Report to Cabinet

Cabinet meeting 25th July 2019
By The Leader

DECISION REQUIRED

Exempt Appendix 1

Oakhurst Business Park – Proposed Investment

Executive Summary

The Council owns a substantial portion of Oakhurst Business Park. The Council's ownership comprises 69,700 square feet of industrial/warehouse space, which provides a rental income of c£810,000 pa. This is a successful scheme, which is popular with tenants. The scheme is valued at £7.8m and accounts for c15% of the Council's total property portfolio.

A small section of Oakhurst Business Park, extending to 0.7 acres, is undeveloped. This was identified as a potential site for a fire station when the business park was first developed but is no longer required for that purpose. The site is therefore available for development by the Council for additional industrial/storage accommodation.

A scheme has been prepared to provide 8 units with a total floor area of 11,431 square feet of industrial/warehouse accommodation. These are small units, which will appeal to new and fledgling businesses. There is a good demand for this size of space, which is not currently being delivered by the commercial development market. This is because developers tend to focus on larger units, which can be let to established businesses. The proposal therefore supports the Council's economic development agenda.

The total capital cost of the proposed scheme is budgeted at £1.96m including a contingency of £54,000. The projected income of the completed development is £163,000 pa, which would show a yield on capital expenditure of 8.3%, which is in excess of the target yield for new acquisitions to the property fund of 6%. The completed investment value is likely to be in the region of £2.2m, which indicates a surplus of c£215,000 after deducting total development costs, including revenue costs such as cost of finance and voids. The surplus would be allocated to profit and the value of the land.

The Council agreed a policy in 2016 to make a capital allocation of £3m pa for investment property, at a rate of £3m pa. This has been underspent in previous years because of the lack of availability of appropriate property. It is recommended that Cabinet approve this development opportunity for allocation to this budget. This opportunity is a departure from normal investment activity because it is not a completed investment and the Council will be taking on additional risk, namely construction risk and letting risk.

A tender process has been completed for the construction works and it is recommended that the Director of Place be granted delegated authority to enter into a construction contract with the lowest bidder, as set out in Appendix 1. A contingency has also been included in the budget figures to offset unknown risks during the construction phase.

To mitigate the letting risk, a void allowance of 6 months has been included in the development appraisal. Recent experience has shown that there is a ready market for small units, often with competition between a number of potential tenants. The 6 month letting risk is therefore considered to be reasonable in the circumstances.

To conclude, this is an opportunity to allocate £1.96m of the overall budget of £3m for the purpose of constructing a new development directed at small businesses. The anticipated return on capital invested is 8.3%, which is significantly in excess of the 6% target yield for new acquisitions.

Recommendations

That Cabinet is recommended:

i) To approve the proposed development of Oakhurst Phase 4, at a budget of £1.96m, funded from the £3m investment portfolio capital budget. The target completion date is Spring 2020, therefore the majority of the expenditure will be incurred in 2019/20.

ii) To delegate authority to the Director of Place to enter into a contract with the building contractor who submitted the lowest tender as set out in Appendix 1.

Reasons for Recommendations

For the Council to continue to expand the Council's property investment portfolio, the income of which is used to support Council services.

Background Papers

Exempt Appendix 1

Wards affected: All

Contact: Brian Elliott Head of Property: telephone 01423 215328

Background Information

1 Introduction and Background

1.1 Horsham District Council has an investment portfolio valued at c£51m, which presently producing a net operating income of c£3.8m, in 2018/19

1.2 The Council has a policy to purchase suitable commercial investment properties within the District, as they become available, to provide a future income stream. The Council allocates £3m per annum for this purpose. Investment purchases are considered and if approved allocated against this budget. The Council's criteria for new investments are that they deliver a yield in excess of 6% and are located in the District.

1.3 It is recommended to allocate a proportion of the budget to a direct development of land that the Council owns at Oakhurst Business Park, this is known as Oakhurst Phase 4.

1.4 The Council's ownership at Oakhurst Business Park, extends to 69,700 square feet of industrial/storage space. The existing investment generates an income of c£810,000 pa and is valued at c£7.8m.

1.5 Oakhurst Phase 4 comprises a site of 0.7 acres. The Council has secured planning consent for 8 small units with a total floor area of 11,431 sq. ft. (ref: DC/17/1023). A cost plan has been prepared for the development of this land and the budgeted total capital cost (excluding land) is c£1.96m, including a contingency of £54,000. The anticipated rental income of the completed development is £163,000 pa and the investment value on completion is in the region of £2.2m. These figures would deliver a return on new capital invested of 8.3%, compared to the target return for new acquisitions of 6%.

1.6 The purpose of this report is (a) for Cabinet to consider whether to develop Oakhurst Phase 4 with a total capital expenditure of £1.96m and an anticipated return on capital of 8.3% and (b) to secure delegated authority for the Director of Place to enter into a contract with the building contractor detailed in Appendix 1.

