

NO LONGER EXEMPT

Decision Record

Report of the Strategic Director for Commercial Development, Assets and Leisure

Leader member: Councillor Jonathan Morgan

PART A

Investment Property Acquisition – Aberdeen

Purpose of Report

This report seeks approval to acquire a commercial investment property.

Recommendation

1. To acquire the commercial investment property detailed in Part B of the report.
2. To approve the Heads of Terms as set out in the appendices and to delegate authority to the Strategic Director – Commercial Development, Assets and Leisure to continue negotiations and finalise the transaction based on these Heads of Terms.
3. To authorise the Head of Strategic Support to complete the legal transactions.

Reasons

1. Purchasing this property is a prudent investment and will support the Medium Term Financial Strategy (MTFS). The proposed acquisition is in line with the Council's approved Commercial Property Investment Strategy. By investing capital in the purchase of this property, the Council will receive a revenue income and will be the freehold owner of the property. Ultimately, the purchase will support MTFS, thereby protecting the delivery of services to Charnwood's residents.
2. Delegation of this authority will allow for the timely completion of the transaction, as well as timely decision making should additional negotiation be required. The Leader, Deputy Leader, Chief Executive, S151 officer and Monitoring officer will be consulted throughout the transaction to completion.
3. To allow for timely completion and signing of contracts.

Alternative Options Considered

The alternative to not invest in this property would not realise any additional revenue to support the MTFS. Any investment carries risk; however, these risks have been evaluated and understood.

Policy Justification & Previous Decisions

The justification for this decision is outlined within the financial projections and associated challenges set out within the latest version of the MTFS (approved by Council on 20 January 2020), and the proposed method of addressing that challenge through the acquisition of commercial investment property set out in the current Capital Strategy as well as the forthcoming Capital Strategy due for approval by Council on 4 November 2020.

Implementation Timetable including Future Decisions and Scrutiny

Officers became aware of the opportunity on 25 August 2020, at which time initial due diligence on lease and title, examination of the tenant covenant and financial modelling were undertaken. The Strategic Director – Commercial Development, Assets and Leisure, with CBC’s property advisor and legal representation, inspected the property on 15 September; no defects or elements of concern were found or noted.

Immediately following approval of the Capital Strategy 20/21 and the associated Capital Plan on 9 November, a bid to acquire the property was submitted to the vendor. The bid was accepted and Heads of Terms (HoT) were agreed on 9 November at 9.30pm. A delegated decision that is supported by this report must be signed by the Leader no later than 11 November. Should the results of further due diligence remain favourable, completion of the acquisition should take place no later than 16 November 2020.

Report Implications

1. Corporate Plan:

A commercial property investment strategy has been outlined in the Corporate Plan, and an investment fund has been approved by Council and forms part of the Capital Strategy and Capital Programme.

2. Legal:

Section 120 of the Local Government Act 1972 empowers a Borough Council to acquire land for the purpose of any of the Council’s functions or for the benefit, improvement or development of their area by agreement inside of or outside of its area.

3. Finance:

This report is effective from 6 November 2020 and has the following financial implications:

Budget Area	Implication
General Fund – Revenue Budget	The General Fund Revenue and Capital Financing implications are contained within an appendix to Part B of the report
General Fund – Capital Programme	The financial implications are contained within an appendix to Part B of the report. This proposed acquisition is part of the Commercial Property Investment Scheme as approved within the Capital Strategy and Capital Programme
Housing Revenue Account – Revenue Budget	No implications
Housing Revenue Account – Capital Programme	No implications

4. Risk:

Risk	Likelihood	Impact	Overall	Mitigation
The tenant does not renew the lease at expiry.	2 Unlikely	2 Significant	4 Low	1. Charnwood will establish and maintain a property reserve in the event of such a circumstance.

