

Wiltshire Council

Cabinet

8 October 2019

Subject: **Commercial Capital Investment Opportunity**

Cabinet Member: **Cllr Toby Sturgis, Cabinet Member for Spatial planning, Development Management and Property**

Key Decision: **Key**

Executive Summary

The purpose of the report is to consider a specific example of investment in commercial property, in context of the Approach to Disposal of Assets and Property Acquisitions.

The report includes the decision to proceed with a commercial property development of the Good Energy offices, including construction and grant of a new lease, subject to completing the due diligence.

Proposal(s)

Cabinet are being asked to:

- a. Agree to construct an office building at Sadlers Mead, at Capital expenditure as set out in the Part 2 paper and subject to further due diligence being undertaken and conditional upon Good Energy signing an Agreement to Lease;
- b. Agree a virement of capital, as set out in the Part 2 paper, from the 2020/21 commercial investment capital allocation;
- c. To procure AHR and Max Fordham by way of direct award, due to their previous knowledge and work on the scheme which is permissible under the Council's procurement rules;
- d. To delegate the decision to award the AHR, Max Fordham and resulting construction contract for Sadlers Mead to Director for Housing and Commercial Development, in consultation with Leader of the Council / Cabinet Member for Finance and Director for Finance.

Reason for Proposal(s)

To enable the Council to enter into a commercial opportunity development within the parameters set by Cabinet subject to further due diligence and signing an Agreement to Lease.

**Alistair Cunningham OBE
Executive Director – Growth, Investment and Place**

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Purpose of Report

1. The purpose of the report is to seek to progress investment in commercial property, in context of the Approach to Disposal of Assets and Property Acquisitions.
2. An outcome of the report is to enable officers to have detailed negotiations Good Energy to commit to construction of office accommodation. The offices will be let to Good Energy, on terms set out in paragraph 11 of this report, subject to detailed negotiations and conditional upon Good Energy signing an Agreement for Lease.

Relevance to the Council's Business Plan

3. The development of commercial property opportunities enables the Council to generate additional revenue to support front line services. The Council will be taking a commercial approach to both acquisitions and redevelopment, ensuring that the return generated is in line with a private commercial property developer and in line with the Capital Investment Strategy.

Background

4. On 26th March 2019, Cabinet approved, in principle, the purchase of the completed office development with Good Energy having signed a lease to occupy the building. Further due diligence has meant that the purchase opportunity will not be available to the Council, but an opportunity to build the offices has presented itself.
5. The council has an appetite to invest in commercial property, as set out in the Cabinet report approved in February 2019; either through purchase of investment opportunities or the redevelopment of its own land. Both have risks attached and this report seeks to demonstrate how such risk is being considered to mitigate the impact it has on any development opportunity.
6. Good Energy are an innovative and valued business for Wiltshire's economy and not investing in the development will result in them not being able to

occupy a HQ in Chippenham and may lead to them vacating Wiltshire. The loss of jobs will have an impact on the local economy

Main Considerations for the Council

7. The Council current owns Sadlers Mead Car Park with the Council having achieved a planning consent, in collaboration with Good Energy, for a 25,000 sq ft office building and multi-storey car park.
8. To enable Good Energy to build their HQ they have asked Wiltshire Council to act as developer under their commercial property investment policy.
9. Terms have been discussed for Good Energy's occupation and a summary of the terms are set out in the Part 2 paper, being in line with current market conditions.
10. An external cost review of the construction cost has been carried out and is included in the Part 2 paper.
11. Authority is sought to allocate capital to build the offices conditional upon Good Energy signing an Agreement for Lease.

Overview and Scrutiny Engagement

12. Overview and Scrutiny Financial Planning Task Group reviewed the content of March 2019 Cabinet paper this report on 21st March with any comments provided as part of the Cabinet discussions.

Safeguarding Implications

13. There are no safeguarding implications with this proposal.

Public Health Implications

14. None direct, although creating additional revenue sources for the Council will enable services to be maintained and, potentially, mitigating public health issues.

Procurement Implications

15. The decision to develop the offices will have direct procurement implications, including compliance with Public Contract Regulations 2015 and the Council's procurement rules. The Council will appoint a Project Manager to work with the Strategic Procurement Hub to ensure contractors are appointed in accordance with procurement rules. A sourcing plan will be produced for approval by the Head of Procurement in agreement with the service lead that will agree the route to market to achieve best value for the Council.

16. AHR were principle designer for the scheme up to planning consent being granted and have been retained to act in this capacity for the car park element of the development.
17. Max Fordham are building services engineers and have significant knowledge of the proposed scheme, having a track record of working with AHR in developments.
18. Both AHR and Max Fordham are proposed to be procured via direct award which is permissible under the Council's procurement rules as this offers best value, due to their previous involvement in the project, to allow the project to develop in an efficient timescale and are being appointed on fees that are competitive in the open market.

Equalities Impact of the Proposal

19. None

Environmental and Climate Change Considerations

20. There are direct impacts arising from the development, as the completed office development is expected to achieve a minimum BREEAM accreditation of 'Very Good' under the 2014 guidelines.

