CABINET – 15TH MARCH 2018

Report of the Head of Finance and Property Services

Lead Member: Councillor Tom Barkley

Part A

ITEM 15 OPTIONS FOR THE FUTURE USE OF INDUSTRIAL LAND AT MESSENGER CLOSE, LOUGHBOROUGH

Purpose of Report

The Council owns industrial land at Messenger Close, Loughborough. This report sets out options for the future use of this land.

Recommendations

Cabinet is asked to:

1. Approve the development of storage compounds as summarised as Option B in Part B of this report (subject to the receipt of planning permissions and other required approvals).

2. Approve the release of a maximum of £120,000 funding from the Reinvestment Reserve to provide funding for the development.

3. Give delegated authority to the Head of Finance & Property Services to make arrangements for the delivery of the development identified above.

Reasons

1. To allow the development of storage compounds as summarised as Option B in Part B of this report to be undertaken.

2. To ensure that adequate funding is available for the completion of the development.

3. To ensure that the development can be completed in an efficient and timely manner.

Policy Justification and Previous Decisions

The objective of developing and evaluating options for the development of land owned by the Council at Messenger Close, Loughborough is included within the Council's Corporate Business Plan 2017-18.

Implementation Timetable including Future Decisions and Scrutiny

It is envisaged that works will be completed by the autumn of 2018 allowing the timely occupation of prospective tenants.

This report is available for scrutiny by the Overview Scrutiny Panel of 12 March 2018, should that Panel choose to consider this item.

Report Implications

The following implications have been identified for this report.

Financial Implications

Option B has an estimated capital cost £85,000 which would be funded from the Reinvestment Reserve. The financial appraisal of this Option estimates that it would generate rental income and business rates for the Council in the range of £40,000 - £45,000 per annum; this represents a payback of approximately two years and a yield (excluding the impact of changes in land values) in the order of 9%.

Risk Management

The risks associated with the decision Cabinet is asked to make and proposed actions to mitigate those risks are set out in the table below.

Risk Identified	*Likelihood*	*Impact*	*Risk Management Actions Planned*
Lack of demand for Compounds	Possible	Moderate	Demand for the units/compounds was initially established by an independent study which included evidence collected from small businesses and public and private sector landlords. Engagement with prospective tenants has established significant interest and informal pre-let agreement has been reached for over 90% of the site.
Delay in completion of the development (resulting in loss of prospective tenants)	Possible	Moderate	Close project management of development. Ongoing communication and engagement with prospective tenants.
Overspends in Option development	Possible	Moderate	Project spend will be monitored through monthly expenditure monitoring procedures and completion progress will be monitored through asset management. Requested Reinvestment Reserve funding includes a contingency to allow the development to be completed within reasonable tolerance.

Key Decision: Yes

Background Papers:	Cabinet report of 11 June 2015 Cabinet report of 22 September 2016 Site Plan
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Part B

Background Information

1. The Council owns a plot of land off Messenger Close, Loughborough. The plot comprises an area of 7,244m^2 (around 1.7 acres or 80,000ft^2) of what might be described as brown field land. It is zoned as being for industrial use within the Charnwood Local Plan. Valuation estimates by the District Valuer from 2016 suggest that the land is worth around £380,000 with planning permission granted, or £300,000 without.

2. The Council has had longstanding plans to develop the site for commercial / industrial purposes. A Cabinet report of 11 June 2015 was presented requesting funding to assess the feasibility of creating business units on the site, with a further report being brought forward on 22 September 2016 with a proposal to develop the site for business units (minute 42 refers). Unfortunately the subsequent detailed contractor quote for the required works were well above their initial outline quote and the scheme described in the Cabinet report did not prove commercially viable.

3. The Council has since developed an alternative scheme for the site based on the creation of industrial compounds (similar in nature to those owned by the Council at Chainbridge Road, Loughborough).

