APPENDIX D
AGENDA ITEM No.6

AYLESBURY VALE ESTATES ANNUAL REPORT 2012-13

1 Purpose

1.1 This report provides an annual update for the Committee on the operation and performance of AVE (the Council's Joint venture partnership with Akeman LLP), whose remit is to manage and improve the commercial property portfolio which properties were originally owned by the Council but are now owned jointly by the Council and Akeman under the umbrella of AVE

2 Recommendations/for decision

2.1	That this report is noted.

3 Background

3.1 As a reminder, AVE (Aylesbury Vale Estates LLP) was incorporated in October 2009 and is owned 50/50 by the Council and Akeman LLP. The partnership is governed by a formal Membership/Partnership Agreement and an Asset Management Agreement.

3.2 **Membership Agreement** - This document sets out the main objectives:

- The constitution of the Board members
- The procedure for running board meetings
- The requirement to prepare the annual Business Plan
- Delegation of decisions between
    - Asset manager (Akeman Asset Management LLP)
    - The Board members
- The payment of interest to the Council
- Dispute Resolution
- Termination of the partnership

The Council's representation on Partnership Board consists of the Deputy Chief Executive and 2 Council Members.

3.3 **Asset Management Agreement –** this document specifies Key Performance Indicators (KPIs) in relation to how the estates are managed, and are reported to the AVE Board on a quarterly basis - indicating levels of achievement. The Asset Manager is paid a fee calculated on a proportion of portfolio value.

3.4 **Financial Structure –** Initially the financial structure put in place 2 loans from the Council. The reason for this was two-fold:
a) to de-risk the Council's income stream and
b) to enhance AVE total returns.

This structure attracted private investors. The hopeful view at that time was the UK economy and banking markets would return to some normality by the end of 2014. The financial model and long term business plan of AVE envisaged one of the loans (the short term) currently carrying an interest of 20%, paid to the Council, would be re-financed in 2014 with a new loan at around 8% coupon. The current income return target on equity is 10%p.a.

4 Internal Audit Report 2011/12

An internal audit report was issued on 12th December 2011. The audit was part of the annual Strategic Audit Plan for 2011/12 the scope of which was to give assurance that:

- Contract – the contractual agreement is being adhered to
- Governance – strategic direction of the partnership. Composition of the Board
- Objective, targets and performance – achieving the agreed aims
- Financial governance – AVE meeting their contractual obligations to the Council
- Risk management – the Council is adequately managing the partnership with the inherent risks in mind.

The internal audit report was presented to the Council's Audit committee on 18 March 2013.

5 Overview 2012 – 2013

5.1 Having spare capital at the start of the year and with other sales of non performing assets, AVE built up a reasonable amount of funds with which to buy opportunistically. During the year, after 10 months of negotiation and complex structuring, AVE completed the purchase of Hale Leys shopping centre which is a strategic holding right in the centre of Aylesbury and adjoins a major town centre regeneration site owned by the Council. The scheme had been poorly run by the previous heavily indebted owners, Warner Estates, and by the time the purchase was completed, a number of shops were already vacant or about to become so. With failures of Clinton Cards and Julian Graves, two further tenants left not long before exchange. A price reduction was negotiated to reflect their demise.

5.2 Sales have gone well with Cambridge Street, the portfolio of 5 ground rents, and Griffin Lane, all producing prices well above valuation. None of the assets sold were producing income high enough to cover their holding cost and thus each sale not only was accretive in capital terms but also helped in improving the net revenue line.

5.3 The end of year valuation showed a small reduction in the value of the portfolio. The multi let industrial assets showed the biggest reduction in valuation which was largely offset by the long leasehold ground rent holdings and the profits made from the sales and reinvestment.

5.4 The AVE portfolio continues to require constant effort, with tenant numbers and rental income remaining fairly static. AVE's priority is to retain tenants and to let vacant space. The latter has triple benefit of reducing costs, increasing income and improving value. The difficulty is finding new tenants.

5.5 The modelled sales target for 2012/13 was £535,000. However at year end actual sales totalled £3,185,120.

6 Performance highlights

Asset management Initiatives	Income collection	Business Plan	Financial Position
Refurbishment – 65% of Budget spent	Variance -2% to Budget	73% of properties refurbished	£199,059 spent
Low or no income properties sold	12 month Rental collection of 99.8%	Continue to sell low or no income properties	Sales totalled £3,153,046
Hayes Leys acquired Purchase completed in Aug 2012 for £12.5m	vacancy rate was 18.2% from 19.4%		

Key Performance Indicators
Rent Collection- The KPIs and Targets

KP Indicators	KP Target	KP Actual
3 mths - 90%	90%	96%
12 mths – 95%	95%	99.8%

The average 3 month collection rate for the portfolio over the 12 months to 31 December 2012 was 96%

The 12 month collection rate based on the rental demanded in Q4 of 2011/12 was 99%

7 Asset Management Initiatives

7.1 Refurbishment

In the 2012/13 financial year, refurbishment works were undertaken at 21 properties and 1 vacant site. Of these:

- 11 new lettings were achieved at properties on the Rabans Lane Industrial Estate and High Street retail premises in the town centre
- 1 new letting completed at the formerly vacant car park site at Ardenham Lane
- 3 lease renewals completed at units on Edison Road
- 1 freehold sale completed with vacant possession at 47 Cambridge Street.

In total, 73% of the properties refurbished were either actively let or sold on the open market.