				2. The reversionary letting rates and location are competitive and will not unduly disadvantage Charnwood, given the current circumstances.
The tenant moves staff/operations from this location to alternative locations, decreasing utilisation of the site.	2 Unlikely	2 Significant	4 Low	Regardless of how the tenant uses the space, the tenant remains liable under contract to maintain rent and insurance payments as well as to maintain the building. If the tenant wished to exit the lease and property early, they would be obligated to pay the balance of rents due under the lease. In this case, the tenant and Charnwood would enter (likely protracted) negotiations, during which Charnwood would be able to plan alternative strategies and develop business cases for viability determination.
Tenant fails to pay rent	2 Unlikely	3 Serious	6 Moderate	The property reserve to be established will serve as a buffer and monies would be released to maintain cashflow. Simultaneously, Charnwood would take Legal action to recover any rents unpaid.
The property is destroyed (e.g. fire, flood or other)	1 Remote	3 Serious	3 Low	Charnwood will be insured against these risks and against the lost rent in the event of building destruction.
The macroeconomic impact of Brexit results in general economic difficulty.	3 Likely	2 Significant	6 Moderate	The Tenant Covenant is strong (Dun & Bradstreet 5A 2) and is likely to be able to withstand a period of trading difficulty. This will be monitored and managed. The Tenant has fared well during the course of the COVID19 pandemic to date. They remained operational as they are classed as an essential business. Retained profit and Net assets remain sizeable.
CIPFA updates Statutory Guidance relating to non-financial investments.	2 Unlikely	2 Significant	4 Low	Charnwood is acting in line with the latest guidance (issued 18 November 2019). Should the guidance be updated further, Charnwood will respond accordingly. The direction of anticipated changes is currently unknown. Should the guidance halt investment activity altogether, Charnwood must find alternative income sources and/or reduce expenditure accordingly to compensate.
Tenant's financial stability – the health and	2.5	2	5 Moderate	Eriks Industrial Services Ltd have a strong trading history and very well-established performance record.

viability of the business				Originally the business' client base was heavily weighted toward the North Sea oil industry. Over the last 12 years, Eriks have diversified their offering and now maintains clients from Defence, Distilling, Brewing and Renewable Energy clients.
Tenant Covenant	2	2	4 Low	Again, the tenant trades and performs well in normal circumstances and is addressing risks of the current pandemic.
Ratio of external Debt/Market value	1	1	1 Low	The purchase will be funded initially without borrowing, and if borrowed, is likely to be internal borrowing. However, prudence dictates that analysis with borrowings be undertaken to ensure the profitability of the investment.
Ratio of Purchase value/Investment pool value	2	2	4 Low	Consumes 35% of the £10M currently allocated in the Capital Plan. Net yields are outlined in Part B. Prudence dictates that the asset be monitored quarterly for performance.
Presence and timing of break clauses & rent reviews	2	2	4 Low	Rent reviews are upwards only at the 5 th and 10 th anniversaries of the current lease and are subject to open market value meaning that the property is not over-rented. Lease end is 1 September 2034, with a tenant only break option at 2 September 2029.
Age and State of repair	1	2	2 Very Low	The property was constructed in 2016. The property is maintained fully by the tenant and is in very good repair. Construction warranties remain in force and will transfer with title. Lease clauses for dilapidations and reinstatements have been reviewed and provide ample recourse and protection to the property owner.
Strength of Market for use / letting	2	2	4 Low	Strong commercial location in Aberdeen. Good reversionary re-let options exist.
Risk of revaluation loss	2	2	4 Low	CIPFA requires LAs to make a prudent provision for MRP. Periodic valuation will be necessary. Charnwood will establish a property reserve to protect cash flow.

3. Human Resources: None

4. Equality and Diversity: None

5. Sustainability Implications: None

Urgency

The proposed acquisition would be a key decision and the authorising report would contain exempt information, but the full 28 days' notice is unlikely to be possible due to the urgency of the matter.

In the circumstances, agreement was reached with the Chair of the Scrutiny Commission on 6th November 2020 that the decision was urgent and could not reasonably be deferred and was also exempted from Call-in. The call-in procedure provides for a period of five clear working days during which councillors can ask for decisions taken by the Cabinet and individual Cabinet members, and key decisions taken by officers to be reviewed. With the agreement of the Chair of the Scrutiny Commission or in her/his absence the Mayor or Deputy Mayor) a decision can be exempted from call-in if the decision to be taken is both urgent and reasonable and the delay caused by the call-in process would not be in the interests of the Council or the public. Scrutiny Committee Procedure 11.9 requires that decisions that are exempted from call-in are reported to Council.

Exemption

NO LONGER APPLIES

The report contains exempt information by virtue of paragraphs 3 and 5 of part 1 of Schedule 12A of the Local Government Act 1972 and in respect of which, the Proper Officer considers that the public interest in maintaining the exception outweighs the public interest in disclosing the information.