4. Unsolicited, a local business contacted the Council about potentially purchasing the site early in February 2018 and subsequently made two alternative offers for the site comprising an initial lease period with the grant of an option to buy the site at a future date.

5. This report outlines that business's proposals, compares them to the proposed Council scheme, and recommends an option for Cabinet approval.

Summary of Options

6. Options considered in this report comprise the following:

   A. Do nothing

   B. Develop industrial compounds on the site; ownership and control retained by the Council

   C. Local business leases the plot of land from the Council for the development of a re-processing factory for a period of 21 years with the option to purchase the land for a fixed sum at the end of that period

D. Local business leases the plot of land from the Council for the development of a re-processing factory for a period of 10 years (at enhanced rent) with the option to purchase the land for a fixed sum at the end of that period

7. Additional detail of each Option and the results of the financial and overall evaluation are set out below.

Option A: Do nothing

8. In this Option the Council would retain the site as investment land with a view that land prices will increase. This option carries no capital cost and is therefore of minimal risk in respect of use of funds but there would be an opportunity cost in that no revenue would be generated, and no wider economic benefits would arise until the land is developed. The decision would be reviewed periodically in the light of extant land values and development opportunities that might arise.

9. The advantages and disadvantages of this Option are summarised below:

Advantages	Disadvantages
+ Low risk - no capital investment required + Council retains control of the site	− Opportunity costs; potential revenues and wider economic benefits foregone − Not in line with Corporate Plan objectives of 'sweating assets'

Option B: Develop site for industrial compounds

10. The Council scheme is to create a small number of industrial storage compounds on the site. Interest from the business community has been strong and informal negotiations are well advanced with three prospective tenants as follows:

- Plot I: Container storage for a consumer self-store site (~2,500m^2)
- Plot II: Storage for highways infrastructure (~ 3,000m^2)
- Plot III: Storage for scaffolding (~1,000m^2)

This leaves a usable balance of around 500m^2 which could also be let.

11. *Capital costs*: The scheme has a cost to the Council of approximately £85,000 which comprises site clearance and levelling, erection of external fencing and creation of an electricity supply. One tenant is considering the creation of a water supply and associated drainage infrastructure but this would be at their cost.

12. *Revenues*: Revenues generated would comprise rents directly receivable from the tenants plus business rates (payable by the tenants) receivable as the Councils share of total rates payable. For the purposes of this appraisal it is assumed that the Council would receive 20% of this total; implicit within this assumption is that (a) the Council's total business rate collection is above the baseline level and (b) that business rate retention rules remain as currently. An inherent risks that should be noted here is that marginal business rate collections in situations where the Council is in an overall 'safety net position' does not result in any additional income arising to the Council under current calculation rules. Further, in the medium term[1] prospective changes to the local rates retention scheme are expected, but detailed proposals are yet to be published.

Rental income

Engagement with prospective tenants strongly suggests an annual rental of £6 / m^2 is achievable for the compounds (this is line with advice on appropriate rental levels from the District Valuer).

- For the pre-let areas this would equate to an annual £39,000
- The maximum annual rental value of the site would equate to around £43,000

The proposed leases (equivalent to those for the Council's existing compounds) would have a duration of ten years with tenant break clause after one year, and a rent review after five years. For the purposes of this appraisal it is assumed that average occupancy equates to 90% of the site, equating to £37,800 per annum.

Business rates

No business rate valuation is possible prior to construction but it is assumed that they would be equivalent to those at the Council's Chainbridge site which suggests a rateable value of £7.50 / m^2

https://www.tax.service.gov.uk/business-rates-find/summary/17509567000?uarn=7745542000

For the purposes of this appraisal it is assumed that the multiplier is 48 pence / £1 (based on an assumed rateable value of below £51,000) and that increases are based on CPI[2] that runs at 2% per annum.

This would give a year-one revenue to the Council in the order of £4,500 - £5,000 based on assumptions above.

