WEST LONDON WASTE AUTHORITY

Report of the Managing Director and Treasurer 23 June 2017

**Head Office Relocation**


**SUMMARY**

This report details the preferred option of buying a new head office before the current one is demolished.


**RECOMMENDATION(S)**

The Authority is asked to:-

1) Authorise the Managing Director together with the Treasurer and in consultation with the Chair to procure a new head office.

2) Authorise a capital budget of £2.5 million for the purchase and all associated costs

3) Note the need to use expertise of commercial property agents, solicitors, refurbishment contractors and other specialists to secure and deliver suitable head office accommodation.

## 1. Background

The Authority’s head office has been located in the Hounslow Council offices since 2012 and is the base for a limited number of Authority personnel (currently 13 people). The Council provide fully serviced accommodation including open plan working areas, two offices, a meeting room, a wide range of facilities and office services (e.g. post, cleaning etc.), storage, parking and technology/infrastructure.

The accommodation is rented under a short term lease arrangement. This expires in June 2018 and coincides with Hounslow Council’s plans to demolish and redevelop the office site for housing. Therefore the Authority will require a new head office.

## 2. Executive Summary

The report provides analysis and commentary which identifies the following conclusions:

- The best financial option is for the Authority to purchase its own office. The Authority will benefit from lower annual running costs compared to renting and will also benefit from the ownership of a valuable asset
- The limited supply and high demand in the market means that the Authority needs to be able to make decisions robustly and quickly. To facilitate this and comply with the Authorities procurement rules, the report recommends delegating authority for decision making to the Managing Director together with the Treasurer and in consultation with the Chair
- To ensure staff retention, the location should be in close proximity / travelling distance of the current head office
- Based on current market information a capital budget of £2.5 million will deliver the above and require Authority approval

These conclusions are detailed in subsequent sections of this report.

## 3. Financial Evaluation of Options

Currently the Authority benefits from fully serviced office space through a short term lease arrangement with a fixed annual rental of £40,000 per year, utilising Hounslow Council's spare office capacity. However, with the demolition of the current head office expected to take place in 2018, the Authority needs to find a new head office.

There are 3 principal options for securing a new head office:

- Fully serviced renting (similar to current arrangements) – the rental of office space which includes the delivery of a range of services including cleaning, reception etc.
- Accommodation only renting with in house service delivery – the rental of just the office space together with employment of contractors or staff to deliver services
- Purchase with in house service delivery – buying the property out-right either as a freehold or through a long lease together with employment of contractors or staff to deliver services

Appendix 1 provides a financial evaluation of these alternatives. Long term cashflows have been produced for the 3 options to identify the lowest overall cost option.

To do this, the prices currently available in the market have been gathered for each option to inform the average rent and average purchase price figures (Appendix 2). The average price per square foot has then been calculated and used to estimate the cost of our specific office requirements (i.e. 2,000 square feet). The service costs are based on 2017/18 budgeted prices for similar services at Twyford.

The following table summarises the net cashflows over 20 years for each option:

| **Option** | **Running costs over 20 years** | **Cashflow over 20 years** |
|---|---|---|
| 1 - Fully serviced rent | £3.7 million | £3.7 million |
| 2 - Accommodation only rent plus separate services | £3.4 million | £3.4 million |
| 3 - Purchase plus separate services | £2.4 million | £1.8 million |

The table shows that purchasing has lower running costs compared to renting, by more than £1 million over 20 years (i.e. £2.4 million compared to £3.4 million). This equates to purchasing being an average of £50,000 per year cheaper than renting.

If the property is sold at the end of 20 years after a modest growth in value of 2% per year, this would result in further improvement to the purchase option cashflow.

Essentially the above table illustrates a very simple principle – if you rent, you pay a significant sum every year and have nothing to show at the end of it, the money is spent. If you buy, although you spend money up front, you have an asset which has a value at the end.

The analysis clearly identifies that the lowest cost option is to purchase. There is little difference between the rented options which are both costlier.