The report contains financial information relating to a proposed land transaction that is subject to contract which, if in the public domain, could adversely affect the Council's ability to achieve a favourable outcome. The report also contains information that is legally privileged.

Key Decision: Yes

Background Documents: None

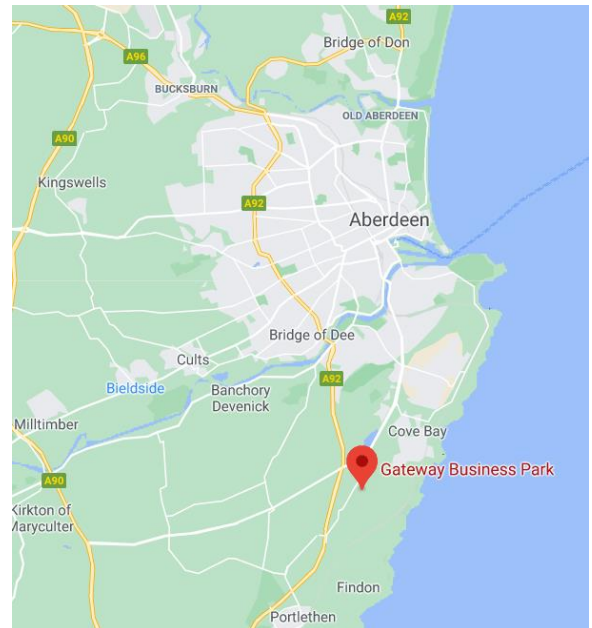
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PART B

Detailed information

The Property Location

1. Aberdeen is Scotland's third largest city with a population of approximately 225,000 and a regional catchment population of over 500,000. It is the administrative capital of the North East of Scotland and benefits from two universities, an expanding international harbour and airport, seven major research institutes, together with food, fisheries and agricultural research establishments.
2. Aberdeen Gateway is located to the south side of the city and is the natural extension to Altens Industrial Estate providing a prime location. The Park lies alongside the main southern access point into Aberdeen city centre and Aberdeen Harbour, close to the A90 junction with the A956, which also gives access to the Aberdeen Western Peripheral Route (AWPR).
3. Development at Aberdeen Gateway commenced in 2007 and has attracted several high-profile occupiers, including Total, National Oilwell Varco, Hydrasun, Oilstates and EnSCO. A location map is provided showing Aberdeen Gateway's close proximity to the city's arterial road network. Neighbouring occupiers in the area include Home Bargains, Aldi, Inchcape Mercedes, Sandiccliffe Ford and Wickes.



Property Specification and Inspection

4. The property address is Unit E7, Gateway Business Park, Moss Wynd, Aberdeen AB12 3UF.
5. The property comprises a warehouse facility with a two-storey office, together with 46 car parking spaces, built on a site of approximately 0.47 hectares (1.15 acres). The specification of the warehouse is:
 - Steel portal frame construction with composite roofing and panel system
 - Floor loading of 35.0 kN/m²
 - 7.0m 'floor to underside of haunch'
 - 2 x Electric sectional overhead doors
 - The tenant has invested heavily in the building with two crane systems inside the warehouse (10 tonne and 15 tonne lifts).

The office specification is:

- Floor to ceiling height of 2.7m
 - VRV cooling & heating system
 - High frequency lighting
 - 8 person DDA compliant passenger lift
6. Officers inspected the property on Weds 28 October 2020 and found that the site presents as described. The Site Manager acted as escort through the building and noted that there are no issues identified with the property.





