

Information Briefing for Cabinet Committee - Local Leadership

Options for the Disposal of Assets

20th December 2016

1. Introduction

This note has been prepared to discharge the recommendation contained in the discussion paper "Forward Together/Chamberlain 21" presented to the Property & Assets Board on the 16th November 2016:

"A short paper is prepared is produced by Birmingham Property Services for Cabinet Committee – Local Leadership's meeting on the 20th December 2016 on the continuum for the potential usage of BCC assets ie from Management Agreements ... through to license arrangements and then on to leases including Community Asset Transfer ... and finally the process of selling of Council Assets"

2. General Principles Governing the Disposal of Assets

Birmingham City Council, under the auspices of Section 123 of the Local Government Act 1972, has a legal duty to obtain best value/consideration in relation to the disposal of assets. This duty relates to both freehold and leasehold disposals. In order to provide transparency and to ensure that best consideration is generated in its dealings, the Council's default model in dealing with surplus property is for a competitive sale (freehold or leasehold) on the open market, with alternative methods of disposal only used in exceptional circumstances to generate best value for the Council. In undertaking disposals the City Council also strives to ensure that no residual liability (legal or financial) remains with the authority.

3. Non-Directed Disposals

In the majority of cases the releasing directorate no longer has an interest in controlling the future use of a property once it has ceased its own operational use. The property is therefore declared surplus to requirements and Birmingham Property Services are instructed to dispose of the asset. In a small number of instances the releasing service may direct the future use as part of the surplus declaration process (e.g. the recent release of a number of district car parks) but otherwise once an asset is declared surplus the releasing service does not have a role in determining its use. There are a number of potential disposal routes:

(a) Freehold Sale

In accordance with the Council's default model for a competitive sale in the open market, surplus assets for which no alternative Council use is identified are offered to the open market by any one of the following disposal methods: formal / informal tender, private treaty or auction. The final disposal option selected will depend on the individual circumstance and the Council's desired

outputs. As a matter of course, the sale option chosen will seek to ensure receipt maximisation and ensure that after completion of legal formalities, the Council has no further rights or responsibilities over the property, the only controls over the future use of the building being, for example, general licensing and planning regulations.

The majority of surplus assets are small premises and land holdings of relatively low values and these are sold via auction as the most cost-effective method of disposal in an open and transparent environment, permitting all interested parties to bid within the auction room.

(b) Long Leasehold Sale

There are a small number of occasions that the City Council may wish to exert elements of control on disposals and in these instances long leasehold disposals (typically involving leases of 125 years) are adopted. These can include specific performance e.g. bringing the property back into beneficial use or undertake development within a certain time period, or restrictions on use. Such restrictions and conditions are far easier to impose and enforce through lease terms than covenants attached to a freehold disposal; it should be noted that such restrictions often have a negative impact on values compared to encumbered freehold disposals. For redevelopment schemes BPS will seek offers via an informal tender process with bids potentially being made subject to planning consent. BPS will evaluate these bids on their conditionality, likelihood of obtaining planning permission and deliverability. The City Council also has a long established policy of disposing on long leasehold basis (125 to 250 years) rather than its freehold interest in the city centre core.

Member involvement in Decisions for options (a) and (b) – local ward councillors would be consulted by the operational service about the decision to withdraw a facility. They would be further consulted on the resulting executive report seeking approval for the surplus declaration and disposal. Depending on the delegations governing the disposal, ward members may be further consulted on the executive decision report seeking approval for the selection of the purchaser.

(c) Restricted Freehold Sale

It is not possible to dispose of the freehold but still exert any real control on the disposal and subsequent activity / development. It is far harder to enforce such impositions via restrictive covenants on the freehold title than lease terms as outlined above in (b).

(d) Appropriation

Under this process another BCC service may, having produced a fully substantiated business case, require the surplus property asset to deliver its own service priorities.

Member involvement in Decision in option (d) – local ward councillors would be consulted by the operational service of the decision to withdraw a facility.

They would be further consulted on the resulting executive report seeking approval for the appropriation.

