AYLESBURY VALE ESTATES BUSINESS PLAN 2013-14

1 Purpose

1.1 To give the Committee an opportunity to consider a draft Business Plan prepared by Aylesbury Vale Estates LLP (AVE) for the 2013-14 financial year and pass their comments onto Cabinet.

2 Recommendations/For Decision

2.1 Whether the Committee wishes to make any comments on the draft Business Plans at Appendices 1 & 2 (appendix 2 contains the business plan for the AVE subsidiary company Hale Leys LLP), with supporting documentation in appendices 3 and 4, for consideration by Cabinet.

3 Supporting information

3.1 As the Committee will be aware, the Council and the Akeman Partnership LLP (Akeman) set up AVE in October 2009, following a competitive dialogue procurement, to manage, improve and develop the Council's commercial property portfolio and provide an income stream to the Council. The partnership is governed by a formal Members' Agreement and managed by a partnership board on which

3.1 the Council has 3 representatives. Akeman produced a draft Partnership Business Plan for AVE as part of their bid, which was approved by the Cabinet in June 2009. The final version of the Plan formed part of the completion documentation approved in October 2009. The Board meets on a regular basis to review progress on the Business Plan and monitor performance of the Asset Manager, Akeman Asset Management LLP.

3.2 The Members' Agreement provides for AVE to prepare a new Business Plan before the end of their accounting year (which now mirrors the Council's financial year) and circulate this to the Council and Akeman for approval. The Agreement also provides that the Council and Akeman will use all reasonable endeavours to agree the Business Plan within 90 working days. A draft plan was first presented to the Partnership Board at their meeting on 4th April but, due to the significant implications the proposed plan will have, on AVDC finances, it was decided to refine it at subsequent Board meetings and in discussion with AVDC officers and delay submitting it to Akeman and AVDC. The Board agreed to recommend the draft plan for approval at its meeting on 1st August. Following consideration by this Committee the draft Plan, together the Committee's comments will be reported to Cabinet on 22nd October.

3.3 The Members' Agreement requires the Business Plan to set out AVE's objectives for the life of the Partnership (i.e.20 years) and the annual overarching objectives for each accounting period. In particular the Plan must include a statement that AVE's business shall be operated with a view to producing the best risk adjusted profit obtainable and to maximise the risk adjusted rate of return to the Council and Akeman. Subject to agreement between AVE, Akeman and the Council the Plan is also expected to include the following matters (based on a 3 year projection where appropriate):-

- Strategic business objectives and targets
- Gross and net rental income projections, including assessment of operating costs, rental voids, rent arrears and any other losses and receipts
- Annual portfolio valuation prepared to a standard acceptable for AVDC financial reporting purposes
- Confirmation that the financial covenants regarding loan to value and interest cover are being maintained
- Projections of estimated receivable rent and confirmation of compliance with maintaining portfolio income levels
- Proposals for working capital budget, any new capital investments and reinvestments plus any distributions to partners
- Performance against key indicators and targets indicate levels of achievement.

3.4 The draft Business Plan tabled at the Board meeting in April and attached as confidential Appendix 1, was accompanied by an Asset Management Strategy and detailed plan for each portfolio asset. The Asset Strategy is included as confidential Appendix 3. A three year ahead budget forecast is also attached as confidential Appendix 4.

3.5 During the 2012-13 financial year, AVE purchased the Hale Leys shopping centre, creating a separate special purpose vehicle Hale Leys LLP to own and manage the centre. By value, the shopping centre makes up about a quarter of the total portfolio value of AVE, hence it has its own dedicated business plan, attached at Appendix 2.

3.6 Once approved the Partnership Business Plan provides the framework within which the Partnership Board works, similar in effect to the Budget and Policy Framework set by Full Council for the Cabinet. Accordingly if the Board wish pursue any substantive action which is not provided for in the Business Plan they must obtain specific authority from the Council (either by a Cabinet or Cabinet member decision) and Akeman. The Committee are therefore invited to consider and comment on the draft Plan.

4 Analysis and summary of key issues in the business plan

4.1 This is a critical point in the future of AVE, and its relationship with the Council which is why the plan has been in development for so many months, and hence was not available to be presented to the Committee alongside the review of previous year's performance back in June. From October 2014, as per the original Members Agreement, AVE is permitted to repay in full the mezzanine loan provided to it by AVDC. Doing so will have beneficial consequences for AVE (which, as a 50% shareholder, the Council will benefit from) but shorter-term detrimental consequences to the Council's general revenue budget.

