

Birmingham City Council

Report to Leader and Cabinet Member Finance and Resources

20th December 2019



Subject: Purchase of head lease of car parking site at Mackadown Lane, Birmingham

Report of: Interim Director; Inclusive Growth – Ian MacLeod
Interim Chief Finance Officer – Rebecca Hellard
Interim City Solicitor – Suzanne Dodd

Relevant O & S Chairs: Councillor Sir Albert Bore – Resources
Councillor Tahir Ali – Economy & Skills

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Are specific wards affected?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
Garretts Green		
Is this a key decision?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
If relevant, add Forward Plan Reference:		
Is the decision eligible for call-in?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
Does the report contain confidential or exempt information?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
Exempt information 12A of the Local Government Act 1972 (as amended) 3. Information relating to the financial or business affairs of any particular person (including the council) Exempt Appendix 6 contains sensitive commercial information on the purchase price, valuation and property lease rents.		

1 Executive Summary

- 1.1 In July 2019, Cabinet approved the Property Investment Strategy which sets out the intention to release underperforming assets from the commercial portfolio and to reinvest the receipts in acquiring better quality assets to support and grow the income stream.
- 1.2 The Constitution agreed by City Council on 11 September 2019 includes a delegation for the Members detailed in this report to approve acquisitions to, and disposals from, the Investment Property Portfolio up to a limit of £25m in any one transaction (Part E3, 3.2 (xi) and reported as per part B6.5 of the Constitution.
- 1.3 The Property Investment Strategy requires investment property purchases and sales to be approved by the Leader of the Council and the Cabinet Member for Finance and Resources, on the recommendation of the Director; Inclusive Growth, Chief Financial Officer and City Solicitor. Initial submissions are to be made to the officer Property Investment Board for assessment.
- 1.4 This report seeks the authorisation to complete the purchase of the head-lease interest of the site at Mackadown Lane, Birmingham (see Site Plan in Appendix 1). The City Council owns the freehold interest in the site

2 Recommendations:

- 2.1 Approves the Full Business Case for the acquisition as set out in Exempt Private Appendix 6d.
- 2.2 Approves the purchase of the head lease interest in the subject site as an investment acquisition for the amount set out in the attached Exempt Private Appendix 6c.
- 2.3 Approves the release of a temporary bridging loan for the amount set out in Exempt Private Appendix 6c.
- 2.4 Authorises the City Solicitor to negotiate, execute and complete all necessary legal documents to give effect to the acquisition.

3 Background

- 3.1 The Property Strategy 2018-2023 sets out a target to grow income generated from the commercial portfolio by 20% by 2023/24.
- 3.2 The Property Investment Strategy provides for income growth by investment in suitable opportunities, which include the acquisition of new assets.
- 3.3 This transaction is the first investment acquisition proposed since the Investment Strategy was approved and will be followed by further acquisitions as capital receipts from sales accrue and opportunities which meet the strategy are identified.
- 3.4 The purchase will be funded entirely from the sale of underperforming properties together with a bridging loan to cover any shortfall due to the timing of completions. A list of the completed and pending sales and details of the bridging loan are detailed in Exempt Private Appendix 6d.
- 3.5 The subject site is owned freehold by Birmingham City Council and subject to a head lease and five sub-leases. The acquisition of the head lease will mean that this lease falls away and the Council becomes direct landlord for the five sub-leases. This entitles the Council to

receive increased rent for the remainder of the term on each lease. The net difference in income factors in the loss of the head lease income, and Exempt Private Appendix 6c contains all relevant lease and financial information.

