ITEM 13

Management of the Industrial and Commercial Property Estate – Policy Update

Joint Report by Service Director Strategy & Policy and Service Director Commercial Services

EXECUTIVE COMMITTEE

26 May 2015

1 PURPOSE AND SUMMARY

1.1 **The purpose of this report is to set out the current position with respect to the management of the Council's industrial and commercial properties. The report highlights properties which are not considered fit to let, and proposed solutions. The report goes on to recommend a policy change to enable the sale of commercial properties at market value in special circumstances.**

1.2 The report sets out the background to the establishment of the Council's commercial estate and goes on to consider occupancies and vacancies. Appendix 1 then details those properties that are either unfit or unsuitable to let for commercial purposes, the underlying reasons for this, and the future plans for them.

1.3 An issue has also arisen in which some commercial property sales have encountered difficulty because the higher capital value to the Council of the future rental income stream of the property is considerably in excess of its market value. The report recommends introducing greater flexibility into the existing policy to enable sales to go ahead at market value in circumstances where the economic development advantages arising through disposal are objectively considered to outweigh the financial loss to the Council. The report also notes the need to plan for the long term sustainability of the estate.

2 RECOMMENDATIONS

2.1 **I recommend that the Executive Committee:**

(a) **Notes the future plans for commercial buildings that are either unsuitable or unfit to let, as set out in Appendix 1.**

(b) **Approves the proposed amendments to the 2010 Policy for the Sale of Council premises, to delegate to the Service Director Commercial Services, the Chief Financial Officer and Chief Officer Economic Development the power to authorise the sale of commercial buildings, let to existing**

tenants, at market value instead of the higher capital value of the rental income stream to the Council, where there is an over-riding economic development reason for doing so, as set out in Appendix 2.

(c) Agrees that consideration is given to the investment needs of the industrial and commercial property estate in the annual roll forward of future Capital Programmes, particularly with regard to the application of grant funding.

3 BACKGROUND

3.1 Scottish Borders Council holds a significant business property asset. The portfolio has grown from 19 industrial premises held by Borders Regional Council in 1975 to 227 industrial units at present. Since the 1980's the Council has been the main provider of factory and workshop space for rental, in terms of the number of premises and spread of location across the Scottish Borders. This provision of business space supports the development of the local economy by assisting local and incoming businesses with their accommodation needs, and encouraging business and employment growth. In addition, the Council benefits from income generated by these assets.

3.2 In the 1990's European funding assisted Scottish Borders Council and Scottish Borders Enterprise in the construction of new industrial premises. In the 2000's, changes in the economy with private developers becoming more active in the property development market, and changes in business requirements, led to a strategic change in direction for the Council. The Council ceased constructing new industrial premises and secured European funding to support the development of sites, where businesses could purchase serviced plots to construct their own premises.

3.3 Since 2008, the economic downturn has constrained growth in private sector activity. However, the recent economic recovery and the major investment in the Borders Railway is expected to increase demand for business property in the Scottish Borders, although at an unknown rate. The Council has a role in maximising this opportunity to stimulate economic growth through the use of its business property and land asset. A review of the provision of industrial units in the Scottish Borders was undertaken by the former Scrutiny Committee in 2008.

4 OCCUPANCY AND VACANCIES

4.1 The Council holds the most significant portfolio of business property and land across the Scottish Borders, and whilst private sector ownership may be important in terms of floor space, there are many different business owners and few developers, who are all in disparate locations. Therefore, the Council continues to have a crucial role in providing this business infrastructure support.

4.2 The occupancy level for industrial premises, yards and retail premises is calculated quarterly and for the last five years has remained high, at around 90%. Generally, the Council's property is in a satisfactory condition, as can be seen in the table below. However, there are a number of the 227 industrial units in the portfolio that are not currently available for lease to businesses. This is due to a number of reasons, including the property being in poor condition, the property needing major investment for refurbishment, and also some units that have been agreed for sale, or are in the process of being sold. Appendix 1 sets out the 14 properties that are in this category. It also identifies what action is planned for each unit in the future. This may involve investment, disposal or redevelopment.

