Agenda Item No:

CORPORATE RESOURCES OVERVIEW AND SCRUTINY COMMITTEE

Committee Report

Public

Date of Meeting: **10TH JANUARY 2008**

Title: **CARLISLE LOCAL ASSET VEHICLE FEABILITY STUDY**

Report of: **DIRECTOR OF DEVELOPMENT SERVICES**

Report reference: **DS.4/08**

Summary:
The attached report was considered by the Executive on 17th December 2007 and referred to Corporate Resources Overview & Scrutiny Committee.

Questions for / input required from Scrutiny:

To consider the findings of the review so far and comment on the proposed way forward.

Recommendations:

To refer comments to the Executive

Contact Officer: Catherine Elliot **Ext:** 7502

Note: in compliance with section 100d of the Local Government (Access to Information) Act 1985 the report has been prepared in part from the following papers: None

CARLISLE CITY COUNCIL
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REPORT TO EXECUTIVE

PORTFOLIO AREA: ECONOMIC DEVELOPMENT & ENTERPRISE / FINANCE & RESOURCES

Date of Meeting: **17th December 2007**

Public

Key Decision: **Yes** **Recorded in Forward Plan:** **Yes**

Inside Policy Framework

Title:	**CARLISLE LOCAL ASSET VEHICLE FEASIBILITY STUDY**
Report of:	**Director of Development Services**
Report reference:	**DS.129/07**

Summary:

This report sets out the key findings from the initial study into the feasibility of establishing a Carlisle Local Asset Vehicle (CLAV) and recommends further work is undertaken to progress and develop two options for the delivery of the Council's property vision for Carlisle.

Recommendations:

The Executive is recommended to:

a) Agree to continue developing two of the options for delivering the property strategy for Carlisle, being Option B (the City Council retains and manages its assets and undertakes site specific joint ventures) and Option E (establishing a CLAV to deliver the programme of development), with the remaining options to be discounted.

b) Direct the Corporate Asset Management Group to undertake further work to develop a Development and Investment Plan for the City Council's property portfolio in the context of the vision for Carlisle that is set out in the draft Economic Strategy. This will provide a costed plan for the future management and development of the City Council's asset portfolio and include an assessment of delivery under both Option B and Option E.

c) Refer the report to Corporate Resources Overview and Scrutiny for their comments on the findings of the review and their views on the proposed way forward.

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1. BACKGROUND

1.1 The City Council holds a portfolio of assets across Carlisle with a book value of £125m at 31 March 2007, which are budgeted to generate an income of £5.0m in the year ending 31 March 2008, and which play an important role in developing and sustaining the local economy.

The City Council's property portfolio has the potential to add value to and assist with delivery of the Carlisle Renaissance Development Programme and the recently published draft Economic Strategy for Carlisle. Taken together, Carlisle is facing a complex, large scale, long-term programme of property development.

As one of the potential mechanisms to deliver the City Council's strategy for its portfolio of assets and possibly other aspects of the property related vision for Carlisle, the feasibility of establishing a Carlisle Local Asset Vehicle (CLAV) has been investigated.

1.2 In 2001 an Audit Commission Best Value Inspection Report of Property Services & Economic Development identified the need for a strategy to rationalise the portfolio, maximise returns and sustain the quality and economic value of the assets. In the period since 2001, the City Council has been developing a strategy for its assets and considering the most appropriate delivery option. This has included:

- Commissioning a study by Lamb & Edge on the Carlisle property market and the City Council's role within it in 2003;
- Publishing an Asset Review Scoping Report in 2004;
- Establishing a Corporate Asset Management Group ("CAMG") of City Council officers;
- The agreement by the Executive Committee of a draft Asset Management Plan (2006 – 11) in June 2006 (DS 37/06), which was subsequently approved by the Council;
- Commissioning a report from Hyde Harrington titled "Asset Review – A Future Strategy (Options Appraisal & Business Case)" which was received on 27 July 2006 and was the subject of a CRO&S workshop on 5 October 2006.

1.3 Over the period since 2001 a series of policy developments have taken place at a local, regional and national level which has had an impact on the development of the City Council's strategy for its assets.

These include Carlisle Renaissance, Shared Services, the Local Government White Paper, the Sub-national Review of Economic Development and Regeneration and most recently, the Housing Green Paper. In part as a result of the above policy developments, the concept of a Carlisle Local Asset Vehicle has arisen and in February 2007 (CE 11/07) the Executive Committee approved a recommendation to direct the Corporate Asset Management Group to undertake a detailed investigation into the risks and benefits to Carlisle City Council of establishing a Local Asset Vehicle ("LAV"). This recommendation was subsequently agreed by CRO&S. The scope of work for this investigation is included as Appendix A to this report.

1.4 Details of the principles behind LAV and those that are currently in existence were included in CE 11/07. The key benefits of the LAV concept are as follows:

- Generating a capital receipt to invest in delivering the Council's property related objectives;
- The ability to accelerate the delivery of the City Council's strategy when compared to a piecemeal approach using City Council financial and other resources;
- Access to property development and management skills of the private sector;
- Enabling the City Council to participate more fully in the profits arising from development on its land, in addition to the receipts from land disposal that it currently receives.

Further information on the LAV concept is included at Appendix B.

1.5 Over the period that the investigation (hereafter referred to as the "CLAV feasibility study") into a Carlisle Local Asset Vehicle ("CLAV") has been undertaken, the City Council has also being developing its Economic Strategy which sets out a vision for the future of Carlisle. The results of the consultation on the Strategy were presented to the Executive on 19 November (DS 111/07) and the final version will be reported in due course. The draft Economic Strategy raises a number of property implications relating to the future vision of Carlisle as a "Place". The CLAV feasibility study has recognised this and has sought to develop options that are consistent with the draft Economic Strategy.

1.6 This report summarises the key findings from the CLAV feasibility study and the implications for the future development and implementation of the City Council's property strategy.

1.7 The CAMG has been assisted by English Partnerships' Urban Finance Team in undertaking the study.

1.8 As part of the CLAV feasibility study Hyde Harrington was commissioned to provide a report on the Carlisle property market and to provide general property related advice.

