



REPORT TO: ECONOMIC DEVELOPMENT AND INFRASTRUCTURE SERVICES COMMITTEE ON 14 NOVEMBER 2023

SUBJECT: INDUSTRIAL PORTFOLIO ANNUAL REPORT 2022/23

BY: DEPUTE CHIEF EXECUTIVE (ECONOMY, ENVIRONMENT AND FINANCE)

1. REASON FOR REPORT

- 1.1 This report sets out the annual performance of the Council's Industrial Portfolio in 2022/23 and seeks approval in principle for a related sale of property.
- 1.2 This report is submitted to the Committee in terms of Section III A (3) of the Council's Scheme of Administration relating to the acquisition or sale of property up to a value of £100,000.

2. RECOMMENDATION

2.1 It is recommended that the Committee:-

- (i) considers and notes the Annual Report for 2022/23;**
- (ii) welcomes the good performance of the Council's Industrial Portfolio; and**
- (iii) agrees in principle to the sale of the property in Lossiemouth as detailed in paragraph 6.3 of this report.**

3. BACKGROUND

- 3.1 The Council's industrial portfolio comprises a range of industrial land and buildings throughout Moray including all of the principal settlements. At 31 March 2023, the Council's industrial portfolio comprised 174 industrial buildings with a total floor area of 29,664m²; 130 development and ground leases with a total site area of 21.81 hectares and a stock of serviced and unserviced land for future development totalling 18.6 hectares. The distribution of industrial buildings, industrial sites and development land in Moray is detailed in **APPENDIX I**.

- 3.2 Annual reports have been presented to Committee since 2002; the last report was presented to the Economic Development and Infrastructure Committee on 6 September 2022 as an information report. This report is submitted as the Council's Annual Industrial Portfolio Report for 2022/23, providing a summary of the portfolio's performance and main issues, but is on the main agenda given recommendation (iii).

4. **PERFORMANCE**

Rental Income

- 4.1 The total gross rental income for the past 6 years is set out below:-

2017/2018	£1,756,000
2018/2019	£1,930,000
2019/2020	£1,954,000
2020/2021	£1,940,000
2021/2022	£2,066,000
2022/2023	£2,085,000

- 4.2 Rental income was impacted by the Covid lockdown in 2020/21 and there was considerable uncertainty over the medium/long term impact on the portfolio. However, the portfolio has recovered well and rental income continues to grow – increasing by £19,000 in 2022/23 and exceeding the target of £2,023,000 by £62,000. Rental growth in 2022/23 was restricted by the sale of properties and difficulties encountered by a number of tenants that survived the Covid lockdowns, but did not fully recover, resulting in more turnover of tenants than usual.
- 4.3 The portfolio's annual income has increased by £895,000 over the last 10 years and **APPENDIX II** illustrates the gross rental income generated by the industrial portfolio over the period 2012/13 to 2022/23.
- 4.4 The net rental income after deduction of property running costs, staff, administrative and capital financing costs in 2021/22 was £1,390,000. This is a decrease of £30,000 from 2021/22 - due to cost increases including staff wages, energy costs, non-domestic rates costs and greater use of external solicitors due to in house staff shortages. **APPENDIX II** illustrates the net rental income generated by the industrial portfolio over the period this has been recorded - 2013/14 to 2022/23.
- 4.5 It is very difficult to compare the rental of the industrial portfolio objectively over a number of years as its composition changes due to the sale of properties, addition of new properties and the refurbishment and repair of existing properties. However, **APPENDIX III** demonstrates how increases in rental achieved at rent review for industrial premises (3 yearly rent reviews) and for industrial sites (5 yearly rent reviews) compare to the Consumer Prices Index (CPI) over the corresponding periods. 2022/23 was the first year recorded that the rise in the CPI outstripped rents, reflecting a dramatic increase in the CPI.

Debt

- 4.6 Debt increased significantly due to the impact of the coronavirus on tenants and the Estates team has deployed considerable resources (working corporately with Legal Services and Finance) to work with tenants to minimise arrears. A range of measures are used to safeguard the Council's interests if discussions with tenants fail to reach satisfactory outcomes.
- 4.7 Progress has been made and the level of rent/insurance arrears was 4.42% at 31 March 2023, down from 6.71% at 31 March 2021.