## 4. Supply and Market Conditions

As well as carrying out in-house market research, market information was sought. GVA, one of our surveyors, recommended the use of an agent with local knowledge, De Souza, who we approached.

De Souza provided a range of property particulars. They also commented:

- That the market around Hounslow for purchase is very limited and competitive, particularly given that our size requirements are similar to small developers who convert offices into residential accommodation – a result of permitted development rights and a key driver of demand.

- Basic rented accommodation is also limited and often of low quality.
- Fully serviced accommodation is however abundant but costly.
- It would be highly unlikely for properties to come to the market with a very good match to our requirements for purchase and rented accommodation e.g. they would be bigger/smaller or require work etc.

Our in-house market research of commercial property agent websites produced the same findings. A summary of the sample used to determine the average rents and average prices for the financial evaluation in section 3 can be found in appendix 2. Although some properties are far from ideal, they help provide a picture of the types of costs involved.

The sample identified that purchasing a head office meeting the current space requirements would cost in the region of £1.8 million to purchase and refurbish with £100,000 annual running costs. The sample identified renting would on average cost between £140,000 to £150,000 per year.

Given the market conditions of limited supply and high demand, it will be challenging to identify and relocate to new offices by June 2018. There are two implications of this:

Firstly as a contingency, it may be necessary to utilise one of the short term rental options until permanent offices can be secured. There may also be an opportunity to extend our arrangement with Hounslow Council for a short period of time, if their redevelopment programme allows. This can be included as part of the 2018/19 budget setting process.

Secondly, any delay to decision making could lead to a missed opportunity as sellers are often looking for a quick sale. Therefore a robust and quick decision making process is needed. With up to 3 months separating Authority meetings, this may be better achieved by delegation of authority to the Managing Director and the Treasurer in consultation with the Chair within specified limits and on the basis of a recommendation and supporting information (surveyors report, legal advice, financial evaluation etc.) from the Head of Finance.

## 5. Risks

Whether renting or buying, it is important to consider the key financial risks. The principal risk in relation to renting is an increase in rent. The principal risk in relation to buying a new head office is a fall in the property value.

Interestingly the risks of both options are largely determined by supply and demand of office space and helpfully these have differing impacts and consequently point to a preferred option.

The London Councils briefing on the *Impact of permitted development rights*[*] confirms agents' comments and our research, showing low supply and high demand for office space, resulting from permitted development rights - this legislation was introduced in 2013 (updated in 2016) and amongst many things included the opportunity to far more easily convert offices into residential accommodation.

The briefing highlights the resulting increasing rents. Indeed our own rent review negotiation with network rail for the transfer stations is currently looking at a 5 yearly rent increase of at least 30%. This equates to a 6% annual increase in rents.

Conversely, low supply and high demand reduces the risk of office values falling. In fact, market commentary forecasts growing commercial property values.

Therefore on balance, given that the market conditions of high demand and low supply increase the risk of renting (i.e. rent increases) but reduce the risk of buying (less chance of loss in value), buying a new head office is the preferred option.

## 6. Funding

Current cash balances stand at over £20 million with treasury management activities delivering a return of about 0.5% on investments. The latest long term financial forecasts predict cash balances will rise to over £40 million within 10 years largely as a result of the PPP contract / project.

Therefore at these low rates of return, using cash to fund new offices will utilise cash more effectively. It is very likely that the property will grow in value particularly given the correlation to residential development highlighted in sections 3 and 5 and recent market forecasts e.g. Savills predict 12% over the next 5 years for Hounslow. This would represent a far better return than currently achieved and help deliver an aim of the treasury management plans, to achieve a better return on balances.

With latest long term forecasts indicating Authority cash balances rising above £40 million, buying an office would use just 5% of the overall cash balances, ensuring ample liquidity is still maintained to manage other business risks.