- 3.6 The purchase has been identified as a suitable investment and addition to the portfolio both internally by Property Services and its appointed external agent (Avison Young). The purchase will realise an added value equal to the price paid (see Exempt Private Appendix 6a) in the capital value of the site due to the removal of the head lease upon completion.
- 3.7 The potential for growth in the current use class is regarded as high since airport car parking demand is expected to increase in line with Birmingham Airport passenger numbers (40% increase by 2033 using 2018 as the base year). Alternatively, the site could be used to free up City Council holdings at the NEC and airport to facilitate growth there. The property also has potential for future industrial storage development subject to airport zone planning restrictions.
- 3.8 The purchase also has economic and strategic benefits. The City Council has other ownerships in the immediate vicinity which could be utilised to maximise future development value and economic development in this key strategic part of the city including the airport, the NEC and the proposed HS2 Interchange. Additionally, the removal of the head lessee enhances and protects the Council's existing ownership of the site.

4 Options considered and Recommended Proposal

- 4.1 It is recommended to proceed with the acquisition outlined in this report. Alternative options are as follows:
- 4.2 Do nothing - retain receipts already accrued to generate a small return on the sublease. The interest rate is far below the property return.
- 4.3 Seek an alternative property investment. This would result in a delay in the income realised. The current opportunity is recommended as a good investment as set out in this report.
- 4.4 Use the capital receipt for other Council priorities: this would result in income loss and would be contrary to the Property Investment Strategy which approved the reinvestment of investment property proceeds in order to maintain and grow the portfolio's income.

5. Consultation

- 5.1 The newly-formed Property Investment Board comprising officers from Property Services, Finance and Legal recommends the decision to proceed with the purchase of the head lease (4th December 2019).

6. Risk Management

- 6.1 The main risk is that one or more of the companies holding the sub leases experiences financial difficulties and defaults on the rent (the schedule of leases is contained in Exempt Private Appendix 6b). This risk is reduced in that these leases are with three independent companies with good credit ratings (see Appendix 5). Further, if one or other of the companies became insolvent there would be good market demand for a new lease.
- 6.2 The risk of achieving maximum long-term value will be due to unknown planning restrictions, flood plain restrictions, underground pipes and contamination. It should be noted that part of the site falls within the Airport Zone and will have some restrictions on development. There is

no mitigation in place at present as this issue will be explored nearer the anticipated expiry of existing leases, which are between 2027 and 2044. The potential profitability and income return for this site/purchase is not dependent upon the future value of potential redevelopment.

- 6.3 The risk of insufficient disposals to fund the acquisition (see Exempt Private Appendix 6c) not completing may delay the repayment of the bridging loan. The risk is mitigated by the expected completion of multiple transactions more than covering the loan value. Other identified, underperforming assets will be sold to cover any shortfall. In addition, the loan required is of a low value and interest on the loan until paid will be funded from income generated through the investment portfolio in Appendix 5c.

7.1 **Compliance Issues:**

- 7.1.1 The acquisition complies with Government guidance 'Statutory Guidance on Local Government Investments' published in 2018 as well as all current legislation including the Local Government Act 1972 and the Local Government Act. Appendix 4 provides a checklist for compliance with such Guidance.
- 7.1.2 The proposal is consistent with Birmingham City Council Plan 2018-2022 (updated) priorities as the acquisition of new investment properties and disposal of underperforming properties will help the Council meet its aspirations to be a great city to grow up on, live in, work and invest in.
- 7.1.3 It supports the Financial Plan 2019-2023 by generating additional revenue income and helping to achieve a balanced revenue budget.
- 7.1.4 The acquisition is consistent with the aims set out in both the Birmingham Property Strategy 2018-2023 which seeks to grow income and the Property Investment Strategy 2019 which sets out more detailed guidelines for investment decisions. The acquisition follows the guidelines as set out in the Investment Decision Matrix at Appendix 2 which is a scoring methodology introduced by CBRE, who are interim property consultants supporting Property Services with its property strategy. The score of 163 is out of 200 and represents a good fit with the Council's overall property strategy.