The % debt on this basis for the last six years is as set out below:-

2017/18 - 4.66%
2018/19 - 6.99%
2019/20 - 7.06%
2020/21 - 8.7%
2021/22 - 6.71%
2022/23 - 4.42%

Occupancy

- 4.8 The occupancy levels of Council industrial buildings in recent years are set out below:-

Year	% of floorspace occupied	% of buildings occupied
2017/18	94.4%	92.7%
2018/19	83.57%*	93.18%
2019/20	93.54%	95.48%
2020/21	88.84%	93.71%
2021/22	92.45%	92.57%
2022/23	90.19%	88.51%

* The floor area occupancy figures for 2018/19 were skewed as a result of the former sawmill at Waterford Circle in Forres (which was by far the largest in the portfolio) becoming vacant.

- 4.9 At 31 March 2023 the occupancy rate in terms of buildings occupied was 88.51% compared to the target of 80%.
- 4.10 As stated at paragraph 4.2 above there was more turnover of tenants than usual in 2022/23 due to difficulties encountered by a number of tenants that survived the Covid lockdowns, but did not fully recover.

Capital Receipts

- 4.11 The sale of industrial land and buildings has generated capital receipts to the Council over the past 6 years as follows:-

2017/18 -	£70,500
2018/19 -	£0
2019/20 -	£417,000
2020/21 -	£605,250
2021/22 -	£23,900
2022-23 -	£320,125

- 4.12 The following properties, which were identified in the 2021/22 annual review of the portfolio as suitable for sale, were disposed of in 2022/23 - 2 Dufftown Industrial Estate, 9 Linkwood Place, Elgin and Land at March Road West, Buckie.

Development

- 4.13 In recent years the Council has invested in general upgrading works to the Industrial Portfolio to ensure the properties remain responsive to future business needs. During 2022/23, the Council invested £67,000 of revenue and £39,000 of capital in the Industrial Portfolio and in supporting industrial development across Moray through a range of projects including roof repairs, electrical repairs/upgrades, new fencing, new doors, foul water repairs/upgrades, estate road repairs, exterior painting and design work to create new yards for let.
- 4.14 Refurbishment works ensure properties continue to meet business needs and safeguard future rental income. Officers will continue to work with tenants on the most appropriate ways to deliver improvements to properties, including agreeing where appropriate for tenants to do works in return for commensurate temporary reductions in rental, or capital payments.
- 4.15 Whilst the revenue repairs budget is sufficient at present to meet ongoing repairs and maintenance needs, as the portfolio expands and the newer units age, there will likely be a future requirement to increase the revenue repairs budget.

5. TRENDS AND CHALLENGES

Coronavirus

- 5.1 The coronavirus pandemic and associated restrictions had adverse impacts on the majority of tenants. All bar a few suspended trading during the first national lockdown from 23 March 2020 until mid July 2020 and many continued to experience trading difficulties thereafter.
- 5.2 The level of rental debt increased significantly during the first lockdown and officers worked closely with tenants to agree phased repayments. As shown at paragraph 4.7 above, the portfolio's debt has reduced, as most tenants managed to make phased repayments. Officers have closely monitored the impact of the phasing out of government Covid support packages and continued to work closely with a number of tenants struggling to recover.
- 5.3 There was a greater level of lease terminations than usual in 2022/23 which was partly due to tenants who failed to fully recover from Covid ceasing to trade.

Economy

- 5.4 There is continuing global and national uncertainty surrounding the war in Ukraine and recovery from the Covid-19 pandemic. Despite nationally low growth and high inflation, the Moray commercial property market is considered to be currently stable, but officers will continue to monitor closely any impacts on local businesses and knock on effects for the industrial portfolio. Fears of weaker demand, increased voids, increased debt levels and pressure on rents have so far not materialised locally - there is currently good demand for units and rentals have continued to increase.