[1] Current information suggests a new business rate retention regime will be in effect from the 2020/21 financial year
[2] Consumer Price Index

13. *Planning status*: A planning application has been submitted for the site excluding any water supply or drainage facilities. Should a tenant wish to pursue these facilities a separate planning application for this element of works will be required.

14. *Timings*: There is some urgency from a prospective tenant perspective with their leases on existing storage facilities due to expire. It is envisaged that works will be completed allowing tenants to occupy the site from 1 August 2018. For the purposes of this appraisal it is assumed that revenues flow for the second half of financial year 2018/19.

15. *Job creation (economic development factors)*: Specific detail around job creation from prospective tenants is not available but it is estimated that around ten jobs would be created on the site.

16. *Control of site and prospective capital receipts*: The Council is not significantly constrained in generating a capital receipt from the site should this be financially desirable in future years. Future options on the sale or retention of the site will remain open to the Council.

17. *Financial appraisal – approach and assumptions*: The approach and assumptions underpinning the financial appraisal (applicable to all Options evaluated) are as follows:

    - Period of appraisal – 21 years (to allow like for like comparison with local business offer)
    - Inflationary uplift – an annual CPI uplift of a 2% per annum is assumed, applicable to rent reviews and business rate
    - A discount rate of 2.5%, equivalent to long term borrowing rates available from the PWLB[3] is applied
    - Two alternative assumptions are used to calculate the extant value of the site at future dates in respect of average growth in the land values applicable to the Messenger Close site; calculations are performed assuming 2% (considered conservative[4]) and 5% year on year growth

18. *Financial appraisal – results*: The results of the financial appraisal are summarised below:

Initial capital cost	£85,000
Payback period	2 years

[3] Public Works Loan Board; this is considered to equate to the Council's cost of capital

[4] Growth in land value is dependent on a range of factors such as actual and prospective use, location and the prevailing economic climate. Annual growth of 2% is considered conservative; under the financial appraisal assumptions this would represent a depreciation in land value in real terms

Indicative yield (initial years of Option)	< 9%
Net present value after 21 years – assuming 2%year on year growth in land value	£1.15m
Net present value after 21 years – assuming 5%year on year growth in land value	£1.43m

19. *Risk assessment*

- There is a significant risk the decision on the way forward for the site is deferred some or all prospective tenants will not occupy the site; this situation would give rise to both financial and reputational risks
- A delay in site works could also result in loss of tenants
- Business rate income is uncertain being subject to changes in government rules
- Standard business risks also apply which would include ongoing void units, risk of tenant insolvency

20. The advantages and disadvantages of this Option are summarised below:

Advantages	Disadvantages
+ Financial metrics (payback, net present value and yield) are all positive + Contributes to economic development of the Borough + Council retains control of the site; benefits of flexibility and maintenance in upside of potential increases in land values + In line with Corporate Plan objectives of 'sweating assets'	– Some initial capital investment required – Usual commercial risks exist relating to periods of unit void and non-payment by tenants

<u>Option C: Local business proposal of 21 year lease with option to buy at lease-end</u>

21. The local business are proposing to locate a factory on the site with a function described as 'shredding and optical sorting of LDPE[5] films to produce high quality clear and coloured bales of LDPE film for use in the LDPE wash plant'. They suggest that the factory would be a

[5] Low density polyethylene

minimum of 50,000ft^2 (around 4,650m^2), require a £7.5m investment and could create 28 jobs.

22. The financial proposal is for the rent of the plot of land in Messenger Close from the council at an annual rent of £25,000 on a 21 year lease with an option to buy after the end of the agreement for £600,000.

23. *Capital costs*: No capital cost would be incurred by the Council.

24. *Revenues*: As with Option B, revenues generated would comprise rents directly receivable from the tenants plus the Council's share of business rates payable by the tenants. Assumptions around business rate receipts are as set out in respect of Option B.

    Rental: The proposal is for an annual rent of £25,000 on a 21 year lease with an option to buy after the end of the agreement for £600,000.

