



ASSET



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Susan Lynch has spent 25 years advising public sector clients including Local Authorities on identifying and realising the development potential of all types of land and buildings.

Her projects and client base are wide ranging – new settlements, city centre retail and mixed use schemes, and employment based regeneration developments on both green and brown field sites. The majority of these involve structuring partnerships between the public sector promoters and private sector developers.



THE AUTHOR:

Rob joined Drivers Jonas in 1991 and led DJ's Strategic Consulting team for the past 8 years.

A valuer by background, Rob's major area of focus is providing property advice to occupiers in the private and public sectors, the latter across local government, health, education, police & security services, central government and arts & culture.

Rob specialises in bridging service delivery needs and real estate solutions, not least in local government. This is provided through estate strategy advice, estate rationalisation, asset management planning, workplace advice and outsourcing (such as LABVs) – backed up by logical and objective appraisal processes, including financial modelling, 'Green Book' option appraisals and business case expertise.

The current challenge is how local government property can support radically changing operating models, whilst cutting costs, releasing capital, maintaining revenue and contributing to carbon reduction commitments.

LOCAL GOVERNMENT TRANSFORMATION AND ITS IMPLICATIONS FOR PROPERTY

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ACES Spring Conference
London, May 2011

ACES Paper No 11.05/8 by

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Reorganisation of Property Assets in the Context of Changing Service Delivery and the Cost Reduction Agenda, Rob Colley

Firstly I will deal with organisational transformation and increasing efficiency. The chart below, "Drivers for Change" sets out the problem. On the one hand there is reduced funding, from Government funding cuts or the impact of the recession on investment properties, ie lower capital receipts or investment income. On the demand side there are rising expectations from service delivery departments and service users are putting pressure on the delivery of public services and response time. There is also growing demand as a result of the recession, unemployment for example, and also changing demographics as the population ages and lives longer. Therefore there is a real need to innovate and create a sustainable model for delivering services through what will be a long period of adjustment.



Opportunities for Cost Reduction

There are many opportunities for cost reduction and in some respects it should be business as usual for estate practitioners as the whole plethora of activities is not just about one single hit. From workplace transformation, and playing a more assertive and proactive role as estate services managers in reducing uninformed demand for property, we are more and more advising estate clients to instigate a corporate landlord function that can then be more assertive about uses of space by services and challenge services about the space that they need and why they need it. All property should be centralised, as service users are only temporary custodians rather than owners of it. Rationalisation of surplus properties means that rather than having small pockets of surplus space dotted all over the estate, useful areas can be created that can be released into the market. Now is a good time, despite the general difficulties of the property market to get the Local Government property into the market before Government gets its act together and starts flooding markets with its own surplus space. Local Government has about a year's advantage to get ahead.

Other opportunities for cost reduction include real estate head count reduction; for example outsourcing lower value aspects of the organisation's estates function and improving processes and systems to increase staff productivity to therefore allow a headcount reduction, strategic property sourcing and financial restructuring. The latter may include not simply disposing of properties straight into the market, but maybe employing more sophisticated models, especially when we know that there is big institutional interest in public sector property.

The level of cuts can be likened to a tree. If you are just reducing by 5% then you are only trimming the branches, but once you are talking about 15 to 20% reductions then it is a root and branch approach. We are not just talking about changing the operation of facilities management and day-to-day property services. We have in mind looking at the size and shape of the organisation too; so reducing the space occupied and optimising that in terms of the operating model.

Cost reduction – not just pruning at the edges

Beyond a certain level, the shape of occupancy has to change



There is a focus on cuts but it is important to say that there is more that could be done, for example in optimising income and service delivery and using property as a platform for improved service delivery. Reducing the amount of space to release budgets or reduce actual expenditure from maintenance, facilities management and utilities, carbon management etc. is important. It is also important to optimise the release of space through Joint Ventures and Asset Backed Vehicles and to create a flexible core estate to deal with the changing environment and future uncertainty. To get the best out of a smaller estate it is also important to consider strategy and investment in the IT infrastructure as well as property.

Not just about cuts!

Service delivery and income optimisation are important too



What we are trying to do is match organisational transformation and change to the management structure to the organisation and shape of the estate being managed. The combination of

these two activities will maximise the savings and improve the quality of space.

Business Transformation



To give a human analogy, over the last decades, the public sector has grown fat on new projects and new programmes. It has added new properties, buildings and leases to its estate without trimming. The analogy is that we (the public sector) is a bit over weight and whilst we can lose weight, it is not just about losing weight quickly, as with a crash diet it is so easy to put that weight back on again. The key is to work out how you reduce weight and build strength, improve flexibility and deal with the psychological side. It is easy in the current climate to get depressed about all this change and the changing operating models, but the positive side of the change and transformation of space is that it will improve workspace and morale generally. It is more than cutting and reducing space; it is building up a healthy estate.

I think it is incumbent upon property professionals to ask fundamental questions of the occupiers they serve. That is are there the right number of people? Are they in the right place? Are they delivering the right services in the right mode? Does the organisation need to deliver these services at all? What does that mean for the estate? Keep asking these basic questions as more and more in property it is all about unlocking some of those difficult conversations that are going on.