Supply of Properties

- 5.5 Although for decades there has been very little private sector provision of industrial property to let in Moray, 36 units for speculative let were completed by private developers in Elgin in the last 3 years. These have been facilitated by public sector investment in infrastructure to provide serviced sites. Officers are aware that a number remain vacant, indicating that there are sufficient units (if not an oversupply) in the town. Officers will continue to monitor the situation and take account of this in assessing future property needs and impact on occupation and rentals of Council properties.
- 5.6 Elgin Business Park was developed by Saltire Properties with infrastructure funding assistance from Highlands and Islands Enterprise to meet a shortage of industrial development land in the town. The Park has been very successful and very few sites remain available. This reflects pent up demand from businesses seeking to invest in developing their own bespoke premises, which were previously frustrated by the lack of suitable sites. The Council's Employment Land Audit 2023 (which was informed by a Property Needs Study by Ryden Property Consultants) states that due to the take up of sites at Elgin Business Park it is anticipated that the level of immediately available land in Elgin will reduce significantly over the next few years and bringing forward and servicing new sites will be critical to maintaining supplies.
- 5.7 The Employment Land Audit also highlights significant shortages of general industrial land in Speyside and Forres that requires to be urgently addressed.
- 5.8 In 2022/23 the industrial portfolio continued to meet its objectives of:-
- (i) minimising the number of vacant properties as far as is consistent with current market conditions; and
 - (ii) maximising overall rental income and thereby minimising the cost of the service.
- 5.9 However, there remain concerns about a shortage of industrial development land and units in various locations and it is very unlikely that the private sector will invest given the relatively high risks and low returns on capital costs.
- 5.10 The following actions by the Council are aimed at addressing supply issues:-
- (i) a major extension of March Road Industrial Estate in Buckie has provided a supply of industrial development land in East Moray;
 - (ii) officers continue to work with private developers to facilitate the provision of new business units;
 - (iii) officers are trying to identify potentially suitable sites as part of work on the next Moray Local Development Plan (which has begun), for medium/long term development by the public and /or private sector;

- (iv) potential further opportunities to acquire and develop land and buildings will be considered as part of the Council's asset management rationalisation programme. A review of the Council's depot and storage properties is expected to be presented to this committee meeting, which will include identifying opportunities to relocate Council services currently occupying industrial portfolio property; and
- (v) existing properties will be repaired and refurbished as required.

Expansion of the Portfolio

- 5.11 Officers have investigated options/opportunities to expand the portfolio to address shortages of available property and generate additional rental income to the Council. These are summarised below.
- 5.12 Forres – working in partnership with Highlands and Islands Enterprise (HIE) it was proposed to purchase and develop land zoned for industrial purposes on the outskirts of Forres with a view to creating a new industrial estate and expansion of the adjacent Business Park. The landowners were willing in principle to sell the land. However, HIE withdrew from the project citing budgetary pressures. Site investigations revealed large areas of peat and clay and these factors, combined with general construction cost inflation, mean the project is not financially viable at present.
- 5.13 Speyside – despite extensive efforts over many years no suitable sites have been identified. Recently, officers investigated a potentially suitable site in Speyside with a view to the Council purchasing land and providing serviced sites and business units. However, access difficulties, abnormal site specific development costs, combined with general construction cost inflation, mean the project is not financially viable at present.
- 5.14 Buckie - the Council's 20 industrial units in Buckie have been virtually fully let for a number of years. When tenants vacate buildings they are readily re-let and it is expected that demand will increase due to Buckie's development as a base for offshore wind operations creating supply chain opportunities. Officers investigated proposals to build more small units on Council owned land at Rathven Industrial Estate. However, construction cost increases mean the project is not financially viable at present.
- 5.15 Officers will continue to investigate any opportunities for expansion of the portfolio, albeit it is unlikely that any financially viable projects will be forthcoming in the short term at least.
- 5.16 Any proposals for funding future development of the Industrial Portfolio will be brought forward through the Council's asset management, capital planning and economic development capital fund processes.

Age and Condition

- 5.17 A significant amount of the portfolio was provided during the 1960s and 1970s and condition surveys circa 2009 identified significant amounts of backlog maintenance/repair. Although tenants are obliged to carry out some of the outstanding repairs/maintenance where their lease includes an obligation to maintain and repair the property, some of the outstanding works, particularly those of an inherent nature, due to the age of the property require to be

addressed by the Council. The Council pursued a refurbishment programme over several years to ensure properties continued to meet the needs of businesses. The works carried out were predominantly to the fabric of the properties – replacing roofs and windows, as well as estate road upgrades.

- 5.18 Further condition surveys have been delayed due to staffing shortages. However, officers are aware that the electrical systems in many units are dated and a prioritised programme of upgrades is now being implemented.

Rentals

- 5.19 The rental generated by the industrial portfolio continued to grow in 2022/23, but as predicted in last year's annual report this was tempered by the sale of rental generating properties and a residue of Covid impacted tenants. As also forecast in last year's annual report, inflation outstripped rental growth in 2022/23 for the first time since the initial Annual Industrial Report in 2002. As is illustrated in **APPENDIX III** this was due to the dramatic rise in the Consumer Price Index rather than changes in rental growth trends.
- 5.20 Barring an unforeseen change in circumstances, the rent of the industrial portfolio is expected to continue to grow in 2023/24.
- 5.21 In Elgin, the construction by the private sector of 36 new units has not materially impacted demand and rents for the Council's properties in the town.