Tenant

7. The tenant, Eriks Industrial Services provides industrial products and services to its customers revolving around the supply of bearings, power transmission, pneumatic and hydraulic products, seals, gaskets, hoses, valve products, electric motors, gearboxes, pumps and other industrial consumables.
8. From this location Eriks provides bespoke engineering services. Locating here in early 2017, Eriks consolidated 3 separate premises in the Aberdeen area. They have diversified their client base from a heavy reliance on the oil sector since 2014 – they work in renewables, breweries and distilleries, the Royal Navy and many others.
9. Classed as an essential business, Eriks have remained open and operational throughout the COVID pandemic. 20 mechanical and electrical engineers work onsite, and their field sales teams are operational from remote locations.
10. Eriks Industrial Services Ltd have a Dun & Bradstreet rating of 5A 2, indicating a tangible net worth of £41.9m and lower than average risk..
11. As of 5 November 2020, Dun & Bradstreet's assessment of the business states:
 - a. Overall assessment of this organisation over the next 12 months: STABLE CONDITION*
 - b. Based on the predicted risk of failure: HIGH LIKELIHOOD OF CONTINUED OPERATIONS*
 - c. Based on the predicted risk of severely delinquent payments: VERY LOW POTENTIAL FOR SEVERELY DELINQUENT PAYMENTS"*
12. There have been no Court Judgements against the tenant and no adverse financial events.

Tenure

13. The property is to be sold with Heritable Interest, the Scottish equivalent of Freehold.

Lease

14. The property has been let to Eriks Industrial Services Ltd on a full repairing and insuring lease for 15 years from 31 October 2016 with no breaks. The initial rent was £211,238 per annum, subject to measurement, and is subject to rent reviews every 5 years, fixed at 2.50% per annum compounded. The lease is guaranteed by ERIKS UK Holdings Ltd.

Red Flag Due Diligence

15. Officers and CBC's legal representation in Scotland have reviewed the Title and Lease documents prior to inspecting the property and found no anomalies or issues that would prevent Charnwood from acquiring the property.

VAT

16. The property has been elected for VAT. It is intended that the property will be sold as a Transfer of a Going Concern.

Bid Strategy

17. Over the 12 months to March 2020, the market for investment properties has struggled to bring forward many quality investments – most activity completed during the period was off market. The slowdown in movement was largely attributed to Brexit and fears of a No Deal scenario. Since March 2020 to date, this has been further impacted by the COVID19 Pandemic. This opportunity, however, remains a strong, long-income investment with a robust tenant covenant. Likewise, the size of the purchase is optimal for private investors, property companies and Self Invested Personal Pensions (SIPPs).

18. The price offered and accepted is £3.325m, which reflects a 6.75% Net in Yield (NIY) after Purchaser's costs based on the next rent uplift. The vendor will top up the rent to this level in the purchase until the rent review scheduled in October 2021..

Financial Performance

19. The full financial performance of the asset is detailed in the appendix.
20. The purchase will be funded by prudential borrowing. Prudential borrowing can be met through internal borrowing or by external borrowing. However, prudence dictates that analysis with external borrowing be undertaken to ensure the profitability of the investment.
21. At the time of the initial investment it is **highly unlikely** that Charnwood will secure borrowing at 100% of the capital value due to its cashflow position and internal borrowing capacity; therefore, the MTFS will benefit from lower interest costs than shown in the above appraisal. However, the internal borrowing position and associated interest rate risk must be monitored and managed, and additional external debt may need to be taken in the future.
22. In order to understand the impact and contribution this asset will make to Charnwood's MTFS, asset performance must be aligned to the timing of Charnwood's Financial Year and for Charnwood's MRP policy to be applied with a likely level of borrowing. The table below, presented for illustrative purposes, shows the financial return after costs assuming that none of the capital value is externalised and a nominal interest rate, payable internally, is applied.

Financial Year	Annual Net Yield
20/21	1.717%
21/22	4.761%
22/23	4.724%
23/24	4.685%
24/25	4.646%
25/26	5.124%
26/27	5.449%
27/28	5.407%
28/29	5.363%
29/30	5.319%
30/31	5.273%
31/32	5.226%
32/33	5.178%
33/34	1.998%

APPENDIX – FINANCIAL PERFORMANCE

NO LONGER EXEMPT

The appendix contains exempt information by virtue of paragraphs 3 and 5 of part 1 of Schedule 12A of the Local Government Act 1972 and in respect of which, the Proper Officer considers that the public interest in maintaining the exception outweighs the public interest in disclosing the information.

The report contains financial information relating to a land transaction that, if in the public domain, could adversely affect the Council's ability to achieve favourable outcomes in the future.