    Business rates: No business rate valuation is possible prior to construction but it is assumed that they would be equivalent to those at a neighbouring factory site (performing processes of a similar nature) which suggests a rateable value of £38 / m^2. For the purposes of this appraisal it is assumed that the multiplier is 49.3 pence / £1 (based on an assumed rateable value of above £51,000) and that increases are based on CPI that runs at 2% per annum. This would give a year-one revenue to the Council in the order of £17,400 based on assumptions above.

24. *Planning status:* No planning application has yet been submitted.

25. *Timings:* The local business have stressed that the factory development is an urgent issue based on recent changes in their regulatory regime. They hope to develop the factory within six months. For the purposes of this appraisal it is assumed that revenues flow from the start of financial year 2019/ 20.

26. *Job creation (economic development factors)*: It is estimated that 28 jobs would be created by this development; the business has indicated that these could be regarded as 'high quality' engineering roles.

27. *Control of site and prospective capital receipts*: Entering into an agreement with the local business will effectively see the Council cede control of the site. The proposed capital receipt (£600,000) arising from the option to purchase the site at the end of the lease period may reflect market values at that time[6] but should values exceed this amount the Council will have no opportunity to participate in any uplift.

[6] A capital receipt of £600,000 21 years hence equates to a 2% year on year annual growth on the current land value of £380,000

28. *Financial appraisal – results*: The results of the financial appraisal are summarised below:

Initial capital cost	£Nil
Payback period	Not applicable
Indicative yield (initial years of Option)	< 11%
Net present value after 21 years	£1.11m

29. Risk assessment

- Delays in site development would result in the absence of business rate income
- Business rate income carries an inherent risk as described above due to uncertainties around changes in calculation rules and the Council's overall business rate collection position at any point in time; the structure of the Option C proposed deal which relies much more heavily on business rate income therefore carries a higher level of risk than Option B (where the bulk if revenue is generated via rental receipts)
- Usual business risks also apply which would include risk of tenant non-payment; however these maybe construed these as lower than for Option B as the business is known to be well-established and profitable
- (Void risks are avoided with this Option)
- The £600,000 option to buy the site after 21 years may prove well below market value at that time (assuming a 2018 site value of £380,000 and a valuation uplift of 2% per annum would produce a 2039 valuation of £576,000; should the valuation uplift be 5% per annum however, then the equivalent valuation would be in excess of £1.0m)

30. The advantages and disadvantages of this Option are summarised below:

Advantages	Disadvantages
+ Financial metrics (payback, net present value and yield) are all positive + Overall the financial appraisal produces very similar results to Option B; net cash flows are slightly better than for Option B in early years but overall net present value is inferior (significantly so if higher than assumed growth in land	− The Council cedes control of the site; a particular risk associated with this is that the Council will fail to receive market value on the sale of the site at the end of the lease period − The structure of the proposal exposes the Council to significant risk in respect of the operation of business rate retention rules

Advantages	Disadvantages
valuations arise) + No initial capital contribution is required of the Council + Contributes to economic development of the Borough; likely to create more, higher quality jobs than Option B + In line with Corporate Plan objectives of 'sweating assets'	− Residual commercial risks exist in respect of non-payment by tenants (considered low)

Option D: Local business proposal of 10 year lease at enhanced rent with option to buy at lease-end

31. The proposal relating to the factory is as set out for Option C.

32. The financial proposal is for the rent of the plot of land in Messenger Close from the council at an annual rent of £60,000 on a 10 year lease with an option to buy after the end of the agreement for £50,000. Enhanced rentals through the lease period are offset by the option price of the site at the end of the lease period.

33. *Capital costs*: No capital cost would be incurred by the Council.

34. *Revenues*: As with Option B and C, revenues generated would comprise rents directly receivable from the tenants plus the Council's share of business rates payable by the tenants. Assumptions around business rate receipts are as set out in respect of Option B.