2. CARLISLE CITY COUNCIL'S PROPERTY PORTFOLIO

2.1 The CLAV feasibility study involved undertaking an "audit" of the City Council's property portfolio and its impact on the City Council's financial position. Key points arising are as follows:

- The City Council is heavily reliant on the income from its non-operational property portfolio, with the annual income received broadly equivalent to the total receipts from council tax. Maintenance and growth of this income stream is critical and must form part of any delivery option that is ultimately selected;
- All of the City Council's industrial estates are in need of some investment to maintain the fabric of the estates and sustain the quality and economic value. The condition of the assets varies across the portfolio, with the older estates at Durranhill and Willowholme in the worst condition;
- Work undertaken by Hyde Harrington 2006 indicated that, in the absence of intervention, in the future the City Council is likely to suffer a reduction in net income from its non-operational portfolio in real terms;
- The work undertaken by Hyde Harrington in 2006 estimated the backlog maintenance liability for the City Council's non-operational assets at £2m. The majority of this liability relates to expenditure required at Kingstown (largely relating to the roads), Durranhill and Willowholme;
- 2007/8 budgeted annual costs for upkeep, maintenance and management of the non-operational property portfolio currently comprise £83,000 for upkeep and maintenance and £471,000 (before internal recharges) for the Property Services department. In addition, a proportion of the cost of the Facilities department can be attributed to the non-operational portfolio;
- The City Council commenced a programme of investment on its industrial estates in 2004, which has comprised annual budgeted investment of £200,000. Prior to 2004, there had been limited investment in its industrial estates and other non-operational assets for a significant period of time;

- Whilst the City Council can improve the condition of its industrial estates through its own investment, the ability to transform them is dependent on the co-operation of its tenants, who are responsible for the condition of the buildings;
- The City Council's budget assumes capital receipts of £0.5m (excluding the Raffles land) per annum over the next three years. This indicates that there is no significant requirement to dispose of assets in order to meet existing capital expenditure plans;
- There are a number of potential development opportunities available within the City Council's asset portfolio. Capitalising on these opportunities could allow either the delivery of modern property that is more appropriate for existing use or a change to alternative use;
- There is currently some backlog on rent reviews for the non-operational assets. The Property Services department expects to have substantially caught up the backlog by 31 March 2007.

3. CARLISLE CITY COUNCIL'S OBJECTIVES

3.1 In undertaking the CLAV feasibility study, the CAMG has adopted the following high level objectives in considering a strategy for the City Council's property portfolio:

- To enable growth in income from, and the value of, the property portfolio;
- Any investment required to be manageable from within the City Council's available resources (financial and staff);
- To not expose the City Council to an unacceptable level of risk;
- To be a positive influence on the Carlisle economy and the local property market.

3.2 The recently published draft Economic Strategy for Carlisle helps to position the City Council's high level objectives for its property portfolio within the wider strategy for the future of Carlisle and also identifies a number of specific property related objectives, the principle ones being:

- Expand the city centre retail offer;
- Develop the potential of the city centre Historic Quarter;
- Develop the city centre office market;
- Provision of 4* city centre hotel and conference facilities;
- Develop the city centre evening and night-time economy;
- Identify sufficient land to accommodate anticipated future housing growth;

- Increase the quality, availability and choice of employment development land;
- Improve the stock of business premises;
- Bring brownfield land back into development.

3.3 Delivery of the above property related objectives will involve a complex, wide ranging programme of development over an extended time period (most likely 15 – 20 years). In order to deliver the strategy in full and maximise the potential benefit to Carlisle, it is vital that the development programme is managed strategically as a whole rather than being viewed as a collection of piecemeal development projects.

3.4 The draft Economic Strategy also includes a number of specific objectives over the next five years:

- Complete development of the proposed Rickergate project and secure a development partner;
- Complete development of the proposed Caldew Riverside project;
- Implement at least 2 city centre public realm improvements;
- Implement one industrial estate regeneration project;
- Implementation of the capital programme for the City Council's industrial estates to 2010;
- Bring one brownfield development site to the market.

3.5 Of the above short term objectives, the development of the Rickergate and Caldew Riverside projects and plans for city centre public realm improvements are advancing and the capital programme for the City Council's industrial estates is agreed and underway. However, proposals for delivering the regeneration of one of the City Council's industrial estates and bringing a brownfield site forward for development are currently at a very early stage. As a result, attention is required to the delivery of these objectives and to how the delivery is to be integrated with the projects whose development is currently further advanced.

4. CARLISLE PROPERTY MARKET

4.1 One of the principal factors that will determine the ability of the City Council to deliver its property related vision for Carlisle is the whether the envisaged development programme is viable given the characteristics and state of the local property market.

4.2 As part of the CLAV feasibility study, Hyde Harrington has undertaken a review of the Carlisle property market. They key findings of relevance to developing a strategy for the City Council's property portfolio and delivering the Economic Strategy for Carlisle are as follows:

- Carlisle needs large-scale investment in order to produce modern employment space for existing businesses and new employment opportunities to support the projected increase in population;
- There is dissatisfaction with the older industrial stock in Carlisle, which is starting to result in businesses relocating to Kingmoor Park. As a significant proportion of the older industrial stock is located on the City Council's industrial estates, in the event that this trend continues, there is a risk of a reduction in the future income stream generated from these assets;
- The City Council has the largest land and property holding in Carlisle. This, allied to its planning powers, results in the ability to control future development in Carlisle;
- The current state of the property market is such that it is unlikely that large-scale speculative development will occur. This indicates that the public sector, in particular the City Council, will need to intervene in some way in order to deliver the property related vision for Carlisle;
- The potential demand may be available in the industrial sector to begin regeneration on a large-scale, starting with the City Council's own industrial estates;
- The CNDR should help to stimulate development in the western side of Carlisle;
- Future growth in the housing, retail and leisure property markets will depend upon an increasing, educated and employed population. The development of the University of Cumbria, retention of graduates, the success in creating new businesses and employment opportunities and in creating an attractive environment to live in will be the key to these other markets.

5. DELIVERY OPTIONS

5.1 In assessing the feasibility of a CLAV, it has been necessary to also consider the alternative options available to the City Council in order to determine the relative potential benefits and weaknesses. The main options identified are as follows:

Option A - Do Nothing;
Option B - The City Council retains and manages its assets and undertakes site specific joint ventures;
Option C - The City Council acts as a developer;
Option D - The City Council sells some/all of its assets and seeks alternative investments to generate income; and
Option E - A Carlisle Local Asset Vehicle.