2 Relevant Council policy

2.1 The Council's policy is to grown the property portfolio to increase income to support other Council activities.

3 Details

3.1 Oakhurst Business Park is an established Business Park adjacent to the A24, one mile north of Southwater and three miles south west of Horsham. Road communications are good with the South Coast, Crawley, Gatwick and the M23/M25 within easy access. Gatwick airport is approximately 12 miles to the north east. The Council's ownership within Oakhurst Business Park has an income of c£810,000 pa from 18 units. Rents on the estate have steadily increased over the last few years and vacant units re-let after a reasonable marketing period. The size of units range from 775 sq ft to 18,500 sq ft.

3.2 Demand for industrial/warehouse space generally, particularly new/modern units, has continued to increase over the last few years throughout the Gatwick Diamond area, including within Horsham District. Current demand is from companies and businesses looking for different space requirements, or those seeking to relocate to more modern purpose built space which is better specified, more flexible, energy efficient and generally better located for ease of access and communication.

3.3 The level of demand for smaller industrial/warehouse units (500 to 3,000 sq ft) is good; this is from new and fledgling businesses coming to the market or expanding. There is no supply of new stock of similar specification to that proposed either existing, or where developments are under way, within a 10 mile radius of Oakhurst Business Park. Similar existing units on Oakhurst Business Park have always let quickly and a good level of confidence can be assumed that the units proposed would let readily, particularly if flexible terms are offered.

3.4 The capital return takes into account all construction costs, professional fees and a contingency. A more comprehensive appraisal takes into account revenue costs such as finance costs, an allowance for voids and legal and agents fees. The projected capital return is as follows:

Analysis of returns		**Comments**
Target income	£163,000	Average rents £14.30psf
Total development costs (excluding land)	£1,960,000	Includes £54,000 contingency
Yield on development costs	8.3%	
Valuation on completion	£2,200,000	7%

A development appraisal has been prepared which includes allowances for a six month void period before the property is income producing, interest and other fees. This indicates a net return taking into account capital and revenue of 7.7%.

3.5 The difference between the final investment value (£2.2m) and total of capital and revenue costs (£2.11m) shows a surplus of £215,000 which is allocated to land and profit.

3.6 A procurement process has been undertaken to identify a contractor to carry out the construction of this development. The process, as recommended to the Finance and Assets Policy Development Advisory Group on the 8th April 2019 was to undertake a limited tender to contractors who specialise in this type of development. This is the preferred route to identify a contractor with a track record of this type of development and at the best price. This exercise has been undertaken in accordance with the Council's procurement code. The results of the tender process are set out in Appendix 1.

3.7 This is a speculative development proposal and therefore there is a risk that the completed development will not be let within the six month period allowed in the budget. Like all risks, this is a judgement. The factors that are taken into account in evaluating this risk are:

(a) Location – this is a popular estate where units have regularly re-let when they have fallen vacant.
(b) Supply of competing accommodation – as highlighted above, supply is constrained in the District.
(c) Demand – as highlighted above, there is good demand at the present time.
(d) Quality – the completed developments will be a high quality product meeting modern requirements.
(e) Rent – the rents proposed are in line with market values with a modest premium to take into account the fact that these are new units.

External influences also impact on the ability to let units, such as recession risk and the risk of continued hesitancy in the economy caused by the uncertainty of Brexit.

3.8 The valuation of the completed investment at £2.2m has been reviewed with the Council's external valuers and is considered to be in line with the valuation of the balance of the estate.

3.9 The capital budget allocated for commercial property investment is £3m per annum. There is adequate budget available for the Council to undertake this development.

4 Next Steps

4.1 To enter into the construction contract and to commence the development with a projected start on site date in mid-September.

5 Views of the Policy Development Advisory Group and Outcome of Consultations

5.1 The proposal was considered by the Finance and Assets Policy Development Advisory Group, who supported the proposals recommended in this report, including the procurement methodology.

5.2 Comments from the Monitoring Officer have been incorporate in this report.

5.3 There are no impacts on staff resources.

5.4 Comments from the Director of Corporate Resources and s151 Officer are incorporated in this report.

6 Other Courses of Action Considered but Rejected

6.1 Not to undertake the development, but this would be an opportunity missed.

7 Resource Consequences

7.1 There are no personnel or other consequences for this proposal, which can be managed within existing resource levels.

7.2 The project meets the commercial investment criteria at above a 6% yield. The 2019/20 capital programme contains a capital budget for up to £3m of commercial investment, which has not been allocated yet; this project fits within the existing capital budget. The income generated (estimated at £163k p.a. in a full year when fully let) will start to contribute to the revenue budget in 2020/21 and help support the Council's longer term financial plan.

8 Legal Consequences

8.1 The Council has the power to undertake commercial property development under sections 12 and 15 of the Local Government Act 2003. The Council's land acquisition power is set out in s120 of the Local Government Act 1972. The Council's general power of competence is included in S1 of the Localism Act 2011.

8.2 In house legal resources will be used to complete the legal documentation.

9 Risk Assessment

9.1 Appropriate risk mitigation measures will be taken during the construction period and collateral warranties will be obtained on completion of the development. The council has a recent record of delivering projects within budget.

10 Other Considerations

10.1 The proposed development will comply with modern standards of accessibility and sustainability as defined by the Building Regulations