Financial Performance

23. At the level of the second bid, Charnwood's total transactions costs will be:

Bid	£3,325,000
LLBT & registration fee	£162,250
Agency Fee	£33,250
Surveys	£10,000
Legal and Contingency fees	£19,950
Total Expenditure	£3,550,450

24. The purchase will be funded by prudential borrowing. Prudential borrowing can be met through internal borrowing or by external borrowing. However, prudence dictates that analysis with external borrowing be undertaken to ensure the profitability of the investment. Using PWLB rates (2.53% as of 05 November 2020) and borrowing 100% of the total expenditure, the maximum costs of finance are shown below:

Loan amount	£3,550,450
Type & term	40yr, Maturity, Fixed rate
Interest rate with certainty	2.53%
Potential borrowing costs per full financial year.	£89,826.39

25. The resulting worst-case asset financial performance is modelled below.

Lease year ending	Rent rec'd in Lease year	MRP - straight line asset method	Finance costs	Net Rent in Lease year	NIY after costs
30/10/2021	£211,238.00	£88,761.25	£89,826.39	£32,650.36	0.92%
30/10/2022	£238,996.41	£88,761.25	£89,826.39	£60,408.77	1.70%
30/10/2023	£238,996.41	£88,761.25	£89,826.39	£60,408.77	1.70%
30/10/2024	£238,996.41	£88,761.25	£89,826.39	£60,408.77	1.70%
30/10/2025	£238,996.41	£88,761.25	£89,826.39	£60,408.77	1.70%
30/10/2026	£238,996.41	£88,761.25	£89,826.39	£60,408.77	1.70%
30/10/2027	£270,402.50	£88,761.25	£89,826.39	£91,814.86	2.59%

Lease year ending	Rent rec'd in Lease year	MRP - straight line asset method	Finance costs	Net Rent in Lease year	NIY after costs
30/10/2028	£270,402.50	£88,761.25	£89,826.39	£91,814.86	2.59%
30/10/2029	£270,402.50	£88,761.25	£89,826.39	£91,814.86	2.59%
30/10/2030	£270,402.50	£88,761.25	£89,826.39	£91,814.86	2.59%
30/10/2031	£270,402.50	£88,761.25	£89,826.39	£91,814.86	2.59%

26. An important point to note: the straight line MRP method above is implied within the current Capital Strategy, but reports will be brought for approval to Council on 9 November 2020 whereby Charnwood will adopt the annuity life MRP method – a standard approach exemplified in the Code - as this is more appropriate for commercial property investments. As such, the MRP charges above will be less than those above. (i.e. Charnwood pays less MRP in early years and more in later years). In the remaining current financial year (2020/21) under either method, there will be no MRP payable.
27. At the time of the initial investment it is **highly unlikely** that Charnwood will secure borrowing at 100% of the capital value due to its cashflow position and internal borrowing capacity; therefore, the MTFS will benefit from lower interest costs than shown in the above appraisal. However, the internal borrowing position and associated interest rate risk must be monitored and managed, and additional external debt may need to be taken in the future.
28. In order to understand the impact and contribution this asset will make to Charnwood's MTFS, asset performance must be aligned to the timing of Charnwood's Financial Year and for Charnwood's MRP policy to be applied with a likely level of borrowing. The table below, presented for illustrative purposes, shows the financial contribution assuming that none of the capital value is externalised and a nominal interest rate of 0.5%, payable internally, is applied.

Charnwood Financial Year	Rent rec'd in Financial Year	MRP - annuity life method	Finance Costs	Net Rent in Financial Year	Annual Net Return
20/21	£78,707.86	NIL	£17,752.25	£60,955.61	1.717%
21/22	£238,996.41	£52,209.55	£17,752.25	£169,034.61	4.761%
22/23	£238,996.41	£53,535.67	£17,752.25	£167,708.48	4.724%
23/24	£238,996.41	£54,895.48	£17,752.25	£166,348.68	4.685%
24/25	£238,996.41	£56,289.82	£17,752.25	£164,954.33	4.646%
25/26	£257,409.84	£57,719.59	£17,752.25	£181,938.01	5.124%
26/27	£270,402.50	£59,185.66	£17,752.25	£193,464.59	5.449%
27/28	£270,402.50	£60,688.98	£17,752.25	£191,961.27	5.407%
28/29	£270,402.50	£62,230.48	£17,752.25	£190,419.77	5.363%
29/30	£270,402.50	£63,811.13	£17,752.25	£188,839.11	5.319%
30/31	£270,402.50	£65,431.94	£17,752.25	£187,218.31	5.273%
31/32	£270,402.50	£67,093.91	£17,752.25	£185,556.34	5.226%
32/33	£270,402.50	£68,798.09	£17,752.25	£183,852.16	5.178%
33/34	£159,278.18	£70,545.56	£17,800.89	£70,931.73	1.998%