5.2 An analysis of the advantages and disadvantages of each of the above options is included at Appendix C.

5.3 Based on the analysis of the above five options and considering the City Council's property objectives, the following initial conclusions can be drawn:

- Whilst requiring minimal action by the City Council, the "Do Nothing" option would most likely result in a reduction in future income in real terms as tenants continue to relocate and the maintenance liability increases. This would also be inconsistent with the draft Economic Strategy;
- Any delivery strategy is likely to involve the City Council disposing of some of its assets in order to re-invest the proceeds. However, wholesale disposal of the portfolio would significantly reduce the future ability of the City Council to influence the Carlisle economy and property market;
- Retaining its assets and undertaking site specific joint ventures should enable the City Council to preserve and grow the income from its portfolio and deliver the property related vision for Carlisle. This option would require additional levels of staff resources and skills) and, as a result of constraints on financial resources, is likely to take an extended period to deliver;
- The City Council could act as master developer in delivering part/all of the property vision for Carlisle. This option would give the greatest potential financial return but also expose the City Council to the greatest financial and operational risk. It would also result in the need for additional staff and skill resource over and above Option B;
- The CLAV option sits somewhere between Option B and Option C. This would result in the City Council sharing both the risk and reward with a joint venture partner. The ability to access the financial capacity of a private sector partner should also enable the development programme to be delivered more quickly than would be the case if the City Council has to find the majority of the funding required.

6. SCOPE OF A CARLISLE LOCAL ASSET VEHICLE

6.1 The Local Asset Vehicle concept is a flexible model that can be shaped to fit specific local requirements. As a result, the scope of a CLAV would be determined by the City Council. The key criteria in determining scope would be:

- The ability to achieve the City Council's delivery objectives, including the ability to raise sufficient funding;
- The extent of the risks involved and any potential mitigating actions;
- The attractiveness to prospective investors.

6.2 The following potential options are available for a CLAV:

A. Development sites within City Council ownership;
B. Development sites within City Council ownership plus the Carlisle Renaissance city centre projects (Rickergate and Caldew Riverside);
C. Either Option A or B, plus management of the City Council's industrial estates;
D. Either Option A or B, plus management of all of the City Council's non-operational portfolio; and
E. Either Option A or B, plus management of all of the City Council's operational and non-operational portfolio.

6.3 The CLAV feasibility study has largely concentrated on the City Council's non-operational portfolio, as these comprise the assets most in need of investment and include a number of potential development opportunities. Operational assets that present future development opportunities could also be included in a CLAV; these could include surplus assets arising from the ongoing Cumbria Shared Services and Car Parking reviews. The City Council could choose to include other operational assets in a CLAV; in the absence of the asset offering a development or property management opportunity, the principle reason to do so would be to act as "collateral" in order to raise further funding to finance the proposed development programme. Any decision on the assets to be included in a CLAV would need to be made in part on the ability to achieve the City Council's property objectives and in part on the wider impact on the City Council and its financial position.

6.4 A Task & Finish Group drawn from the City Council and key stakeholders is currently assessing the range of delivery mechanisms and their suitability for the delivery of Carlisle Renaissance and its priorities. This will include the role a CLAV could have in the delivery of the development and infrastructure proposals set out in the draft Economic Strategy and the Development Framework & Movement Strategy.

7. FINDINGS FROM "SOFT-MARKET TESTING" WITH PROSPECTIVE PROPERTY INVESTORS/DEVELOPERS

7.1 In order to enable any decision on the future strategy for the City Council's portfolio to be informed by the likely attraction to prospective developers/investors, a series of meetings were held in order to "soft-market test" the options identified in Section 5 and Section 6 above. This involved officers from the City Council, with support from English Partnerships, explaining the vision for Carlisle, the property related implications and the options under consideration and then seeking views on the relative merits of the options concerned. The process did not involve any commitment on behalf of the City Council or the developers/investors concerned.

7.2 A number of meetings were held with property development companies and property investment companies. Key findings from the series of meetings held to date are as follows:

- All of the developers/investors were attracted by the potential opportunity to work with the City Council in delivering the property related vision for Carlisle through a CLAV. It was acknowledged that the ability to work alongside a Local Authority that owns a significant proportion of the land in its locality, has a good pipeline of future development planned for its area and has the ability to use it planning powers to support the proposed development programme is extremely rare;
- In order to provide critical mass to the development opportunity and enable control of the delivery of the overall property strategy for Carlisle, all of the developers/investors were of the view that it would be necessary to include the Carlisle Renaissance city centre projects (Rickergate/Caldew Riverside) in a CLAV;
- It would be possible to deliver the strategy through a number of piecemeal projects, but the developers/investors were of the view that this would probably result in the end product being of a lower standard and a reduction in the value/return to the City Council when compared to a comprehensive approach;
- As a number of the development projects involve assets that are generating an income stream and the re-profiling of the City Council's industrial estate portfolio may well include some transfer of tenants between industrial estates, it would be

difficult to separate the property management and development functions for the portfolio in delivering the strategy;

- It should be possible to structure a CLAV that would allow the City Council to receive a guaranteed minimum income stream until such time as the additional income generated by the CLAV more than offsets the income foregone through sharing the income currently received with a joint venture partner;
- It was acknowledged that the programme of development envisaged in Carlisle will be complex to deliver. As a result, it will be critical to ensure that the team tasked with delivering the programme is appropriately resourced. This team would probably comprise a combination of existing City Council staff, resource available from within the joint venture partner's organisation and new appointments;
- In agreeing to work alongside the City Council, any developer/investor would in effect be buying into the future vision for Carlisle. Before deciding whether to commit to the investment, the private sector partner would need to undertake due diligence on the City Council's business plan and the Carlisle property market to satisfy itself that the business plan is deliverable;
- The value of future development across Carlisle is likely to be extremely high. One developer/investor commented that the development value of the Rickergate project could be in the region of £300m and that redeveloping the City Council's industrial estates could have a value of a further £300m. Whilst the funding requirement to deliver any development is less than its development value, based on these figures, it suggests that the City Council may need to borrow well in excess of £100m to deliver both projects itself;
- Piecemeal re-development of individual plots will not be sufficient to arrest the decline in the condition of Durranhill and Willowholme industrial estates. Only a comprehensive remodelling would achieve this;
- It was acknowledged by the developers/investors that the LAV concept is unproven at Local Authority level in the UK. However, feedback received indicated that the developers/investors feel the concept is valid. It was also commented that any Local Authority that wants to wait to see whether vehicles established by other Local Authorities are successful before committing to establishing a LAV will probably need to wait for some time before meaningful feedback becomes available.