(e) **Unrestricted Open Market Lease**

There may be circumstances whereby part of a larger operational building or site becomes vacant. Here a tenant would be sought to generate a rental income for the City Council and remove a potential liability from the owing service to make most effective use of the asset. The opportunity would be advertised on the open market and tenders submitted. Once in occupation, there would be no further involvement of the Council in the day to day activities of the tenant. Such arrangements can extend up to 25 years although lease terms of between three and ten years are more commonplace.

Leases are offered on a Full Repair and Insuring (FRI) basis to divest the Council of future liabilities although a number of historic lettings are not on these terms causing potential revenue budget pressures where some degree of responsibility rests with the City Council. Leases are now generally contracted out of the security of tenure provisions of the Landlord and Tenant Act 1954 to avoid tenants acquiring rights of occupation beyond the lease expiry. This offers the Council flexibility in the future and safeguards the Council's interests in the property.

Leases are the preferred route to ensure the transfer of liabilities away from the Council for a significant and set period of time. However other solutions such as licences or tenancy agreements are also considered, depending on the individual circumstances and the requirements of the service and/or incoming tenant. Licences do not grant exclusive possession of a space and permit the licensor greater freedom and flexibility to end the arrangements with the licensee, whilst a periodic tenancy isn't granted for a fixed period but runs month-to-month or quarter-to-quarter. These offer more protection to the occupier than a licence but are easier to terminate than a lease. Management agreements were previously used to document occupations of such facilities as tenants' halls but were very ambiguous in the allocation of responsibilities and legal rights; these have now largely been superseded by leases.

Member involvement in Decision for option (e) – local ward councillors would be consulted by the operational service of the decision to withdraw a facility and then intention to let on the open market

4. Service Directed Disposals

As outlined earlier the general principle is that assets surplus to the City Council requirements will be disposed of. However there may be a small number of scenarios where the owning department, whilst no longer wishes to directly deliver a service, wishes to retain the property to enable a third party to continue some form of ongoing local provision service. This can be achieved in a number of ways:

(f) Restricted Lease

In a small number of instances the City Council, in response to and as mitigation of the withdrawal of its own direct service delivery, may wish to lease the building to a third party but restrict the purposes that the building may be used for and/or include other constraints, for example that the letting will only be made to a third sector not-for-profit organisation for ongoing community provision. Clearly, the more conditions put on the lease the lower the rent figure that will be achieved and the smaller the pool of potential tenants; this is best adopted in specific targeted circumstances.

Member involvement in Decision for option (f) – as per Option (e) but as there is an element of service delivery in the ongoing proposal it is anticipated the service would advise members of the incoming tenant and the nature of their operations

(g) Community Asset Transfer (CAT)

BCC's approach to Community Asset Transfer was established by Cabinet in March 2011 ("Community Asset Transfer - A Revised Protocol and New Way of Working"). This is a primarily a service delivery process rather than a property process driven by an options appraisal about how best to deliver a service which is consistent with the Council's objectives and the Corporate Business Plan. The Birmingham model offers a Full Repairing and Insuring lease for a fixed period of time (typically 25 years) to a selected Third Sector not-for-profit organisation delivering specified community services e.g. family support, social and recreational activities, youth provision or welfare advice. The lease contains an annual market rent figure for the property but this is discounted through an assessment of the community benefit that will be provided by the in-coming tenant, referred to as "Valuing Worth".

There is an opportunity cost to a CAT – represented by the market rental value or the capital receipt that could be obtained from a disposal on the open market – and before a CAT is advertised the process requires that consideration is given to the question "*is a CAT proposal the highest Council priority for using the land value – or are there higher priorities that could be funded if the land was sold at best price?*". The lack of a receipt or rental from a CAT also needs to be reflected in assessing the overall financial position on city-wide service budgets with their various savings targets. Prior to any executive decision it is recommended that all emerging CAT proposals should be assessed through a "triage" process at a very early stage to identify and prioritise those of the many suggested that have the strongest prospect of success and focus the limited resources available on those with the strongest chance of a positive result.