Just to reinforce the difference between size and shape. Size is about the number of people you have. Shape is about how they are organised.

Comparing organisational size and shape

	Size	Shape
Key question	How many people?	How are they organised?
Includes	Not just core staff Agency and temporary workers Contractors and consultants Commissioned providers	Not just structure Governance arrangements Performance management Cultural norms
Articulation	Simple: Headcount and numbers	Complex: Concepts and models
How size and shape interact	We need to reduce headcount	How are we going to act differently to achieve that?
	How does that impact our staffing and property needs?	We need to operate differently
Focus	Cost reduction Revised headcount	Organisational design and systems Revised number of employees

And it is not just about the core staff, but also about consultants and agency staff. They take up space as well. And shape means more than just structure; it is also about governance arrangements, performance management and

the whole culture of the organisation. We need to work on the interaction between shape and size to improve the estate and reduce running costs.

A key factor is local collaboration, not only with the users of your facilities, but also with your neighbours in the public sector. Whether you call it Total Place, Place Based Budgeting or Localism, it is really important to talk to colleagues in Police, Fire, Ambulance, Education, Central Government and other occupiers and begin to map out what you have locally. We are surprised at how few conversations have been going on in the past but some of these frozen relationships are now breaking down so it is well worth establishing a local property tier with some simple information about who, what, where and how they occupy.

Mechanisms for sharing the benefits can be somewhat complicated. We are aware of some towns and cities where they have established a property group or forum. This is really business driven but property can act as the catalyst for the wider discussions. For example, we are currently working with a police authority on a custody suite and that is enabling a discussion with a neighbouring authority on that issue, but that will help raise many other issues about, for example, collaborative models and the outsourcing of to the private sector.

It is also important to remember that there are other issues to deal with, for example carbon reduction, cost reduction as carbon pricing takes effect, the abolition of the LDA, further education and BSF, and the whole wider remit of social infrastructure, regeneration, and the increasing tendency of urbanism and the increasing density of towns and cities and the impact of demographics.



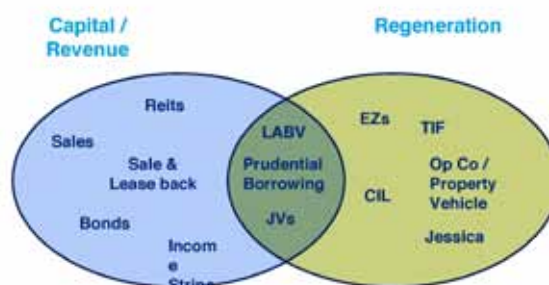
Finally be clear about priorities. Are you considering individual buildings and the portfolio as a whole in the context of historic service delivery rather than future service delivery? Are you really going all out for capital receipts or are there other issues that may result in a lower capital receipt whilst achieving wider social objectives? If so it is important to be clear about why you are doing that. There is, of course, always a political dimension but the role of the property professional should focus on fundamentals, dealing with the property challenge of why you have what you have where it is and, importantly, creating and maintaining dialogue within your own Authority and with others.

Practical Use of Property Assets to Meet Authorities' Wider Objectives, Susan Lynch

I intend to deal with some of the ways that we are working with Authorities across the country to get the most out of their property assets through facing up to some of the above challenges, whilst recognising that we are still, unfortunately, in the worst property recession most of us have ever known.

The property market is in bad shape but there are some pockets of activity, which is encouraging. We had a tender last week for a pretty average development opportunity in central London and we got 3 times as many bids as we would have received 12 months ago. More activity is taking place and in particular we are seeing it in the town centre areas where developers and retailers are looking at opportunities again, which is also encouraging. I think that Local Authorities still have a key role to play there. It is not all doom and gloom and if you look at the available options for maximising the values of what you have got whilst in some ways they are a bit baffling, but on close inspection the mechanisms fall within 2 overlapping categories: the things that you can do to generate capital revenue; and the things that you can do to encourage regeneration and economic development. In addition, there are other actions you can take that fall somewhere in the middle and can do both.

Use of Property Assets – understanding priorities



Overlaying all that you have the morass of procurement, how to involve the private sector and the issue of state aid; it is not all straightforward but there are lots of opportunities out there.

Releasing Value from Property Assets

How do you generate value from your estate? As ever it is a fine line to balance realising capital whilst maintaining your income flow and not over-committing yourself on income as well. We have to strike those balances. We are still seeing some sale and leasebacks, particularly on new accommodation, but I think a lot of Authorities are hesitating as they do not know what the shape of their organisation will be in 3, 4 or 5 years' time; so why make a commitment now on a future building may not be needed or used.

Most Authorities do not have assets sitting around that they can dispose of. Those that are left are the difficult ones, the ones that need working on. At the moment we are doing a

lot of work on income streams. We are looking at Authorities' investment portfolios, and the income profiles, and then working out how they can raise capital from that. For example, can they fix their income for the next 5 years and then sell on that and potential future uplifts? This solution offers an income stream for 30/35 years and is currently attractive to some investors. We also get involved in actual estate management and estate strategy as well.