7.3 Whilst accepting that the views of the developer/investors that participated in the meetings could in part be influenced by their preferences for the sort of investment opportunity that a CLAV would present, the feedback suggested that in principle, were the City Council to choose to do so, establishing a CLAV would be feasible and that in doing so the City Council could preserve the income stream from its portfolio.

7.4 It is intended to undertake further “Soft-market testing” in the future in order to help shape the development of the City Council’s property strategy.

8. CONCLUSION

8.1 Combining the ongoing Asset Review, the Carlisle Renaissance development programme and the recently published draft Economic Strategy results in a complex, large-scale, long-term programme of development that, if delivered successfully, will transform Carlisle as a “Place”.

8.2 At this point in time, there is insufficient information on the financial and other implications of the potential development programme to determine with any certainty the preferred delivery option. It will only be possible to obtain the necessary information to make a fully informed decision through undertaking further work.

8.3 However, despite there being insufficient information to make a final decision on the preferred delivery option, the work undertaken to date does enable a number of initial conclusions to be made:

- Whilst it is included as a baseline, the “Do Nothing” scenario (Option A) is likely to have negative financial implications over the medium/long term and will not enable the City Council to achieve its economic development and other objectives. As a result, this option is not recommended;
- Whilst the City Council could in theory act as developer (Option C) itself to deliver the development programme envisaged, the likely scale (based on feedback from one of the developers/investors the City Council could potentially need to borrow in excess of £100m), complexity and duration of the programme would give rise to an unacceptable level of financial and operational risk. As a result, this option is not recommended;
- The wholesale disposal of the City Council’s non-operational assets (Option D), whilst generating a large capital receipt, would significantly reduce the City Council’s control and hence its ability to deliver its strategy and, as a result, is also not recommended.

8.4 The CLAV feasibility study indicates that both Option B (City Council retains and manages its assets and undertakes site specific joint ventures) and Option E (establishing a CLAV) should, in principle, be capable of delivering the City Council's property objectives. Whilst ultimately delivering broadly similar outcomes, the two approaches are likely to differ in terms of the share of risk and reward between the City Council and private sector partners and in terms of likely speed of delivery.

8.5 In order to enable the City Council to make a fully informed decision on the most appropriate delivery mechanism to achieve its property related objectives, it will be necessary to undertake further work to develop a costed Development and Investment Plan for the City Council's property portfolio. The scope of this work will include:

- Establishing a pipeline of development projects that could be delivered on land owned by the City Council;
- Assessing the viability of the identified development projects based on estimated development values and costs;
- Establishing the likely timetable for individual projects;
- Projecting future income levels from the City Council's non-operational asset portfolio and the related operating and maintenance costs;
- An assessment of which City Council assets should be transferred into a CLAV;
- An assessment of the likely resources required to deliver the development programme;
- A comparison of delivery of the development pipeline under Option B and Option E, including financial, risk and other implications for the City Council;

8.6 It is envisaged that undertaking the work outlined above will take approximately 6 months to complete. A report will be brought back to the Executive in June 2008 with an assessment of the findings and future recommendations.

8.7 Undertaking this work will require specialist property and development finance advice. It is estimated the cost of procuring this will be in the region of £100,000, which will be met from existing budgets.

8.8 English Partnership has confirmed its willingness to continue to support the City Council in assessing whether a CLAV is an appropriate delivery mechanism to achieve its property related objectives.

8.9 Regardless of the delivery option that is ultimately selected, it is vital that the overall property strategy for Carlisle is co-ordinated so that the individual strategies for the Carlisle Renaissance city centre projects, the City Council's assets and the housing strategy help to support each other. This may require some reassessment of the timetable of the various projects currently at the planning stage, but should result in benefits in the medium/long term.

8.10 The soft-market testing exercise highlighted considerable interest amongst developers/investors in working alongside the City Council to deliver the vision for Carlisle. At present there appears to be a great opportunity for the City Council to capitalise on the evident interest in Carlisle to enable its vision to become a reality.

9. CONSULTATION

9.1 The following have been consulted in preparation of this report:

- Corporate Asset Management Group; which includes the Director of Corporate Services, Director of Legal and Democratic Services and the Director of Carlisle Renaissance
- Head of Economy, Property and Tourism and members of the Property Services department;
- Council Members (via briefing held on 15 October 2007)
- Corporate Resources Overview & Scrutiny (via workshop held on 18 October 2007);
- English Partnerships;
- Hyde Harrington (property consultants); and
- A number of property developers/investors (whose views are summarised in Section 7)

9.2 The report will now be referred to Corporate Resources Overview and Scrutiny

9.3 In addition to the above interested organisations will be informed on the process once this report has been considered by the Executive:

- Occupiers of City Council property;
- Lanes and Market Hall partners;
- Trade Unions;
- Cumbria Chamber of Commerce;
- North West Regional Development Agency;

- Government Office for the North West; and
- Department of Communities and Local Government.

10. RECOMMENDATIONS

10.1 The Executive is recommended to:

a) Agree to continue developing two of the options for delivering the property strategy for Carlisle, being Option B (the City Council retains and manages its assets and undertakes site specific joint ventures) and Option E (establishing a CLAV to deliver the programme of development), with the remaining options to be discounted;

b) Direct the Corporate Asset Management Group to undertake further work to develop a Development and Investment Plan for the City Council's property portfolio in the context of the vision for Carlisle that is set out in the draft Economic Strategy. This will provide a costed plan for the future management and development of the City Council's asset portfolio and include an assessment of delivery under both Option B and Option E; and

c) Refer the report to Corporate Resources Overview and Scrutiny for their comments on the findings of the review and their views on the proposed way forward.

11. REASONS FOR RECOMMENDATIONS

11.1 To further progress the review of the City Council's asset portfolio and to develop proposals that would enable the delivery of the property related vision for Carlisle.

12. IMPLICATIONS

- Staffing/Resources – The establishment of a CLAV could involve the transfer of staff from the City Council. Other examples of public private property partnership have involved the transfer of public sector employees on full TUPE terms.

- Financial – This initiative has the potential to cause major financial implications for the City Council. It is imperative therefore that these implications are very fully understood before a decision on any option is taken. The Council clearly needs to retain its existing revenue stream from these assets, whatever option is chosen because of its contribution to the current revenue budget. It is recognised that some options will provide the opportunity for accelerated investment in the property portfolio but this can only come at a cost at least in the short term and the Council must be aware of the financial and other risks involved.