## 7. Budget implications

The Authority will be able to utilise its cash balances to procure new offices. However, the purchase of new offices still requires the Authority's approval of a capital budget in order to undertake this spending, in accordance with the Financial Regulations.

The budget will include the cost of bringing the office into operation so includes cost of works, agents, solicitors etc. With the overall current prices of reasonably suitable offices ranging from £1.1 million to £2.5 million including refurbishment, a working budget of £2.5m will allow the flexibility to secure suitable accommodation in a challenging market and meet the range of objectives detailed in preceding sections.

There are no immediate budget implications for rental options. If necessary (e.g. as a temporary measure), the 2018/19 budget setting process will incorporate any temporary rental and service requirements costs, detailing any change or growth.

The only other budget implication to note is that like all other assets, there will be an annual depreciation charge to the income and expenditure account to reflect the usage throughout its life. All depreciation charges are passed on to boroughs in the usual way through the levies to ensure a balanced budget.

## 8. Employees

With the small number of personnel that the Authority employ, staff retention is a key consideration. Given the number of head office staff changes over recent years it is particularly important to hold on to the remaining personnel, their knowledge and experience.

The main elements for staff retention from an employee perspective are the location and working arrangements.

The current head office location provides a central and convenient location which most staff are happy to continue working near.

Appendix 3 provides a location map of personnel. The majority of operational personnel are concentrated around West Hounslow. At these grades the location and commute times/cost are a key concern for personnel. Indeed, a staff survey 2 years ago considering a move of head office from Hounslow to Ealing, indicated overwhelmingly that there was no appetite for a move away from the Hounslow area. It is unlikely this has changed. There are a few outliers who are mainly from management where location is less of a concern.

Interestingly, comparing the current prices across several areas (Ealing, Harrow, Hounslow, Richmond and Heathrow) indicated that office properties within the Heathrow area were the cheapest (£370 per sq ft) with Hounslow second cheapest (£424 per sq ft) followed by Harrow and other areas (from £451 to £580 per sq ft). Therefore focussing the search on a 3 mile radius of the current office will cover both the cheapest areas and is likely to ensure best staff retention.

In terms of working arrangements, there are a range of issues:

- Space - whilst some flexible working arrangements (e.g. home working/desk sharing) may be possible and the staff to desk ratio can be improved to reduce space requirements, due to the nature of work and technological limitations the scope is limited. Parking is also an important factor for employees and once again with flexible working there is a possibility to reduce the requirements. However, in broad terms the same office space and parking facilities will be required.

- Services – The condition and services (e.g. maintenance, cleaning, storage, security, reception, post etc.) are also important issues for personnel and are also an essential part of business operations. Continuity of these services will need to be maintained as part of any new accommodation agreement or separately through contractors or employees. Essentially the new accommodation and services should meet the current standard delivered by Hounslow Council.

## 9. Conclusion

In summary:

- The preferred option is to purchase as it's the best financially
- The new office may need work or be bigger and take longer to move into because of poor supply
- It may be necessary to rent elsewhere in the short term if suitable offices cannot be procured relatively quickly
- Purchasing an office provides an opportunity to better utilise cash balances
- The office search will focus on a 3 mile radius of the current office for staff retention purposes

There are a range of variables to manage within this decision making. Importantly the Authority needs to be in a position to take advantage of market opportunities as they arise. The decision making also has to be robust. Therefore the report recommends the delegation of this authority to the Managing Director and Treasurer in consultation with the Chair.

To limit the risk in relation to purchase, the delegated authority should be limited to £2.5m based on current market prices to provide a little flexibility in a difficult market.

10. **Financial Implications** – These are detailed in the report.

11. **Legal Implications** – There are no legal implications as a result of this report**.** Legal issues regarding change of head office location will be dealt with as part of the subsequent relocation project.