4.2 When AVE was created in 2009, the country was in the early stages of the current recession. In those economic conditions, the Council and AVE could see that short-term commercial rental income projections due back from the portfolio were declining below those which the Council had made provision for in its general revenue budget. Consequently, to minimise the impact on the

Council's general revenue budget, the Council and AVE agreed a loan structure to cover the purchase of the portfolio, made up of:

- 75% senior debt loan lasting 20 years at relatively low interest rates, alongside
- a five year 10% mezzanine debt at very high 20% interest rate.
- (The remaining financing of the purchase was achieved through equity)

4.3 The combination of these two loan note repayments would, over the initial five years of the partnership, broadly provide the Council with its predicted returns from its commercial property portfolio. A five year term for the mezzanine loan was agreed on as it was believed at the time that by 2014, the commercial property recession might largely be over, and the portfolio rental income should have grown back to a point where dividend income returns to the council could replace the loan income derived from this mezzanine debt.

4.4 As we all now know, the recession has been longer and deeper than was widely expected at that time. With the exception of the purchase of Hale Leys, portfolio growth has been minimal and the level of empty property voids is only slightly lower than when the council directly managed the portfolio. Additionally, the Government legislated a few years ago to remove business rate rebates for empty properties. This has reduced annual cashflow to the partnership to the tune of around a quarter of a million pounds each year from that predicted in the original business plan. The upshot is that AVE has not been able to make dividend payments to its shareholders for several years.

4.5 From AVE's perspective, the mezzanine loan note is at a cripplingly high rate of interest, and it makes absolute commercial sense to repay this at the earliest opportunity. It has not provided possible (and this will continue to be the case for some time) for the company to identify alternative asset acquisitions providing relatively secure income at sufficient rates of return to cover the cost of loan repayments at such high levels of interest. Repaying the mezzanine debt in full will improve the company's cashflow by around £700k per annum, allowing it to finally start to generate dividend returns to all its investors, including the Council. It will also allow the company to begin to grow the portfolio through further asset acquisitions, generating further rental income to all shareholders over time.

4.6 From the Council's perspective, AVE's repayment of the mezzanine loan will generate a sizeable capital receipt but will leave a sizeable hole in the Council's revenue budget in the short term, as the loan repayments would cease in October 2014 but the benefits accruing from the knock-on improvement in the company's cashflow will grow gradually thereafter.

4.7 The Council has held negotiations with AVE to identify whether this short-term revenue impact could be mitigated by AVE renewing a loan, perhaps at lower current commercial rates of interest, or at a different level, or even varying the rate of amortisation of the senior debt. At the time of writing, those negotiations are continuing, though it is unlikely that AVE would be able or willing to take out a further loan from the council to part-finance an asset acquisition unless it was at commercial market rate commensurate with other senior debt.

4.8 This is because the Board and private sector investors in the company believe that, given the current levels of void premises in the portfolio, it would be prudent to avoid investment into further fragile and short-term income. It is therefore the plan to only pursue assets with an income profile that will enhance the average for the portfolio, i.e. longer leases than the current mean lease length. This more secure income will balance the high income short leases AVE currently holds and help even out any nasty shocks from tenant failures elsewhere.

4.9 A key plank of this business plan is therefore for the company to continue to pursue a policy of disposal of non-strategic assets generating low returns (principally long ground leases), in order to accumulate sufficient capital to repay the mezzanine loan in full at the earliest opportunity in October 2014. Further than this, the company intends to generate surplus cash than that strictly needed to repay the mezzanine debt, in order to pursue this policy of asset acquisitions to risk balance the portfolio in the manner described above.

5 Resource implications

5.1 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. The Partnership Business Plan confirms that AVE is maintaining and will continue to maintain its financial covenants and interest payments.

5.2 The impact of the proposed repayment of mezzanine loan to the Council and the knock-on growth in dividend income is covered above and set out in more detail over the next three years in appendix 4. The potential for a further loan to be made to AVE is still being negotiated, and any such further loan proposal would be brought to full Council for consideration.

6 Response to Key Aims and Objectives

6.1 The formation of AVE supports the Corporate Plan objective of helping companies find suitable premises in the Vale, as well as the objective of keeping council tax increases to a minimum.

Contact Officer	Jon McGinty x5251
Background Documents	AVE Annual Report 2012-13 – Report to Economy Scrutiny Committee June 2013