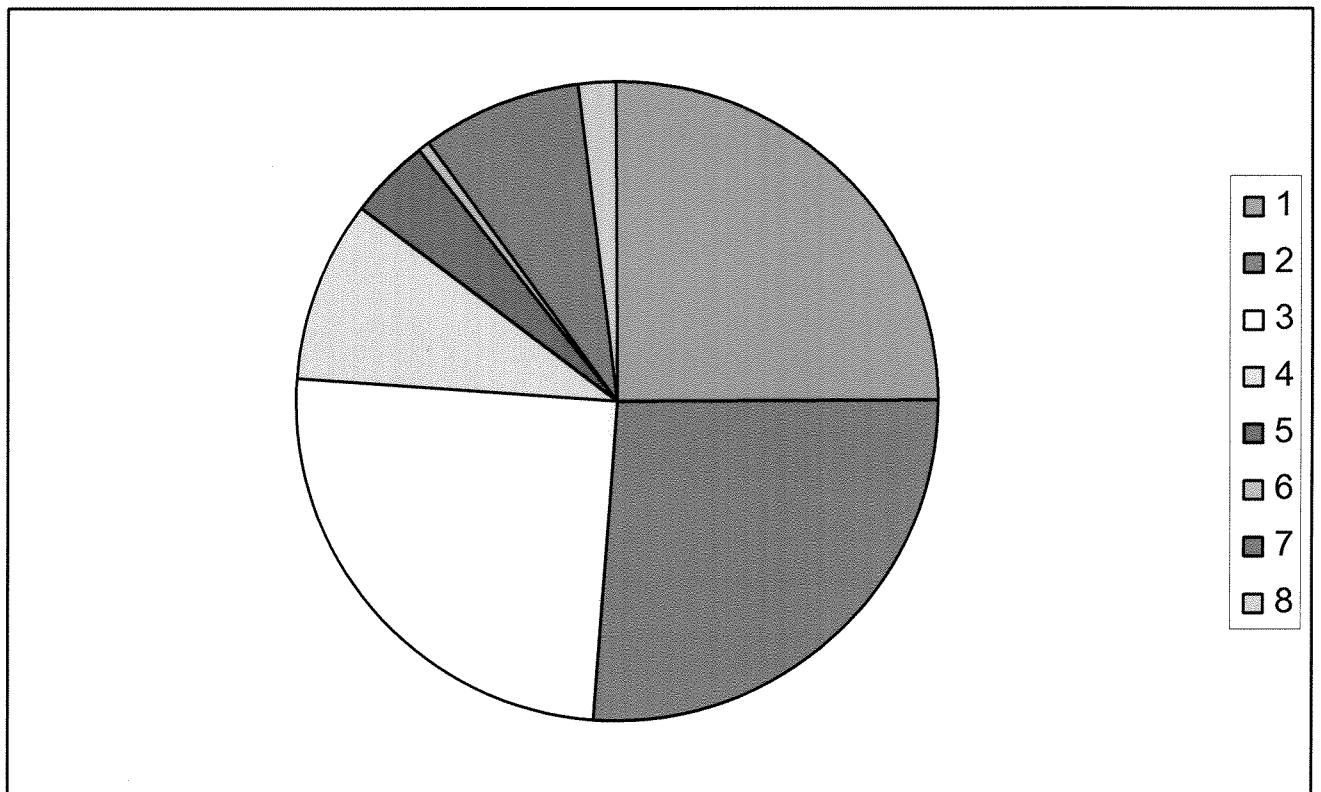
**14. Local Government (Access to Information) Act 1985**

14.1 N/A

## APPENDIX 1 - Breakdown of the commercial property portfolio

The current net income of the portfolio can be represented as follows:-

1. Retail	25%
2. Industrial	26.2%
3. Office	25%
4. Land	9%
5. Aerials	4.3%
6. Substations/Way leaves	0.5%
7. Community/corporate	8%
8. Utilities	2%



## APPENDIX 2 – Summary of the review undertaken by Drivers Jonas

Drivers Jonas carried out a detailed review in consultation with the Officer Steering Group. A summary of the review is as follows:

### Strategic Fit

The portfolio has been reviewed and properties categorised based on how they best fit to financial and regeneration objectives as follows:-

- **Financial** – the commercial estate should provide sustainable income to support the Council's revenue budget in the short to medium term taking account of the scope for enhancing capital gains in the longer term.
- **Regeneration** – the portfolio should be directed to supporting community and strategic projects and ensure that the estates are maintained to enhance the local neighbourhoods thereby supporting the Council's priorities for the Borough.

The portfolio has been evaluated in terms of how property is held as a financial and regeneration objective as follows:

#### The % and number of properties by Financial, Regeneration objectives

Strategic Objective	Number of Properties	% of Properties
<i>Financial</i>	781	66.5
<i>Regeneration</i>	394	33.5
<b>Combined</b>	<b>1175</b>	<b>100</b>

The properties are split into wards as follows:-

The % and number of properties (in the Financial and Regeneration strategic objective categories) by ward are as follows:-

Ward	Property Objective		Grand Total
	Financial	Regeneration	
Alexandra	16	0	16
Bounds Green	48	12	60
Bruce Grove	22	0	22
Crouch End	24	4	28
Fortis Green	32	0	32
Harringay	32	1	33
Highgate	33	0	33
Hornsey	33	6	39
Muswell Hill	70	0	70
Noel Park	72	48	120
Northumberland	63	30	93
Out of Borough	6	0	6
Seven Sisters	29	14	43

St Anns	27	20	47
Stroud Green	21	2	23
Tottenham	4	1	5
Tottenham Green	101	88	189
Tottenham Hale	27	121	148
West Green	33	4	37
White Hart Lane	36	41	77
Wood Green	6	1	7
Woodside	46	1	47
<b>Grand Total</b>	<b>781</b>	<b>394</b>	<b>1175</b>

The land and property review has concluded that there is a continuing benefit to the borough in retaining the majority commercial property portfolio to facilitate regeneration, deliver investment and deliver services. However, many of the properties require money to be spent on them in order to maximise their potential to the Council.