12. **Impact on Joint Waste Management Strategy** – Improvements to financial management in the Authority will continue to ensure that the Authority addresses policies of the JWMS.


| | | |
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*Reference material*

**http://www.londoncouncils.gov.uk/our-key-themes/housing-and-planning/permitted-development-rights*

**Appendix 1**

## Office options - high level cashflows

| | | Total | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 | Year 8 | Year 9 | Year 10 | Year 11 | Year 12 | Year 13 | Year 14 | Year 15 | Year 16 | Year 17 | Year 18 | Year 19 | Year 20 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Option 1 - fully serviced rental - current approach** | | | | | | | | | | | | | | | | | | | | | | |
| Rent (inclusive of services and rates) | RPI uplift (2%) | | -148,000 | -150,960 | -153,979 | -157,059 | -160,200 | -163,404 | -166,672 | -170,005 | -173,406 | -176,874 | -180,411 | -184,019 | -187,700 | -191,454 | -195,283 | -199,189 | -203,172 | -207,236 | -211,380 | -215,608 |
| Incidental costs | RPI uplift (2%) | | -5,000 | -5,100 | -5,202 | -5,306 | -5,412 | -5,520 | -5,631 | -5,743 | -5,858 | -5,975 | -6,095 | -6,217 | -6,341 | -6,468 | -6,597 | -6,729 | -6,864 | -7,001 | -7,141 | -7,284 |
| Total cashflow / running cost | | -3,717,498 | -153,000 | -156,060 | -159,181 | -162,365 | -165,612 | -168,924 | -172,303 | -175,749 | -179,264 | -182,849 | -186,506 | -190,236 | -194,041 | -197,922 | -201,880 | -205,918 | -210,036 | -214,237 | -218,522 | -222,892 |
| **Option 2 - accomodation only rental or short leasehold plus services** | | | | | | | | | | | | | | | | | | | | | | |
| Rent | RPI uplift (2%) | | -51,000 | -52,020 | -53,060 | -54,122 | -55,204 | -56,308 | -57,434 | -58,583 | -59,755 | -60,950 | -62,169 | -63,412 | -64,680 | -65,974 | -67,293 | -68,639 | -70,012 | -71,412 | -72,841 | -74,297 |
| Rates | RPI uplift (2%) | | -25,000 | -25,500 | -26,010 | -26,530 | -27,061 | -27,602 | -28,154 | -28,717 | -29,291 | -29,877 | -30,475 | -31,084 | -31,706 | -32,340 | -32,987 | -33,647 | -34,320 | -35,006 | -35,706 | -36,420 |
| Running costs | RPI uplift (2%) | | -65,000 | -66,300 | -67,626 | -68,979 | -70,358 | -71,765 | -73,201 | -74,665 | -76,158 | -77,681 | -79,235 | -80,819 | -82,436 | -84,084 | -85,766 | -87,481 | -89,231 | -91,016 | -92,836 | -94,693 |
| Total cashflow / running cost | | -3,425,929 | -141,000 | -143,820 | -146,696 | -149,630 | -152,623 | -155,675 | -158,789 | -161,965 | -165,204 | -168,508 | -171,878 | -175,316 | -178,822 | -182,399 | -186,047 | -189,767 | -193,563 | -197,434 | -201,383 | -205,410 |
| **Option 3 - purchase plus services** | | | | | | | | | | | | | | | | | | | | | | |
| Purchase price (freehold or long leasehold) | | | -1,525,000 | | | | | | | | | | | | | | | | | | | |
| Asset value at end of term (assume 2% pa growth) | | | | | | | | | | | | | | | | | | | | | | 2,266,070 |
| Refurbish costs | | | -250,000 | | | | | | | | | | | | | | | | | | | |
| Lost investment income @0.5% | fixed | | -8,875 | -8,875 | -8,875 | -8,875 | -8,875 | -8,875 | -8,875 | -8,875 | -8,875 | -8,875 | -8,875 | -8,875 | -8,875 | -8,875 | -8,875 | -8,875 | -8,875 | -8,875 | -8,875 | -8,875 |
| Rates | RPI uplift (2%) | | -25,000 | -25,500 | -26,010 | -26,530 | -27,061 | -27,602 | -28,154 | -28,717 | -29,291 | -29,877 | -30,475 | -31,084 | -31,706 | -32,340 | -32,987 | -33,647 | -34,320 | -35,006 | -35,706 | -36,420 |
| Running costs | RPI uplift (2%) | | -65,000 | -66,300 | -67,626 | -68,979 | -70,358 | -71,765 | -73,201 | -74,665 | -76,158 | -77,681 | -79,235 | -80,819 | -82,436 | -84,084 | -85,766 | -87,481 | -89,231 | -91,016 | -92,836 | -94,693 |
| Total cashflow | | -1,873,194 | -1,873,875 | -100,675 | -102,511 | -104,384 | -106,294 | -108,242 | -110,230 | -112,257 | -114,324 | -116,433 | -118,584 | -120,779 | -123,017 | -125,300 | -127,628 | -130,003 | -132,426 | -134,897 | -137,417 | 2,126,082 |
| Total running cost | | -2,364,263 | -98,875 | -100,675 | -102,511 | -104,384 | -106,294 | -108,242 | -110,230 | -112,257 | -114,324 | -116,433 | -118,584 | -120,779 | -123,017 | -125,300 | -127,628 | -130,003 | -132,426 | -134,897 | -137,417 | -139,988 |