APPENDIX – HEADS OF TERMS

3 November 2020



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Dear Andy

Eriks Industrial Services Ltd
Unit E7, Gateway Business Park, Moss Wynd, Aberdeen, AB12 3UF
Agreed Heads of Terms

Further to our ongoing correspondence, I am pleased to confirm I have instructions to issue the agreed terms in respect of the above property.

1. Purchaser

Charnwood Borough Council (CBC)
Southfields,
Loughborough
Leicestershire
LE11 2TR

CBC has 95 assets in their portfolio across all commercial property sectors. Within the last 2 weeks CBC have completed the purchase of a car show room investment for £3.2m and a High Street retail purchase. The investment team have completed 20 investment transactions with a value of over £68m within the past 24 months.

2. Vendor

Balgownie Development Company Ltd
9 Caroline Terrace
London
SW1 W8JS

3. Property

The property comprises 19,500 sq ft (1,811.59 sq m) of warehouse and ancillary office accommodation. The property is let in its entirety to ERIKS Industrial Services Ltd until 30 October 2031 on a full repairing and insuring lease, with a passing rent of £211,238 per annum. The lease is subject to rent reviews every 5 years fixed to 2.50% per annum compounded. The vendor will top up the rent to £238,996 per annum until the next rent review.

4. Tenure

Heritable (Scottish equivalent of English Freehold).

Offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.

Savills (UK) Limited. Chartered Surveyors. Regulated by RICS.

A subsidiary of Savills plc. Registered in England No. 2605136. Registered office: 33 Margaret Street, London, W1G 0JD



5. Purchase Price

£3,325,000 (Three Million Three Hundred and Twenty Five Thousand Pounds), subject to contract and exclusive of VAT.

6. Funding

The purchase is not subject to third party finance and will be completed using existing cash resources.

7. VAT

The property has been elected for VAT; the purchaser will opt to tax the property upon agreed HoT; therefore, the sale will be treated as a TOGC.

8. Approvals

In order to complete the purchase, the Leader of the Council must sign a Delegated Decision record (DD), a constitutional governance requirement. The Leader has been fully briefed on the property, the results of the due diligence, and financial analysis; The DD will be secured within 5 working days of agreed Heads of Terms.

9. Capital Allowances

All available capital allowances are to be retained by the vendor.

10. Timetable

Simultaneous exchange and completion to take place within 15 working days from receipt of a complete legal pack.

11. Due Diligence

CBC have completed their analysis and financial modelling and their solicitors have undertaken initial due diligence on the title, lease and associated documents received to date.

CBC's Strategic Director - Commercial Development has inspected the property.

12. Conditions

- a) Contract.
- b) Subject to measured, building and environmental surveys, to be cleared within 12 working days of receipt of a complete legal pack.
- c) Chamwood BC's formal Delegated Decision Report approval.
- d) Receipt of a complete legal pack; confirmation to be provided by CBC's solicitors.
- e) Exclusivity from agreed heads of terms until the agreed completion date.
- f) Verification of the information contained within the sales details and satisfactory due diligence.



13. Purchaser's Solicitors

Aberdein Considine
18 Waterloo Street
Glasgow
G2 6DB

Contact: Paul Jennings (Partner)

T - 0141 225 5425

E - piennings@acandco.com

14. Vendor's Solicitors

Burness Paull LLP
5th & 6th Floor
Union Plaza
1 Union Wynd
Aberdeen
AB10 1SL

Contact: Mike Morrice (Partner)

T – 01224 618 523

E – mike.morrice@burnesspaull.com

Lastly, I am required by the Requirements of Writing (Scotland) Act 1995 to confirm that this letter is not intended to form part of a legally binding contract and the correspondence of which it is part is expressly subject to completion of formal legal missives in accordance with Scots Law.

Yours sincerely

A handwritten signature in black ink that reads "Rodric Leslie". The signature is written in a cursive, slightly slanted style.

Rodric Leslie
Director
Savills (UK) Ltd