- Legal –

a) The report sets out a number of options for Members to consider and, ultimately, the authority will have to determine which option represents the best way forward in terms of the management and development of its property portfolio, having regard to the risks and benefits of the various options particularised in the report and to its fiduciary duty to its local taxpayers to manage its assets prudently.

b) Each of the options outlined are within the legal capacity of the authority to pursue if it so determines and some of them e.g. that the Council retains and manages assets and undertakes site specific joint ventures, or acts as a developer itself, are avenues which the authority has pursued in the past. The more radical option is the creation of a Local Asset Vehicle which, as the report points out, is a novel approach currently under consideration by other bodies but which is an unproven concept at local authority level in the UK. This in itself does not mean that the Council should not pursue the option further, but rather that it needs to give particularly careful consideration to the risks and benefits in this option and be clear what the approach will offer to the authority more than any other option if it chooses to pursue it.

c) The basic premise of a Local Asset Vehicle is set out in the report and envisages that the Council should establish a joint venture limited company or similar special purpose vehicle with a selected private sector partner and the Council will then transfer ownership or de facto control to the special purpose vehicle of a range of its property assets yet to be determined. It is then proposed that the governance and income sharing arrangements within the vehicle will be structured in such a way that the City Council will receive a guaranteed income from the assets to be transferred (presumably with some guarantee for future growth at no less rates than would occur had the property been retained by the City) and that the Council would also look to receive a capital premium as consideration for entering into the joint venture arrangements, as well as the private sector partner undertaking to provide further capital to be invested in the portfolio which the City Council is currently unable to do. The precise nature of what the Council would receive for transferring its assets will ultimately be determined by inviting bids from partners but, given the authority's high dependency on rental income to sustain its budgetary position, it would be essential that any arrangements secured the current income level with future inflationary growth.

d) In terms of legal powers, the City Council has power under Section 2 of the Local Government Act 2000 to do anything which it considers is likely to achieve the promotion or improvement of the economic, social or environmental wellbeing of its area. This power is comprehensive and may be exercised in relation to or for the benefit of the whole or any part of the authority's area or all or any persons resident in it. It includes power to incur expenditure and to enter into arrangements or agreements with any person, and co-operate with or facilitate or co-ordinate the activities of any person. In determining whether or how to exercise the power, the Council must have regard to its own community strategy and to any relevant guidance issued by the Secretary of State. On the face of it, this power (apart from any others which are available) should be sufficient to enable the Council to establish a Local Asset Vehicle and enter into an arrangement of the sort described in the report and also to pursue the other options which are set out.

e) Some of the options envisage that the Council would transfer the legal interests which it currently holds in the freehold and leasehold of the assets to the Local Asset Vehicle, which would then become the legal owner, or sell its property assets generally. The Council has power, under Section 123 of the Local Government Act 1972, to dispose of its interests in land in any manner it wishes, subject (with the exception of short term lettings) to it receiving the best consideration that can be reasonably obtained. In making any disposal to the Local Asset Vehicle or any other disposal the authority would be required to ensure that this obligation was complied with, unless it had either a specific or general consent from the Secretary of State to sell at less than best consideration.

f) In addition to identifying appropriate powers to enable it to pursue any of the options indicated in the report, the Council also has to have regard to its overriding fiduciary duty to its Council Tax payers when determining which option to follow. This will involve an assessment of the risks and benefits accruing to the authority under each option and they are summarised in the appendices to the report. As mentioned in the report, Members will be aware that the income stream enjoyed by the Council from its property portfolio underpins the Council's financial base and is critical in maintaining the authority's budgetary position. It is therefore necessary to be satisfied that any arrangements which are entered into do not detrimentally affect this income flow or expose it to unacceptably high risks. The point is made in the report that the level of the Council's dependency on income from its property holdings distinguishes it from other examples of Local Asset Vehicle use. Prior to committing itself to this particular option, therefore, the Council needs to be satisfied that its income stream under any LAV sharing arrangement can be guaranteed at a level which is at least equal to that which it currently enjoys, including any future expected growth, for the duration of any joint arrangement, and that the overall benefits of participation exceed any risks arising. Consideration would need to be given in any negotiations regarding the LAV option as to whether, for example, provisions could be made for the transfer of the assets back to the Council if circumstances so dictated and the Council will need to give detailed consideration to this and other relevant risks and benefits before finally determining whether to proceed in this way.

g) Other relevant legal issues which will need to be addressed (albeit at a future date) relate to the appropriate governance arrangements under which a Local Asset Vehicle would operate, the potential taxation consequences (if any) of operating such an arms length joint venture company, and issues potentially arising under the TUPE regulations if it transpired that any of the authority's staff were to transfer to the Local Asset Vehicle. Additionally, consideration would need to be given to the appropriate procurement route in selecting any partner for the Local Asset Vehicle to ensure compliance, where applicable, with relevant EU and domestic tendering requirements and any prohibitions regarding State Aid. Given the novel element of some of these issues and the fact that there may be no exact precedent to draw on in respect of the Local Asset Vehicle option, specialist legal, financial and (possibly) valuation advice will be required at some point to ensure that any option ultimately pursued is soundly based, which will necessitate a budgetary provision being set aside.

- Corporate – The Asset Review process derives from the findings of an Audit Commission Best Value Review of Property and Economic Development Services. It is identified in the Medium Term Financial Plan as one of a series of service review planned or underway.

- Risk Management – The high level risks related to the delivery options are identified in Appendix B. This will be updated and revised as part of the proposed next stage of work.

- Equality and Disability – None

- Environmental – Any development undertaken by a CLAV or otherwise on the City Council's property portfolio will be expected to operate within the context of the Local Plan and environmental policies adopted by the City Council.

- Crime and Disorder – None

- Impact on Customers – Occupiers of City Council property will be consulted during the process of determining the preferred delivery mechanism for the City Council's property strategy.

APPENDIX A

SCOPE OF WORK
EXAMINING THE OPPORTUNITIES AND RISKS ASSOCIATED WITH A LOCAL ASSET VEHICLE FOR CARLISLE

Specific Aim:

To provide evidence for understanding and addressing the issues involved in setting up and operating a Local Asset Vehicle for the management of some or all of the City Council's property assets and to assist in the delivery of the City Council's regeneration, housing and economic development strategies.