Occupation of Industrial Portfolio Properties by Council Services

- 5.22 At 31 March 2023, 12 of the Council's properties were occupied by Council services, which is contrary to the objectives of the portfolio to maintain an adequate supply of affordable premises in appropriate locations within Moray and maximise overall rental income. However, the vast majority of these properties are within the scope of the current review of Council depots and stores being taken forward by the Head of Housing and Property and it is planned that where opportunities arise officers will seek to relocate Council services to free the properties for letting to private enterprises.
- 5.23 Occupation of industrial units by Council services has occurred in a piecemeal fashion over many years. In order to take a strategic asset management approach any new requests by Council services will be considered by the Asset Management Working Group.

Energy Efficiency

- 5.24 Since 2018 in England and Wales there has been a prohibition on letting properties with Energy Performance Certificates (EPCs) worse than E ratings. In 2018 the Scottish Government consulted on draft proposals to make non-domestic properties more energy efficient and further consultations were delayed due to the coronavirus. It is unclear at this stage if proposals will be targeted at CO² producing heating systems of which there are 19 industrial units, or impact more widely on the portfolio which has approximately 63 units with heating systems. Officers will continue to monitor developments closely whilst investigating cost effective means to comply.
- 5.25 Officers are monitoring current Scottish Government consultations on revised EPC methodology.

Mosstodloch Industrial Estate

- 5.26 This estate has suffered flooding on several occasions during periods of exceptional rainfall, despite significant investment by the Council in upgrading the surface water drainage system. A major adjacent business has installed various water/drainage alleviation measures, which have mitigated flooding at this location. That business is seeking to expand its operations in Mosstodloch, including comprehensive flood solutions within its proposals and officers continue to liaise with the company.

Budgetary

- 5.27 Budget pressures limited opportunities to further develop the portfolio for several years, but recently monies, including additional funding for economic recovery, were allocated in the Capital Plan. However, due to the difficulties encountered with expansion proposals as detailed above, as well as the Council's financial pressures, the monies have been reprogrammed to future years, when potential projects can be reviewed in terms of need, financial viability and available budgets at that time.
- 5.28 A number of industrial portfolio developments were funded with assistance from the European Union. The audit processes for a number of the funding schemes have now been completed with the others due to be complete in the next 1-2 years. As such, conditions attached to European funded projects may no longer apply and the Scottish Government will be consulted on a case-by-case basis if any change of use of properties that were funded by the 2007- 2013 European funding programme are proposed. Opportunities to potentially secure funding for industrial development from the UK Shared Prosperity Fund, the Place Based Investment Fund and the Just Transition Fund appear very limited.

2023/24 Projects

- 5.29 Monies have been allocated in the current capital programme to carry out condition surveys and for the refurbishment of the portfolio. The condition surveys have been delayed due to staff shortages, but meantime officers have identified the following projects:-
- a) Create secure yards at Rathven Industrial Estate, Buckie.
 - b) Upfill site at Chanonry Road North, Elgin.
 - c) Upgrade road, circulation and parking areas at 4-8 Chanonry Road South, Elgin.
 - d) New fencing, gates and roller door at unit in Buckie.
 - e) Upgrading of yards at Waterford Circle and Greshop, Forres.
 - f) Remove glass entrance atriums and create additional parking at various units at Isla Bank Mills Industrial Estate, Keith.
 - g) Roof upgrades at Isla Bank Mills Industrial Estate, Keith.
 - h) Create new vehicular entrance to Unit F Isla Bank Mills Industrial Estate, Keith.
 - i) Lighting, windows and insulation upgrades at units at Isla Bank Mills Industrial Estate, Keith.
 - j) Electrical upgrades of various units.