    Rental: The proposal is for an annual rent of £60,000 on a 10 year lease with an option to buy after the end of the agreement for £50,000.

    Business rates: As set out in respect of Option C, it is estimated that year-one revenue to the Council would be in the order of £17,400.

35. *Planning status:* As for Option C; no planning application has yet been submitted.

36. *Timings:* As for Option C; it is assumed for the purposes of this appraisal it is assumed that revenues flow from the start of financial year 2019/ 20.

37. *Job creation (economic development factors)*: As for Option C; it is estimated that 28 high quality engineering jobs would be created by this development.

38. *Control of site and prospective capital receipts*: Entering into this agreement with the local business will effectively see the Council cede control of the site. The proposed capital receipt (£50,000) arising from the option to purchase the site at the end of the lease period is unlikely

to be other than well below market values at this time, reflecting enhanced rents receivable through the lease term.

39. *Financial appraisal – results*: The results of the financial appraisal are summarised below:

Initial capital cost	£Nil
Payback period	Not applicable
Indicative yield (initial years of Option)	< 20%
Net present value after 21 years	£0.73m

40. *Risk assessment*

- As Option C; delays in site development would result in the absence of business rate income
- As Option C; business rate income carries an inherent risk as described above due to uncertainties around changes in calculation rules and the Council's overall business rate collection position at any point in time; the structure of the Option C proposed deal which relies much more heavily on business rate income therefore carries a higher level of risk than Option B (where the bulk if revenue is generated via rental receipts)
- As Option C; usual business risks also apply which would include risk of tenant non-payment; however these maybe construed these as lower than for Option B as the business is known to be well-established and profitable
- (Void risks are avoided with this Option)
- The £50,000 option to buy the site after ten years will almost certainly prove well below market value at that time.

41. The advantages and disadvantages of this Option are summarised below:

Advantages	Disadvantages
+ Financial metrics (payback, net present value and yield) are reasonable but significantly less so than other available options + No initial capital contribution is required of the Council + Contributes to economic development of the Borough; likely to create more, higher quality jobs than Option B + In line with Corporate Plan	− Financial metrics (see left) are inferior to other available Options − The Council cedes control of the site; a particular risk associated with this is that the Council will fail to receive market value on the sale of the site at the end of the lease period − The structure of the proposal exposes the Council to risk in respect of the operation of business rate retention rules

Advantages	Disadvantages
objectives of 'sweating assets'	– Residual commercial risks exist in respect of non-payment by tenants (considered low)

Summary and conclusions

42. Options A (Do nothing) and D (Offer a ten year lease with the option to purchase the site at the end of the lease period) can be rejected as being clearly inferior to other available Options.

43. Qualitatively, Option C (Offer a 21 year lease with the option to purchase the site at the end of the lease period) may be considered superior to competing Option B (develop Council scheme to develop compounds) on the grounds that this proposal is likely to create more, and higher quality jobs. However, this assertion is only valid if the prospective factory either is not constructed, or is constructed outside of the Borough.

44. Financially, there is little to choose between Option B and Option C. Option C offers better cash flows in earlier years but overall appears less favourable over the whole (21 year) appraisal period; this difference is more marked if higher levels of growth in the site value arises.

45. Option C offers more financial stability in respect of rental incomes but leaves the Council exposed to greater levels of risk in relation to the extant business rate retention scheme. However, the major downside of this Option is that the Council loses control of the site and, in particular, the ability to participate in increases in the value of the site over the 21 year lease period.

46. Finally, it may be noted that whilst no formal legal agreements have been signed, the Council has created the expectation amongst the prospective tenant group that the compounds will be developed. The pursuit of alternative Options at this late stage in the development of Option B may create reputational issues for the Council.

47. On balance it may be concluded that Option B - for the Council to develop site for industrial compounds – is the best Option available to the Council. This report therefore recommends that this Option is taken forward.