Appendix 2

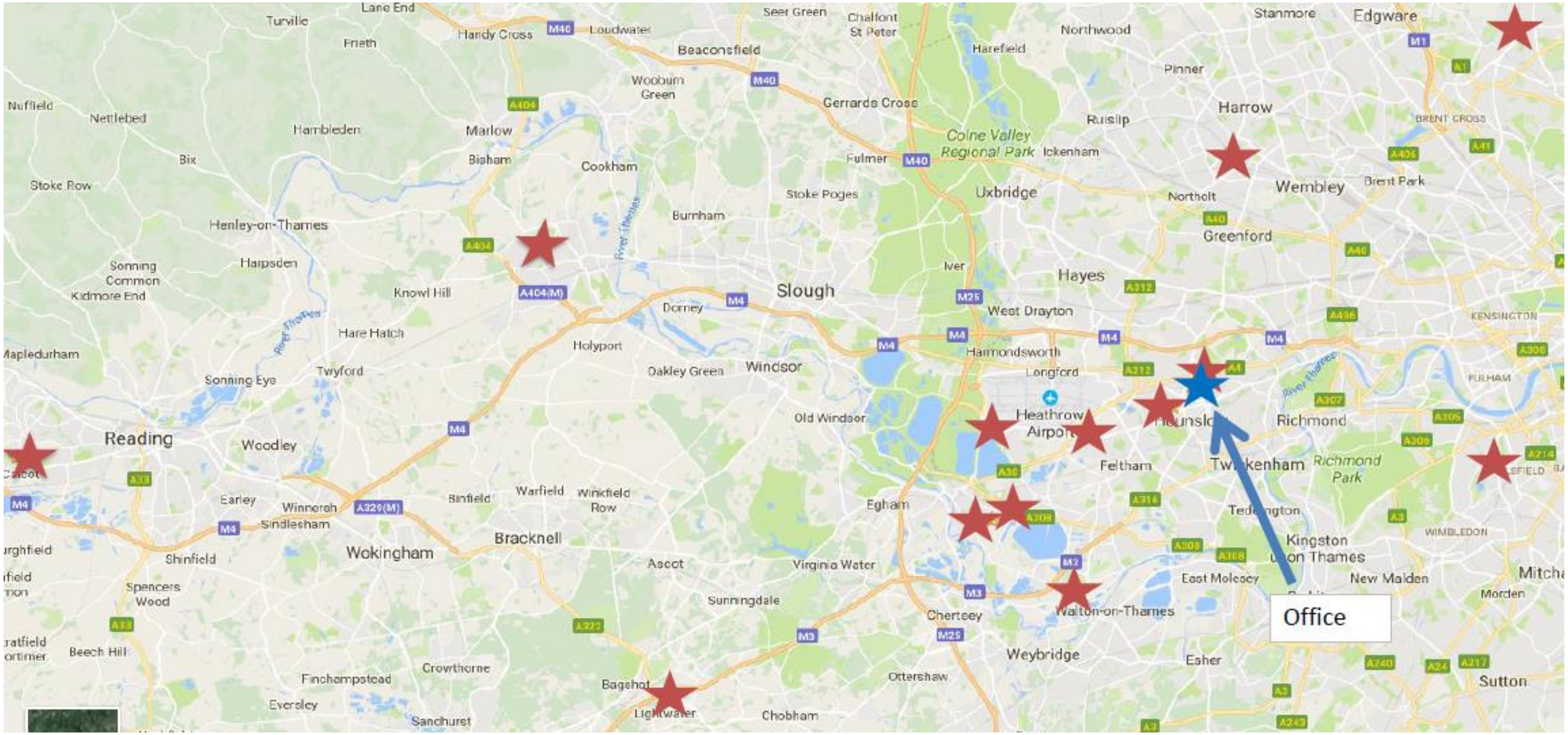
# Market Information

| Serviced accomodation | Provider | Details | 2000sq ft | Rates | Services | Total | | | |
|---|---|---|---|---|---|---|---|---|---|
| Heathrow and Hounslow | Regus | fully serviced 61 m2 = 656 ft sq for £4579 pm = annually | 167,524 | 0 | 0 | 167,524 | | | |
| Vista Centre heathrow | FlexiOffices | partly serviced 1050 ft sq for £3500 pm = annually | 106,600 | 25,000 | 0 | 131,600 | | | |
| Salisbury Rd, Hounslow | SearchOfficeSpace | Up to 7000 ft sq with 480 ft sq for £2784pm | 139,200 | 0 | 20,000 | 159,200 | | | |
| TW15, Ashford | SearchOfficeSpace | Up to 7000 ft sq with 480 ft sq for £3072pm | 153,600 | 0 | 10,000 | 163,600 | | | |
| Civic Centre | Hounslow Council | partly serviced @ £50 per sq ft | 100,000 | 0 | 20,000 | 120,000 | | | |
| **Average** | | | | | | **148,385** | | | **148,000** |

| Rented accomodation | Agent | Details | 2000sq ft | Rates | Services | Total | | | |
|---|---|---|---|---|---|---|---|---|---|