Background:

The City Council holds a significant portfolio of assets across Carlisle. This portfolio generates considerable income for the City Council and has an important impact upon the local economy. In 2001 an Audit Commission Best Value Inspection Report of Property Services and Economic Development identified the need for a strategy to rationalise the portfolio, maximise returns and sustain the quality and economic value of the assets.

In 2003 a report by property consultants Lamb & Edge highlighted that without a change in approach to its portfolio the City Council could see a considerable reduction in income and an increased liability over the long term. Whilst noting the significant role the City Council has in the local property market it concluded that without a change of approach it could be seen to be holding up economic development.

The next stage of work was a report 'Asset Review – a Future Strategy (Options Appraisal and Business Cases) which recommended a mixed approach to the various assets comprising retention, disposal and joint venture with a private sector partner.

Much of the rationale for the Asset Review remains as it was at the beginning of the review process: -

- Pressure for public sector spending efficiencies from Central Government
- The need for continuous improvement in the quality of services delivered by the City Council
- The opportunity cost of not investing in the portfolio in terms of reducing returns
- The challenge to effective medium term financial planning associated with reactive property maintenance

- Opportunities presented by the introduction of the Prudential Borrowing Code

However a series of policy developments have taken place at a local, regional and national level which potentially impact upon the review process and ultimately the delivery of any property strategy. These include Carlisle Renaissance, Shared Services, the Local Government White Paper and the sub-national review of economic development and regeneration (CLG, Treasury and DTI).   This has prompted a more detailed examination of placing a greater proportion of assets into a joint venture through a Local Asset Vehicle. The attached reports give more detail on the background and the initial views of Members. Report CE11/07 to Executive 19 February 2007, minutes CROS. 18/07 and CROS/ 44/07 from Corporate Resources Overview and Scrutiny Committee 22 February and 12 April 2007.

The Next Stage of Work Required ('the Study')

Local Asset Vehicle (LAV) concept is based on experience of existing public private property partnerships. It involves the establishment of a special purpose vehicle into which a public sector organisation transfers property assets and the private sector partner contributes cash and other resources, which are used to deliver an agreed business plan. Selection of a private sector partner would be by competitive tender. This next stage of work involves an examination of the feasibility of a LAV for Carlisle City Council's property assets and, if feasibility can be established, development of a range of options over the possible scope and form of a LAV and includes:

- Setting out the strategic context and the City Council's future development aspirations for Carlisle
- An assessment and a justification on which to base a decision on those assets to be included
- The parameters upon which any LAV would be based
- Soft market testing to determine a potential level of interest from the private sector.
- An assessment of setting up and ongoing costs
- Development of a business case, including the financial aspects, for operating a LAV
- Structural and operational options
- Potential risks and possible safeguards

A fundamental issue for the City Council is the degree to which it relies on the income generated from its property portfolio for the delivery of services. Whilst the majority of this income derives from more secure longer term leasehold arrangements, fluctuations in short term property derived income, such as car parking income, have a disproportionate impact upon its budget structure.

The principal difference between existing examples of the application of the LAV concept and that which may be applicable to the City Council is therefore the extent to which the City Council is dependant upon the income generated from its property portfolio. For this approach to be of any advantage to the City Council it would need to secure from a private sector partner: -

- A guarantee to maintain the level of income the City Council currently derives from the portfolio introduced to the LAV
- An agreement to share any increase in revenue from the portfolio with the City Council
- Capital to invest in the portfolio
- Revenue to operate the LAV
- A premium (capital sum) to support investment in regeneration projects such as those proposed in the DF&MS.

Deliverables

Prior to commencement of the Study a detailed work/action plan for progressing the work will be agreed between Carlisle City Council and English Partnerships' Urban Finance Team

The study itself will provide:

- Details of Asset vehicles operated by other public sector bodies;
- An explanation of the LAV concept, including how it could be established, how it could operate and the benefits and risks to Carlisle City Council of establishing a LAV;
- A range of options available to Carlisle City Council to assist in determining a strategy for its asset portfolio and for delivering its regeneration, housing and economic development objectives;
- Details of the next steps and related implications in the event that the City Council decides to proceed to establish a Carlisle LAV.

The Study will be completed by 30 October 2007

Management Arrangements

The Corporate Asset Management Group will lead the work for the City Council. Any external work commissioned by the City Council will be undertaken in compliance with the Council's agreed procurement policy.

Appendix B

Local Asset Vehicles (“LAV”) - Structuring Overview

Introduction

During the City Summits in 2005, Ministers recognized the need to develop an approach to the financing of regeneration, which will enable private sector capital and expertise to be leveraged swiftly into local area schemes.

The focus on cities, new governance, housing and infrastructure funding in the context of limits on public sector funding and a strong property market is expected to encourage further activity in the area of public/private sector partnership arrangements.

The LAV approach has the potential to facilitate and enhance public service delivery and wider government and sub-regional economic objectives through:

- Kick-starting sustainable development in key areas and re-investing returns into future pipeline projects and public sector outputs;

- Enhance the role that Local Authorities play in improving the physical environment, social and economic well being in an area;

- Creating a delivery conduit through which a range of public sector bodies can deliver public service and regeneration plans;