Ideally, the delivery of the commitments set out in an organisation's business plan and the Valuing Worth documentation would be assessed annually, and the assumption is that the Valuing Worth exercise (and rent levels) will be reviewed every five years. However, with the demise of the District Teams this envisaged level of monitoring, supervision and direct engagement with community groups cannot be easily resourced and could pose a future risk to the robustness of the policy. It needs also to be noted that the process of

preparing and progressing a CAT application is very resource intensive and time consuming for the relevant Council service, support functions such as Finance, Property and Legal Services, and for the applying groups themselves; there is also the potential complication of TUPE employment legislation applying in certain instances whilst finally, despite extensive due diligence. To date 15 CATs have been completed of which one has ceased to operate; a number of CAT opportunities which have been explored have subsequently been deemed to be unsustainable and the premises either sold or leased, whilst several recent applications have taken an increasing time to come to fruition. Experiences to date would indicate that the CAT process appears to have been more successful when dealing with well-established third sector organisations with governance structures already in place rather than organic “start-ups”

Member Involvement in Decision for option (g) - there is a need to re-align the governance arrangements for CATs following the recent Constitutional changes. Recommendations on these matters will be brought through to Cabinet for consideration in due course.

In the above instances the holding service may be subject to internal capital charges for continuing to hold property assets and these need to be considered against the ability to totally disinvest itself of the asset.

(h) Historic “Community” Lease Arrangements

A number of other community lease arrangements pre-date the introduction of CATs, including management agreements, peppercorn rents and the most frequent, “grant-for-rent”. In this arrangement, a market rent figure has been established but is met by an equivalent grant from a Council service. The net result is the same as a CAT in that external groups occupy BCC buildings, meeting most of the running costs but without paying rent, effectively receiving a subsidy equivalent to the annual market rental value of the property.

Technically the rental subsidies represented by “community leases” reflect the value of the services being provided to the community by the tenant. However these inherited lease arrangements were not necessarily commissioned in a structured manner to deliver against the Council’s current priorities and in some cases there is no clear relationship between the financial benefit conferred by the lease arrangement to the third party and the benefit being realised for local communities from the arrangements.

In theory, an annual Conditions of Grant Aid (COGA) would be completed by each group as required by Financial Standing Orders, the tenancy would be monitored for breaches of lease conditions, and routine re-assessments would be undertaken to confirm that the arrangement continues to offer best value to the Council and is providing services that contribute to the achievement of the Council’s priorities. However, the staffing resource constraints referred to above have impacted on the service’s ability to manage this process and as a result the arrangements may not be as robust as initially intended.

When the CAT Protocol was introduced it was intended that these “other” lease arrangements would be migrated across to CATs, with the Valuing Worth tool used to assess the fit with the Council’s priorities to determine the level of rent that would be charged to the occupying organisation. This has not happened as originally envisaged, primarily because of the extensive workload and costs that would be involved and the legal constraints on the Council’s ability to substantially vary lease terms. The default position is that CAT applications will be automatically processed when existing leases expire and there are currently three pending the resolution of the governance issues referred to above, with more due to emerge in future years, as leases expire.

5. Use of Capital Receipts

The Council’s current capital receipts policy as set out in the Business Plan 2016+ (pages 70-71) is to use all capital receipts to reduce the authority’s Equal Pay liability (hence relieving the pressure on revenue budgets) and there are corporate targets for the levels of capital receipts that need to be achieved each year to deliver the Council’s financial strategy. The capital receipts policy states that the Council’s general policy is that assets will be disposed of for cash at the best market value.

Releasing services generally receive an ongoing annual revenue incentive, currently equivalent to 7.5% of the capital receipt achieved, to help balance service budgets. For example a £400,000 disposal would result in a £30,000 annual revenue stream to the service. Services can make a business case to earmark some / all of a capital receipt to fund invest-to-save schemes (eg to achieve service re-designs) but would have a corresponding reduction to the revenue incentive.

6. Conclusion

There is a range of options available to dispose of a building and the methodology selected may be influenced by a wide variety of factors including the need for ongoing service provision, revenue budget pressures within the service, the level of risk the authority may wish to take in retaining a potential liability, future service intentions, and the impact of adjacent holdings to name but a few. There needs to be a careful and reasoned balance reached in each instance between service provision, regeneration potential, city-wide service budgets and the corporate capital receipts challenge.

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