Capital expenditure budget for 2012/13 was £307,009. Actual spend for the year was £199,059 (65% of budget spent). Capital expenditure attributed to the improvement of commercial property amounted to £164,000

7.2 Sales

Year end, sales totalled £3,153,046.

This comprised an assortment of ground lease assets, plots of land and properties with either an incumbent tenant or sold with vacant possession on the open market. These were all low or no income producing properties which were thus damaging income returns.

7.3 Acquisitions

Hale Leys Shopping Centre acquired 31 August 2012 and the majority of the sales proceeds were used to acquire this key asset together with Bank finance and a loan from the Council

8 Income collection (including levels of income lost through voids and arrears, and strategies to correct losses)

8.1 Total rent received for the financial year 2013/12 was £2,817,182, against a budget of £2,885,864 showing a small -2% variance to budget.

8.2 Akeman have managed to maintain their strong rental collection throughout the financial year 2012/2013. The 12 month collection figure of 99.8%, comfortably outperformed the 12 month KPI of 95%. Akeman remain active in their debt recovery process which has ensured that bad debts have been kept to a minimum.

8.3 The vacancy rate for the portfolio improved over the Financial Year from 19.4% to 18.2%. Further asset management initiatives are underway, as outlined above, with the view to letting more vacant units where possible.

9 Financial position – especially any significant factors

9.1 The CBRE March 2013 valuation of the core AVE portfolio was finalised at £31,632,500 which takes into account the sales that occurred during the financial year. This gave a -3.84% movement on the March 2012 valuation. The purchase valuation for Hale Leys (£12.5m) and the cash across all accounts of £2,719,709 the revised Gross Asset Valuation for March 2013 is £46,852,209.

9.2 Total debt, including third party debt, is £39,384,916 resulting in a revised Loan to Value position of 84.1%.

10 Proposed Business Plan for 2013

10.1 The main focus of AVE's portfolio for the coming year will be on:

- Maximising net operating income
- Further disposal of low yielding assets
- Overall capital structure

10.2 The next 12 months will be another difficult year for AVE which will be concentrating not only on more of the same in terms of tenant retention and letting vacant space but also on generating profits from sales of further underperforming assets which may include non strategic assets such as Buckingham Street, further ground leases, vacant sites .

10.3 High yielding opportunistic acquisitions will continue to be pursued with the view of driving the total return of the portfolio.

10.4 The coming three years covered by the 2013 draft Business Plan mark a crossroads in the structure and medium term performance of AVE. A particular focus has been placed on the restructure/repayment of the short term mezzanine loan from the Council. Discussions are on-going and AVE are working towards a solution that provides the greatest flexibility and return profile to its investors.

11 Current Position

11.1 The banking market is such that there is no current prospect of the Short term loan being refinanced as envisaged in the commercial market. However the short term loan represents expensive debt for AVE as it attracts a coupon of 20% and AVE are therefore keen to find ways to repay the debt and lift the burden of debt repayments. This can be achieved by either releasing capital through asset sales or through restructuring the loan arrangement upon the expiration of the current loan term. The Council's officers together with AVE are looking into the various options to find the solution which offers the greatest mutual benefits. Once agreed this will be recommended to Cabinet as part of the annual process of agreeing the Business Plan for AVE

12 Resource implications

12.1 The Council receives income from AVE in the form of interest on the loan notes issued to the Council on the transfer of the commercial portfolio in 2009. The position is as reported above.

12.2 Despite difficult trading conditions AVE met all of its financial obligations to Aylesbury Vale District Council under the terms of its loan agreement with the Council. This resulted in loan interest payments being made to the Council of £2.334 million.

12.3 Overall AVE returned a surplus of £253,000 on its combined operations, including a dividend of £90,000 paid to it by Hale Leys LLP, but the Board concluded that no dividend should be paid to its joint owners this year. This surplus has therefore been retained within AVE and will be used to fund future operations and new investment activity.

12.4 Hale Leys LLP also returned a small surplus on its operations in the part year from August 2012 to March 2013. Out of this surplus the aforementioned dividend of £90,000 was paid to AVE LLP as the 100% owner of Hale Leys LLP.

12.5 The trading conditions affecting the whole economy have impacted on AVE operations and growth predictions. It had been forecast when AVE was created that the value of income derived by its operations would grow in line with the whole economy and as a consequence it would have greater surpluses to distribute. In practice economic stagnation has meant the focus has largely been on retaining existing tenants and attracting new tenants where vacancies have arisen. Growing income in this environment via rent increases has been extremely challenging and as a consequence growth in the income base has not happened as predicted.   As a result whilst the income derived from loan repayment is secure the expected growth in dividends has not happened and this will impact on the Council's budget assumptions.

12.6 AVE continues to try and identify new acquisitions which will diversify and expand the income base and acquired Hale Leys, with the Council's support, in furtherance of this objective. It has also focused on investment in the existing portfolio to retain and attract new tenants whilst at the same on increasing efficiency in its operations. Inefficient assets have have been sold with the intention of reinvesting the receipts in higher yielding investments.

12.7 As the economy slowly moves out of stagnation it is hoped that the trading position will gradually ease and the expected growth in income will begin to materialise.

13 Response to Key Aims and Objectives

13.1 The formation of AVE supports the Corporate Plan objective of keeping any Council Tax increases to a minimum. It also assists in the promotion and development of the local economy and provides environmental benefits through the modernisation and improvement of the commercial property portfolio.

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