| Brentford | Workspace | 767 ft sq for £1300pm | 53,278 | 25,000 | 65,000 | 143,278 | | | |
| Fiveways, Feltham | Snellar Commercial | 1555 ft sq for £43500 pa | 55,949 | 25,000 | 65,000 | 145,949 | | | |
| Holdsworth Hs, Hounslow | Vokins | 2900 ft sq for £40600pa | 40,600 | 25,000 | 65,000 | 130,600 | | | |
| Heathrow | Knight Frank | Up to 20000 ft sq at £33.5 psqft | 67,000 | 16,000 | 65,000 | 148,000 | | | |
| **Average** | | | | | | **141,957** | -90,000 | 51,957 | **51,000** |

| Purchase | Agent | Sq ft | Price | Refurb | Total | | | |
|---|---|---|---|---|---|---|---|---|
| Hamworth Rd, Hounslow | Vokins | 5,700 | 2,170,000 | 250,000 | 2,420,000 | | | |
| High St, Feltham | Milestone | 2,540 | 1,030,000 | 250,000 | 1,280,000 | | | |
| Vicarage Rd, Teddington | Milestone | 3,957 | 2,000,000 | 250,000 | 2,250,000 | | | |
| Britannia Hs, W Drayton | Rose Williams | 2,688 | 900,000 | 250,000 | 1,150,000 | | | |
| **Average** | | | | | **1,775,000** | -250,000 | 1,525,000 | **1,525,000** |

**Appendix 3**



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