6. ANNUAL REVIEW

- 6.1 Officers keep the performance of the portfolio and its constituent parts under constant/ongoing review to ensure it continues to fulfil the objectives of the Portfolio (as detailed in section 7 below) and give consideration to proposals to maintain its ability to meet those objectives.
- 6.2 The main criteria are income generation compared to costs/risks (such as repairs, void periods and empty property rates) and potential to release development value.
- 6.3 A review of the portfolio has been carried out concluding that all the portfolio's constituent properties should be retained with the exception of the following properties.
- Rothes Industrial Estate – the estate comprised 2 small industrial units and 2 site leases all of which had been leased to Forsyths Engineering for many years, as well as a telecoms site lease. As approved by the Economic Development and Infrastructure Services Committee at its meeting on 7 February 2023 (para 20 of the Minute refers) the Council sold the estate on 26 June 2023 to Forsyths for £245,000. The rental income foregone is £16,200 per annum. As these properties had been leased and occupied by Forsyths for many years the sale will not impact on the availability of commercial properties to let to small businesses in Speyside. The sale of these properties was linked to the acquisition from Forsyths, by the Council, of land at McLaren's Brae, Buckie to facilitate offshore wind farm operations at Buckie Harbour.
 - 7 Coularbank Industrial Estate – this property is leased for five years from 1 July 2021 at a rent of £28,800 per annum. The tenant wishes to build an extension to facilitate business growth, but would like greater security of tenure for his investment. It is proposed that this Committee agrees in principle to officers negotiating main terms with the tenant for a sale of the building, conditional on a 99 year ground lease – with a view to reporting provisionally agreed main terms to the Corporate Committee.

7. SUMMARY OF IMPLICATIONS

(a) Corporate Plan and 10 Year Plan (Local Outcomes Improvement Plan (LOIP))

The management and development of the Industrial Portfolio supports the LOIP priority of “a growing, diverse and sustainable economy” as well as the priority of the Corporate Plan of promoting economic development and growth. It also accords with the aim of the Moray Economic Strategy of facilitating economic growth and diversification of the local economy.

(b) Policy and Legal

The policy objectives of the industrial portfolio are as follows:-

- a) To maintain an adequate supply of affordable premises in appropriate locations within Moray;
- b) To minimise the number of vacant properties as far as is consistent with current market conditions; and
- c) To maximise overall rental income and thereby minimise the cost of the service.

(c) Financial Implications

Gross rental income in 2022/23 was £2,085,000 and net rental income £1,390,000.

A number of revenue and capital works were delayed due to various factors, including difficulties securing contractors and £138,000 of capital has been carried forward into 2023/24.

The allocations in Table 1 below have been made in the capital plan for 2023/24.

Table 1

<u>Item</u>	<u>Monies</u>
Serviced Sites Elgin	£24,000
Road Upgrades	£10,000
Refurbishments	£164,000

Revenue expenditure on repairs and maintenance is forecast to be within the current budget of £70,185 in 2023/24.

Proposals for future years' capital developments will be taken forward through the Council's financial planning process. However, recent assessments of potential development projects concluded that rental income compared to construction costs, ongoing management costs and risks, was insufficient, rendering the projects financially unviable. The timescales for returns on investment are incompatible with the Council's current budgetary situation in an area where intervention is discretionary.

(d) Risk Implications

The main risks are detailed above in Section 5 of this report.

(e) Staffing Implications

The Estates Team manages the Industrial Portfolio on behalf of the Council. Workload within the team is at capacity and timescales are having to be extended on priority tasks.

Any expansion of the industrial portfolio would require additional staff resource.

Legal Services staff continue to be involved in formalising lease agreements and pursuing rent arrears where necessary.

(f) Property

The property implications are as detailed in this report.

(g) Equalities/Socio Economic Impact

There are no equalities or socio economic issues arising from this report.

(h) Climate Change and Biodiversity Impacts

No climate change or biodiversity implications have been identified relating to the recommendations of this report.

(i) Consultations

The Head of Housing and Property Services, the Chief Financial Officer, the Property Asset Manager, the Legal Services Manager, the Head of Development Services, the Equal Opportunities Officer and Caroline O'Connor, Committee Services Officer have been consulted and their comments incorporated in this report as appropriate.

Discussions continue to take place regularly with Highlands and Islands Enterprise (HIE) to ensure a co-ordinated and complimentary approach to property provision. HIE concentrates on the provision of larger, higher specification/amenity properties, whereas the Council focuses on smaller more general industrial properties.

Officers continue to liaise regularly with private sector developers/providers of industrial property.

8. CONCLUSIONS

8.1 The Industrial Portfolio exceeded targets for rental income and occupancy in 2022/23.

8.2 To ensure the portfolio continues to meet business needs a programme of works is in place to improve the condition of the Council's existing industrial buildings. The projects have been delivered within budget and ensure the Council's portfolio continues to meet business needs and support economic development in Moray.

Author of Report: Stuart Beveridge, Asset Manager (Commercial Buildings)

Background Papers: None

Ref: SPMAN-1285234812-1406