Suitability	**% of industrial units**
A - Excellent	9%
B - Satisfactory	64%
C – General satisfactory but in need of minor improvements	27%
D - Unsatisfactory	Non-lettable stock

4.3 St Mary's Mill in Selkirk is a good example of a property that the Council has owned for some time, but has not been able to bring back into productive use. A number of potential users have considered the building over the last decade but the size of the floorspace, the condition of the building and issues such as asbestos have all deterred potential tenants. The asbestos issue in the building has been tackled safely by the Council, but the age and size of the building, coupled with its poor energy efficiency, means that it is a challenge for a future tenant or owner. Site clearance was not previously an option because of the flooding issues in the Ettrick Riverside area, but with the major investment in the Selkirk Flood Protection Scheme under way, there are new options for the future of the property. This requires a site assessment and feasibility work to properly determine the best option for the site. It is worth noting that St Mary's Mill will also have to comply with new regulations on energy performance resulting from the Climate Change (Scotland) Act 2009.

4.4 As can be seen in Appendix 1, some of the properties are due to be sold immediately, whilst others will be put on the market as local market conditions permit. Some of the units require investment, either to refurbish them to a lettable condition, or potentially to demolish some of them with a view to providing a redevelopment opportunity for the private sector. It is recommended that the buildings in Appendix 1 are dealt with as proposed. Current property policy allows the planned for actions to proceed, subject to the right market conditions prevailing and, if appropriate, capital and revenue funds being made available for refurbishment or demolition.

5 SALE OF COMMERCIAL PROPERTY

5.1 The Policy for the Sale of Council premises, let to commercial tenants, at commercial rents was approved by Executive on 7 October 2010 and is set out in Appendix 2. This policy was established in order to provide guidance and set strategic criteria for the sale of our commercial and industrial property to tenants. The Council needs to strike a balance between the long term viability of its portfolio and the sale of units to tenants whose business plans drive them towards owning their property.

5.2 The Council has traditionally sold properties to sitting tenants at market value, or at a level that would cover any outstanding loan debt on the property. However, the 2010 Policy introduced a requirement to consider the long term income generation of a property in its final sale price as well. This latter criteria has led in some cases to high valuations being calculated for the sale of some properties, with the capital value to the Council of the future rental income stream from the property exceeding market value. Officers are concerned that the current approach may, if rigidly applied, prevent the future sale of some commercial buildings to local businesses where there is an over-riding economic development case for a sale to proceed. It has also led to delays in the disposal of property which has limited alternative economic value to another tenant.

5.3 It is proposed to change the policy for the sale of Council premises, let to commercial tenants, to allow greater flexibility in the terms of the final sale valuation that can be approved in line with the policy. It is proposed that an additional element is added to the policy to cover special economic circumstances where there are evidenced economic development considerations, or site or business specific considerations, which mean a valuation commensurate with meeting outstanding capital debts and future income is not appropriate in full. Where appropriate this would allow for the sale, at market value, of commercial buildings let to tenants, instead of the higher capital sum required to offset the outstanding debt and loss of rental income. This would only be appropriate where a clear economic development justification is provided by the business in question. Examples of over-riding economic development considerations include the scale of local employment involved, the impact of the business on the local economy or the potential growth enabled by the proposal. The proposed amended policy is set out in Appendix 2, with the amendments highlighted. The Appendix has also updated the policy to reflect the current Council structure.

5.4 In order to maximise the use of assets that are going through the sale process, Estate Management and Economic Development are now considering whether some of these units can be used by businesses for shorter periods, where the property is slow to attract a purchaser. In a similar example, the former Halyrude Primary School in Peebles currently has a new business as a tenant until a purchaser comes forward. This keeps the asset in use, produces revenue for the Council, and supports economic growth.