The local authority income stream issue is an interesting one we are working with Authorities accounting and related legal logistics. Our accounting friends get excited about Bonds and REITs, and this is not surprising as the set up costs for those are astronomic. As a result, these would not normally be used unless an Authority was contemplating raising hundreds of millions pounds worth of capital. Now Prudential Borrowing interest rates are going up there is increasing of excitement from the private finance institutions particular in those longer-term stable income streams. Some of the funds are able to offer almost better rates than through Prudential Borrowing and I think that is a tendency we will see more of over the next couple of years.

Using Property Assets in Regeneration

How to use assets to encourage regeneration continues to be important. We still do not know what is to happen to RDAs, LEPS and the HCA and who might take over those responsibilities, but one of the things we are seeing Authorities doing is using their land as an equity stake, not taking out value, but taking out a portion of the end value and so, in effect, acting as an investor. Some Authorities are also borrowing to fund CPOs, and if you have CPOs running out you can keep them alive by funding those yourself and then promoting the schemes.

One of the big issues and uncertainties at the moment is TIFs. We are looking at business cases for TIFs with Authorities and the 2 big issues that stand out are:

1. What sort of local rate retention are you going to be able to keep? Is it just non domestic rates? Will it be new homes bonus? Will it be council tax? Because that will have a big impact on the sort of TIFs which might be brought forward and the sort of opportunities which you might be able to create. If all you are doing is being able to keep local business rates then the possibility of using a TIF and creating a TIF for schemes that have quite a high residential content will be remote.
2. Keeping the risks down on TIFs. There are certain types of opportunities where we can see that the risks for a Local Authority are actually much smaller than others. So if you took the example of infrastructure which is needed to create a shopping centre, you know broadly that when you have got unconditional consent you know that the shopping centre will be built and the rates will flow because it will probably be about 90% pre let when it's open. That is a more secure option than an office park, for example, which may take 20 years to build out and there

is no certainty on when the rates are actually going to come in.

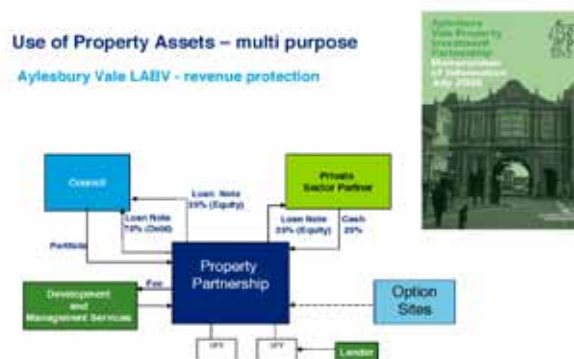
Those are some of the issues we are looking at with authorities and with funders, for example the banks and institutions, as well. Developers and many retailers are looking at opportunities again and you need to think about how are you going to smooth out those discrepancies and what sort of risks would they take on. I do think that with those types of arrangements it is not just going to be Prudential Borrowing; it's also going to be private finance as well.

With regeneration though you should not forget that there are some tried and tested routes that are still there to be used. There is the traditional joint venture option that developers will sign up to if the scheme is being well run. There are also still routes of working exclusively with one person if you really want to. They can involve transfers and options to buy back and restrictions and so forth, and they do require a large degree of trust between the two parties, so whilst we are structuring them, they are still a bit clunky at the moment.

Finally, Asset Backed Vehicles are talked about a lot but there are not actually that many of them around. They are right for certain things but not for others.

Some Case Studies

Aylesbury Vale LABV Aylesbury has some industrial estates which generate an important revenue stream but needed capital investment and intensive management to prevent that revenue falling off a cliff in a few years' time. We brought in a private sector partner. The assets, including the estates and a few others, were transferred into the vehicle. The vehicle pays back to the council in terms of interest the same amount of revenue and that is guaranteed for the next 20 years or so. That revenue is funded by the income that comes in from the assets. The surplus, over and above what goes back to the council, is then recycled through the vehicle back into the industrial estates and into development opportunities.



Bournemouth This is another vehicle that has just closed. We just advised a bid on that, an example that has been used for regeneration. The council had 20 sites, mostly car parks, across a small area of the town centre and the Authority wanted someone to sort out their car parking. They wanted better use of some car parks so that they could release others. Also

they wanted someone to improve the quality of some of the development opportunities in the town. From a private sector point of view it was an interesting opportunity because in effect the developer had first call on 20 sites over the next 20 years. They were good sites because there was quite a bit of early win, so developers were funding the upfront costs of bringing the sites forward, but because some of those sites were actually coming quickly, they were actually getting repaid back on that. I think importantly there is value capture here because it is such a small area that once the developer starts raising the quality bar and raising the values they will benefit directly from it because they are the ones who will do the other opportunities; another available tool to consider.

Bournemouth LABV – development/regeneration



Conclusion

We are very aware of the issues that are facing you in terms of cost cutting and transformational changes, and property is a fundamental and integral part of that. There are all sorts of different ways that you can use it and I think that the issue here is being aware of those and making sure you pick the right solution for what you are trying to achieve.