- Meeting wider Government aspirations to make better use of existing assets

Background

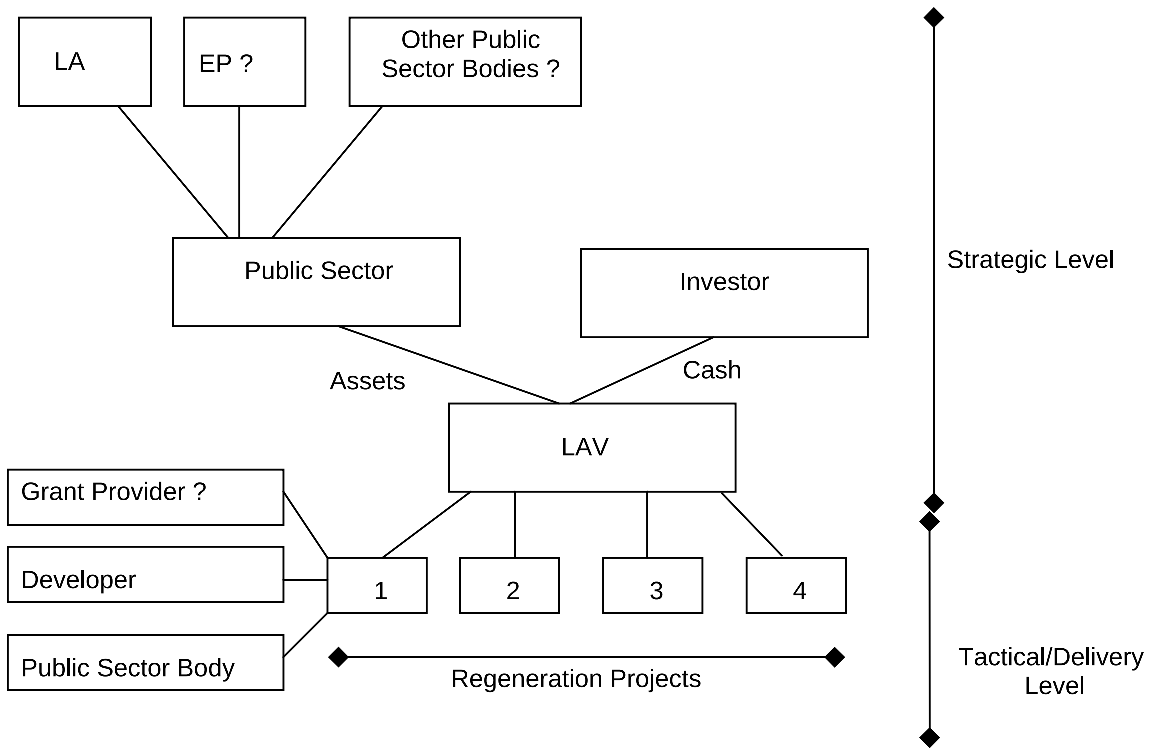
A variant of the LAV model has been used in a number of instances to date, principally by the English Regional Development Agencies (“RDA”):

- One North East (“Buildings for Business”) – joint venture with UK Land established in 2004. Remit is largely property management;
- East Midlands Development Agency and English Partnerships (“Blueprint”) – joint venture with the Igloo regeneration fund (managed by Morley Fund Management) established in 2005. Remit is property management and development;
- Advantage West Midlands – joint venture with Langtree and Bank of Scotland established in 2007. Remit is property management and development; and
- North West RDA – joint venture with Ashtenne Industrial Fund (Morley Fund Management and Ashtenne Holdings Ltd) established in 2007. Remit is largely property management; and
- British Waterways Board (“ISIS Waterside Regeneration”) – joint venture with the Igloo regeneration fund and Amec (now Muse) established in 2002. Remit is largely property development.

Whilst there are no LAV type models are currently in operation at UK Local Authorities, at present a number of Local Authorities are actively exploring the feasibility of adopting the model in order to deliver the property related vision for their locality. The Croydon Council proposal for an “Urban Regeneration Vehicle” is probably the most advanced, being currently part way through the process of procuring a development partner.

There are a number of public private partnership arrangements in existence between Local Authorities and the private sector which are similar to LAV in certain respects. Examples include the joint ventures between Liverpool City Council and InPartnership Ltd (established in March 2007 to deliver housing related regeneration) and the North Solihull Partnership (again housing related regeneration) between Solihull Council, InPartnership Ltd, Bellway Homes and Whitefriars (a Registered Social Landlord).

The model essentially works as follows:



1. The Local Authority (and possibly EP and any other public sector bodies identified as having assets appropriate to the venture) identify a portfolio of assets and a pipeline of regeneration projects which require funding. Clarity over future pipeline will be a key investor issue.

   In the event that more than one public sector body is involved, the collaboration needs to be formalized into one organisation, so that the institutional investor, investing alongside the public sector, deals with only one partner.

Assets could encompass any, or a mix, of the following:

- Surplus properties which would otherwise be disposed of;
- Investment properties;
- Sites for development;
- Operational assets; and
- Income producing assets.

One or more of the public sector participants could contribute cash rather than assets.

The assets may well be, but don't necessarily have to be, related to the regeneration projects.

2. In identifying regeneration projects, the structure of this vehicle is most suited to substantial long-term, strategic projects.

3. Summary details of the portfolio, together with an outline business plan for each individual asset, and each regeneration project is produced. The outline business plan details the restrictions on the use of the assets, the development proposals for each asset, and regeneration projects (to the extent that they are to be carried out through the vehicle).

4. An investor is procured in accordance with public sector procurement practice. Once a list of investors is drawn up, the summary business plan is circulated to potential investors, who are then invited to submit outline bids for the portfolio on the basis of the business plan. Once outline bids are received, they are short-listed to a manageable number (typically 3 - 6).

5. A full due diligence pack and draft legal agreements are then produced on the portfolio properties and the business plans, and circulated to the short-listed investors, in a formal invitation to negotiate, who are then invited to submit bids (the due diligence pack is assignable to the winning bidder).

6. Experience of the vehicles that have been established to date is that the bids submitted for the asset portfolios have been significantly in excess of their estimated market value as individual assets (as much as 30%). This has been for the following reasons:

- *Lotting premium*: There is a premium associated with the aggregation of assets to form a good-sized portfolio. Many investors will pay for the opportunity of acquiring such a portfolio

- *Marriage value*: Derived in one of three ways:

  - Combining assets which are linked geographically;

  - Combining assets which are linked functionally (e.g. creating portfolios of residential assets, industrial parks etc.); and

  - Uniting freehold and leasehold interests which had hitherto been split.

- *Exploiting public sector covenant*: To the extent that stock within the portfolio is occupied by a local authority or other public sector body, there is a premium to be paid for that covenant.

- *Securing product pipeline:* Investor appetite for investment in quality UK assets is strong at present. The attraction of LAV models is that not only do they provide a safe haven for funds on day 1, but they also provide an opportunity for the investor to acquire completed quality projects whose development they have been actively involved with, at the end of the life of the LAV

7. In bidding for the portfolio, it is usual for the investor to fund as a premium up-front payment all or at least a substantial part of the public sector's costs incurred in connection with procuring and setting up the vehicle.

8. As an example, it is assumed that the public sector portfolio has a market value of £70million, but investor bids £100m for the portfolio. There is thus an immediate uplift in value at this point.

9. The ownership of the SPV in the examples cited has to date been a 50/50 deadlocked joint venture, with arbitration provisions for resolving disagreements. The assets are transferred with individually agreed business plans into the model, so as to minimize the risks of disagreement. This is one of the principal ways in which the public sector exerts control over the vehicle. The other is that the memorandum and articles of association of the SPV are explicit in recognising the aims, objectives and operating rules of the SPV upfront.