7.2 **Legal Implications**

- 7.2.1 Sections 120 - 123 of the Local Government Act 1972 authorises the City Council and its solicitors to hold, appropriate and dispose of land [for the purpose of any of its functions or for the benefit, improvement or development of its area]. As set out in this report the acquisition provides opportunities for future regeneration and growth around the NEC and airport.
- 7.2.2 Section 12 (the Investment Power) of the Local Government Act contains the Council's primary investment powers which can be exercised in the same way as the S1 Power to Borrow. The Council can rely on the S12 Investment Power for the reasons set out in sections 3.5-3.8 of this report and the appointed external agent report at Exempt Private Appendix 6a.
- 7.2.3 Section 1 (Power to Borrow) of the Local Government Act 2003, gives the Council power to borrow for any purpose relevant to its functions or for the prudent management of its financial affairs. In the exercise of the S1 Power to Borrow, S3 of the Local Government Act 2003 requires local authorities to determine and keep under review how much money they can afford to borrow as required by the Local Authorities (Capital Finance and Accounting) (England) (Regulations 2003) and to have regard to the Chartered Institute of Public Finance & Accountancy Prudential Code. The Council can rely on the S1 Power to Borrow for the reasons set out in sections 3.5-3.8 of this report and the appointed external agent report at Exempt Private Appendix 6a.

- 7.2.4 Exempt information 12A of the Local Government Act 1972 (as amended) 3. Information relating to the financial or business affairs of any particular person (including the Council). Exempt Appendices 2-6 are considered to be in the public interest as they contain commercially sensitive information of a financial or business nature, which if disclosed to the public could be prejudicial to a named person, individual or company.
- 7.2.5 The Council's in-house Legal team will complete all legal matters associated with the transaction.

7.3 Financial Implications

- 7.3.1 The acquisition will be funded entirely from the sale of underperforming properties together with a bridging loan to cover any shortfall due to the timing of completions. A list of the completed and pending sales and details of the bridging loan are detailed in Exempt Private Appendix 6d.
- 7.3.2 The annual net increase in rent income as a result of the head lease purchase is set out in Exempt Private Appendix 6c. Further details of the Business Case and financial implications are set out in Exempt Private Appendix 6d.
- 7.3.3 Increased income from this acquisition will be used to support the Council Financial Plan 2019-2023 by helping to achieve a balanced revenue budget.
- 7.3.4 The ongoing income position of the transaction will be monitored through the Council's Property Investment Board by Property Services, through quarterly Treasury Management reporting and as part of the Council's budget monitoring process.
- 7.3.5 The tenants are responsible for maintaining the land and property within their demise. The Council is responsible for insurance for which it will charge the tenants. The only additional responsibilities to the Council will be for ensuring that the tenants pay all the rental income and this will be managed through existing resources. Appendix 5 shows that the credit scores for the three tenants are satisfactory and payment history is good.

7.4 Human Resources Implications

- 7.4.1 Internal resources are used to evaluate and execute the acquisition and external consultants have been used to provide an independent assessment of value.

7.5 Public Sector Equality Duty

- 7.5.1 An Equality Assessment has been carried out in connection with Property Investment Strategy transactions (EQUA313, see Appendix 3). This identifies no adverse impacts on any groups protected under the Equality Act 2010. A transaction-specific Equality Assessment is not required in this case.

8. Appendices

- 8.1 List of Appendices accompanying this Report:

Appendix 1 – Site plan

Appendix 2 – Investment Decision Matrix

Appendix 3 – Equality Assessment

Appendix 4 – Checklist for Compliance with Government Investment Guidance

Appendix 5 – Credit scores and financial health of sub tenants

Exempt Appendix 6 – All exempt and private information excluded from this report.

Appendix 6a – Valuation & Recommendation Report

Appendix 6b – Schedule of underleases

Appendix 6c – Financial information

Appendix 6d – Full Business Case

9. Background Documents

- 13 November 2018 Cabinet report, Property Strategy 2018/19 – 2023/24 including First Phase Projects
- 30th July 2019 Cabinet report, Property Investment Strategy
- Statutory Guidance on Local Government Investment (v3) published in 2018 by the Secretary of State for Communities and Local Government