### **Analysis of the Portfolio**

The economic appraisal confirms the property policy objectives and sets out the property review process including four property holding criteria. These are:-

**Continued investment** – continue to manage, maintain and monitor investment performance

**Improved Investment Strategy** – asset has the potential to be improved through increased investment

**Surplus** – property identified as under-performing with no prospect or potential to improve and to be sold.

**Improved property management** – asset has the potential to be improved through more intensive management.

The portfolio includes a number of minor assets including substations, aerials, advertising hoardings etc. These are assessed as being held as continued investment in the future and number a total of 527 units.

Drivers Jonas has reported that 92.93% of the portfolio should be retained although they have identified areas where improved property management is required. These have been reflected in the scoring process and include problems relating to backlog of rent reviews, voids and service charges.

Overall the portfolio after being assessed and categorised as above can be represented as follows:-

<b>Strategic Property Holding Category</b>	<b>Number of Properties</b>	<b>% of Properties</b>
<i>Continued Investment</i>	1092	92.93%
<i>Improved Investment Strategy</i>	81	6.89%
<i>Improved Property Management*</i>	0	0.0%
<i>Surplus</i>	2	0.18%
<b>Combined</b>	<b>1175</b>	<b>100</b>

In analysing the properties Drivers Jonas also focussed on major assets in terms of assessing those that require an improved asset strategy and those that are surplus. If the minor assets (527) are removed the assessment can be shown as follows for major assets:-

<b>Strategic Objective</b>	<b>Number of Properties</b>	<b>% of Properties</b>
<i>Financial</i>	332	51.2%
<i>Regeneration</i>	316	48.8%
<b>Combined</b>	<b>648</b>	<b>100</b>

The results shown below reflect the highest and second highest scores for each of these properties and categorised above. This shows an underlying management weakness in the portfolio with 82% having a second highest score as improved investment strategy and 7.4% as improved property management.

The Highest and second highest Scores - % and number of properties in each strategic property holding category, i.e. Continued In Investment, Improved Investment Strategy, Improved Property Management, Surplus.

<b>Strategic Property Holding Category</b>	<b>Highest Score</b>		<b>Second Highest Score</b>	
	<b>Number of Properties</b>	<b>% of Properties</b>	<b>Number of Properties</b>	<b>% of Properties</b>
<i>Continued Investment</i>	565	87.2%	69	10.6%
<i>Improved Investment Strategy</i>	81	12.5%	532	82.0%
<i>Improved Property Management</i>	0	0.0%	47	7.4%
<i>Surplus</i>	2	0.3%	0	0%
<b>Combined</b>	<b>648</b>	<b>100</b>	<b>648</b>	<b>100</b>

## **Financial Performance**

A representative sample of properties has been assessed on financial performance and this shows an internal rate of return ranging from 4.82% to 11.25% with the majority over 10%. This suggests that the portfolio is performing in line with requirements with 6% to 7% generally used as a benchmark.

## Portfolio Strategy

In summary, Drivers Jonas have concluded that 92.93% of the portfolio is appropriate to hold and is performing satisfactorily. The remaining 7.07% requires further review.

Only 2 properties have been assessed as surplus to requirements and if these are added to the 81 that need for investment to improve condition and performance that there are potentially 83 properties that may be surplus or uneconomic to invest.

## Portfolio Management

It is also apparent from the Drivers Jonas review that whilst property management of the portfolio has improved in recent years it continues to be considerably weaker than is required for such a portfolio. Lease covenants are not always enforced, service charges not collected, rent reviews and lease renewals continually outstanding. There is a lack of clarity in terms of a business and asset management plan.

## Strategic Options Appraisal

Taking both the management and ownership options it is suggested that the following matrix of models from elsewhere are considered:

Option	Rank	Service Action	Ownership	Capital	Risk
Status Quo	6	Continuation	LA	LA (minimum)	LA
LBH all actions	4	Improvement	LA	LA	LA
Externalise management	3	Strategic Shift	LA	LA	LA, Part & Priced with KPI
Strategic Contract	2	Strategic Shift	LA	LA	LA, Part & Priced with KPI
Joint Venture	1	Strategic Shift	LA/PSP	LA/PSP	Allocated, KPI
Sell portfolio	5	Financial Decision Strategic Shift	-	-	LA

### Notes

LA – Local Authority

PSP – Property service provider

KPI – Key property indicator

### Key to options

- Status Quo – retain, no new investment, continue to manage in-house
- LBH all actions – retain, invest, improve in-house management and project manage changes through internal resources
- Externalise – property management is provided by an outside property management specialist
- Strategic contract – the Council retains ownership and works with an external property management adviser and identifies specific development partners for individual projects.
- Joint Venture – A partner is identified who can share equity and provide additional funding
- Sell portfolio – the commercial property portfolio is sold.

The current economic climate has an impact on these options and should be considered in the longer term.