6 IMPLICATIONS

6.1 Financial

(a) Capital receipts associated with industrial and commercial property are used to help support the whole Capital Programme rather than being ring-fenced individually for specific capital projects. However, if there is any outstanding loan debt against a sold property, this is deducted from the receipt before it is allocated to the Capital Programme.

(b) Furthermore, if the sold property was generating a rental income, the capital required to replace the lost income is deducted from the sale proceeds before the latter is allocated to the capital programme. If the capital sum required to replace the lost rental income exceeds the sale price, then the Council notionally makes a loss on the sale overall. However, in some circumstances economic development considerations outweigh the reduced capital receipt and the report proposes a change in sales policy (see Appendix 2) to enable the Service Director Commercial Services, the Chief Financial Officer and the Chief Officer Economic Development to determine, under delegated authority, whether a sale on economic development grounds is justified in these circumstances.

(c) The commercial estate generates around £1.2M per annum of rental income and has an asset value of around £10M. Thus in addition to providing key business infrastructure, the estate provides the Council with an important income stream which must be preserved where possible.

(d) The commercial estate is affected by gradual obsolescence and the need by some tenants to buy their units outright to meet their business strategies. This requires a sales policy to ensure the Council retains an optimum portfolio of commercial properties for the benefit of the local economy and the proposed change in sales policy in this report helps support this.

(e) The ageing nature of the commercial estate also raises the issue of how the Council reinvests in the properties. Previously, individual buildings have received minor investment in order to make them available for letting. As noted, some properties have not been able to be let because of the major investment required to achieve that condition. In order to plan for the long term sustainability of the portfolio, it is planned to initiate formal consideration of the investment needs of the industrial and commercial property estate in the annual roll forward of future Capital Programmes, particularly with regard to the application of grant funding. It is likely that the Council will need to reinvest in its industrial and commercial properties, so making a planned provision for that investment is a prudent approach.

6.2 **Risk and Mitigations**

(a) There is a reputational risk of having a number of properties lying in an unlettable condition. This risk is ameliorated by having a clear future plan for each property on the list, involving sale, transfer, refurbishment or redevelopment. This is outlined in Appendix 1.

(b) There is a risk that the sale of some properties will fail because the price currently required by the Council exceeds market value. Adopting the policy change set out in Appendix 2 of this report would mitigate this risk.

6.3 **Equalities**

An Equality Impact Assessment (EIA) is not required as this report relates to the continuation of the property service to ensure that it meets best practice.

6.4 **Acting Sustainably**

The efficient use of the Council's property asset can have a positive effect on the economic, social or environmental implications. The provision of property by the Council has a positive economic impact on the Scottish Borders by helping to address the industrial property market failure that exists in the area. The potential for the reuse of some buildings, or for their transfer to community ownership could have positive community and environmental impacts.

6.5 **Carbon Management**

The Council's property asset is one of the main areas of focus in the Carbon Management Plan in view of the carbon footprint that derives from the use of our buildings. Finding ways to reduce the amount of floorspace that the Council owns has a positive impact on our carbon footprint, along with proactive actions to increase the energy efficiency of our property. The age and type of our buildings makes this challenging. Additional challenges will face the Council in future as new Energy Performance Certificate requirements come into force in later years, requiring the Council to improve the energy performance of its industrial and commercial properties.

6.6 **Rural Proofing**

Rural Proofing is required as the proposals relate to an amended Council policy or strategy. The change to the policy will not have a significant impact on our rural areas. One element of the Council's approach has been to ensure the provision of business space across the whole of the Borders, including the smaller towns and villages.

6.7 **Changes to the Scheme of Administration or Scheme of Delegation**

There are changes to be made to the scheme of delegation as set out in

Appendix 2.

7 CONSULTATION

7.1 The Chief Financial Officer, the Service Director Regulatory Services as Monitoring Officer, the Chief Legal Officer, the Service Director Strategy and Policy, the Chief Officer Audit and Risk, the Chief Officer HR, and the Clerk to the Council have been consulted and their comments have been incorporated into the report.

Approved by

Service Director Strategy & Policy Signature ....

Service Director Commercial Services Signature ....

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