Risks that may arise if the proposed decision and related work is not taken

21. The revenue pressures on the council will continue to increase and finding ways to generate additional revenue will put the council in a better financial position and will assist when decisions have to be made to reduce service levels.
22. Good Energy are an innovative and valued business for Wiltshire's economy and not investing in the development will result in them not being able to occupy a HQ in Chippenham and may lead to them vacating Wiltshire. The loss of jobs will have an impact on the local economy.

Risks that may arise if the proposed decision is taken and actions that will be taken to manage these risks

23. The acquisition of commercial property has risks associated but such risks are factored into the price paid for the property.
24. The decision sought is the principle of development, with further due diligence to be undertaken to ensure that the construction cost estimate is appropriate and the revenue risks are mitigated. Further due diligence is required and will include, but is not limited to:
 - i. A further review of the financial position of Good Energy Ltd and PLC – to ensure that the company is of sufficient capacity to fulfil the obligations of the lease, including the payment of rent. An initial review

- has been undertaken by Finance and this will be refreshed before the Council commits;
 - ii. Agreement of Heads of Terms – to ensure that they do not contain any terms that put onerous obligations on the Council;
 - iii. Appointment of a professional team – to ensure that the construction is designed and procured in line with construction market opportunities;
 - iv. A review of the office development design – to ensure that the building can be re-let if Good Energy vacate at the end of the lease.
- 25. Should the due diligence flag up any matters that are not considered acceptable, it will be recommended that the development does not proceed.
- 26. The due diligence as set out above will be undertaken to mitigate the risk of business failure. In addition, property is a tradable asset so there is an opportunity to dispose or re-let the offices in the future. There will be development risks but these will be mitigate by working with a professional team through the decision and construction process, enabling opportunities to mitigate such risks and remain within the budget envelope.

Financial Implications

- 27. The previous Cabinet paper set out that the total outlay for purchasing the site would be in the region of £8m, inclusive of all purchase costs. The cost estimate received sets out that a similar capital expenditure to build the offices will be required.
- 28. The initial valuation of the internal Chartered Surveyors, included in the March 19 Cabinet report, indicated that the purchase price, with associated costs, would have generated a average annual return above that required in the Capital Investment Strategy.
- 29. With the Council having to construct the offices, the rate of return will reduce due to borrowings being incurred prior to rent being received. On a like for like basis the return for the initial 15 years of the lease does reduce but remains above the target return of the Capital Investment Strategy.
- 30. The Heads of Terms set out that there is a rent-free period equivalent to 12-months, which will mean no income during the period of construction and during the rent free, although borrowing costs will be incurred. Income, at the full rent, will be gained from the second year of the lease, generating surpluses increasing from the fifth and tenth year of the lease.
- 31. The internal financial review of the opportunity, over the life of borrowing (50 years at 2.6%) and reflecting costs being incurred during construction and during the rent-free period, demonstrates an average return, over borrowing, more than the requirements of the Capital Investment Strategy. The review includes an element of expenditure at year 15 of the lease to accommodate for costs of voids and minor alterations to the building, this assumes that the

tenant returns to the building to the Council in a good condition (including all capital maintenance requirements).

32. The Council are prepared to take on the development risk on the basis that the asset remains within the Council's ownership. The Council will enter into a binding contract with Good Energy for them to take a lease on practical completion, therefore, mitigating the risk of construction costs being incurred with no income generated.
33. Further Heads of Terms set out that the Council will make contributions to Good Energy for various fit-out items. The Council's due diligence will ensure these are included within the overall project cost and are appropriate given market conditions.
34. Due to partial exemption limits, the Council will opt to tax the site and completed building, so full recovery of VAT is made on construction costs.

Legal Implications

35. The grant of a 20 year lease means that best consideration must be obtained under s123 Local Government Act 1972, in this instance by achieving market rent from the letting. The market rent for high quality offices is in the region of £17.50 psf, with the initial rent being higher. As such, best consideration is being obtained from the leasehold interest being granted.
36. The Council currently owns the land, so are well aware of the title implications of holding the land, and this will not change as a result of this proposal.
37. Legal due diligence will be included within the review of the Heads of Terms for the occupational lease.
38. The current threshold for works is £4,551,413 and any works to be undertaken in excess of this threshold are subject to procurement in accordance with The Public Contracts Regulations 2015. The Council can utilise a procurement process without a call for completion where (most notably) the works can be supplied only by a particular supplier where competition is absent for technical reasons or for the protection of exclusive rights. This will need to be considered further in the sourcing plan referred to in the Procurement Implications referred to above.

Options Considered

39. Not to pursue the development, which will not expose the Council to any financial risk associated with the construction. The financial benefits described above would be derived.

Conclusions

40. That the investment in development is agreed, subject to the due diligence set out being undertaken.

**Simon Hendey (Director - Housing and Commercial)
Alistair Cunningham, Corporate Director – Growth, Investment and Place**

Report Author: Mike Dawson, Asset Manager (Estates & Asset Use)

18 September 2019

Appendices

Part 2 Cabinet Paper

Background Papers

The following documents have been relied on in the preparation of this report:

Part 2 Cabinet Paper – 26 March 2019 – Approach to Disposal of Assets and Property Acquisitions - Acquisition example