10. To maintain the 50/50 structure, the institutional investor matches the public sector's asset contribution and subscribes the £100m it bid for the portfolio for shares in the vehicle. At this stage, the SPV is worth £200m

and consists of £100m of cash from the private sector and £100m of assets from the public sector.

11. It is possible at this stage to gear the SPV, and it would not be unreasonable to introduce debt of at least 50% of the equity subject to public sector accounting and treasury debt policy. Thus, the vehicle now comprises:

- Total equity of £200m (of which £100m is cash, £100m is property); and
- Total debt of £100m.

On the assumption that the portfolio had a market value of £70m, the assets have used them to produce a further £230m of investment funding. This level of gearing will need to be sustained through income or disposals within the SPV and is therefore only viable if the joint venture is generating sufficient income to service the equity and debt requirements.

The 50/50 ownership structure ensures that the return is split equally between the public and private sector, and therefore that risk and reward are equally split. It would be possible to structure the vehicle in such a way that each party can take his return in a different way. For example, the institutional investor may prefer not to take his dividend from the vehicle but to reinvest it, or alternatively, the public sector partners may wish to take profits out of the vehicle early to fund alternative projects.

12. A hands-on management team is generally formed once the LAV is established to oversee the running of the company, this may involve the transfer of some existing resources into the joint venture. The Local Authority will also need to allocate appropriate Board level resource to ensure that effective governance and control is maintained.

13. As a variation to injecting all the assets on day 1, an alternative structure would be to grant the institutional investor an option over the assets (with a value of say 10% of the asset), and to gradually transfer assets into the vehicle as and when needed for the delivery of the business plan.

14. Once the SPV is up and running, it can begin to embark on the delivery of the agreed business plans, as this is the principal way in which value is created by the vehicle. In addition to the agreed regeneration projects, the business plans established at the outset would also have envisaged some of the following:

- Realising development potential;
- Re-gearing leases;

- Implementing professional property management practices;
- Deriving scale opportunities;
- Land assembly; and
- Trading assets etc.

The LAV may also choose to make strategic acquisitions within its established powers which will enable it to release more long-term value. Any value generated by the partnership can be re-invested into future pipeline regeneration projects approved by the Local Authority and developed jointly within the partnership. Alternatively the Authority may choose to extract value, or exit completely, from the LAV allowing it to invest directly into other core projects and programmes. The scope of initial investment and pipeline projects undertaken by the LAV will be governed by the Public Sector partners informed by wider government policy, sub-regional economic targets and specific local public service objectives. The LAV can also undertake projects that are not identified at the outset; this would be by agreement of the LAV partners.

15. These projects can be managed through any number of delivery vehicles, which are all subsidiaries of the SPV and therefore subject to the same restrictions and controls set up for the overarching joint venture. It would not be unreasonable to seek a further investor (potentially a developer) to match the SPV's equity investment in a development project (and for that equity itself to be geared). Thus it would be possible to attract further equity at the delivery level together with further debt (subject of course to the vehicle's ability to service both).

16. Any number of specialist partners can be introduced at the delivery level (either public or private).

17. Previous LAV type vehicles have had a finite lifespan as the vehicle has been constituted as a limited partnership. Typically, therefore these structures could last for at least 10-15 years (they have to be long enough to enable the value to be captured by the mechanisms outlined in 14. above).

18. At the end of the 10-15 year period, the vehicle can either be extended or it can be wound up. In the event that it is wound up, the following would happen:

    - Any assets/projects which were deemed to be key strategic assets to the public sector could be acquired back from the vehicle at Market Value, possibly having agreed pre-emption rights at the time the LAV was established;

- The partners would then have the opportunity to bid for the remaining assets. In the current investment climate, it is highly likely that the private sector investor would want to acquire a significant proportion of the assets; and

- Remaining assets would be sold on the market in the usual manner and the proceeds distributed equally to investors.

19. The joint venture will need to satisfy Local Authority capital finance and wider regulatory requirements eg State Aid, TUPE etc.

Appendix C

Delivery Options

Summarised below are the main advantages and disadvantages of the options identified in Section 5 of the report to the Executive.

Option A – Do nothing

Advantages	Disadvantages
▪ Income will increase in the short term; ▪ No significant additional resource requirements.	▪ Income likely to reduce in real terms if tenants continue to relocate; ▪ Maintenance liability will increase as assets age; ▪ Lose opportunity to use assets to help deliver vision for Carlisle; ▪ Not consistent with draft Economic Strategy.

Option B – Retain and manage assets and undertake site specific joint ventures

Advantages	Disadvantages
▪ Risk shared on development projects; ▪ Majority of income preserved in the short term and income growth in the medium/long term; ▪ Would support economic development objectives; ▪ Flexible approach.	▪ Will require additional in-house resource to be delivered; ▪ Limits on City Council financial resources are likely to lead to an extended delivery period; ▪ Short term loss of income whilst assets are being re-developed; ▪ Individual projects may not be large enough to attract private sector interest; ▪ Total procurement costs are likely to be higher through piecemeal disposals.

Option C – City Council acts as developer

Advantages	Disadvantages
▪ City Council will retain 100% of the proceeds of development; ▪ City Council retains 100% control of the development programme; ▪ City Council would be seen as taking a lead in delivering the vision for Carlisle; ▪ Would support economic	▪ City Council retains all of the development risk; ▪ Significant additional staff resource required; ▪ City Council would need to borrow significant funding, which would expose it to potential financial risk; ▪ The scale of the development

development objectives;	programme could divert attention from other priorities.

Option D – Sale of some/all of existing assets and re-invest proceeds

Advantages	Disadvantages
▪ Generate capital receipts	▪ Loss of income until re-investment starts to generate income; ▪ Loss of control over assets.

Option E – Carlisle Local Asset Vehicle

Advantages	Disadvantages
▪ Raises significant private sector funding to invest in delivering the vision for Carlisle; ▪ Access to partner's development and property management skills and experience; ▪ Enables delivery of vision to be accelerated when compared to City Council only funded approach; ▪ Scale of investment opportunity likely to be more attractive to investors; ▪ Uses City Council assets to deliver future growth.	▪ Loss of 100% control of assets; ▪ Loss of 100% control over future development; ▪ Future income levels less certain; ▪ Long term arrangement with one partner; ▪ High set up costs.