

Subject:	Acquisition and Leaseback of Land and Buildings at Moulsecoomb Way		
Date of Meeting:	8 October 2020		
Report of:	Executive Director Economy, Environment & Culture		
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Ward(s) affected:	Moulsecoomb & Bevendean		

FOR GENERAL RELEASE**1. PURPOSE OF REPORT AND POLICY CONTEXT**

- 1.1 The report presents a proposal for the acquisition of a vacant building currently owned by Custom Pharma Services; a pharmaceutical manufacturer based in the city. The proposed acquisition is subject to Custom Pharma simultaneously taking a 25-year lease from the council.
- 1.2 The proposed acquisition and leaseback transaction will support Custom Pharma's refurbishment of the vacant building to expand their manufacturing service and support employment in the City and regeneration of two major sites in the East and West of the City.
- 1.3 This report is complemented by a separate report in Part Two of the Agenda.

2. RECOMMENDATIONS:

- 2.1 That the council acquires the building at Moulsecoomb Way (shown in Part One Appendix 1) and simultaneously grants a 25-year lease to Custom Pharma at a market rent.

3. CONTEXT/ BACKGROUND INFORMATION

- 3.1 Custom Pharma are a full-service contract, development and manufacturing organisation of investigational medicinal products based in Brighton and Hove that covers a spectrum of activities from process development to manufacturing.
- 3.2 They are currently based at 2 sites in Conway Street Hove and Moulsecoomb Brighton. In 2016 they acquired the subject property at Moulsecoomb Way (plan attached at Appendix 1) and began conversion to a state of the art pharmaceutical facility. Whilst works have partially been carried out, further funding is required to complete the next stage of the conversion of the building. This would be funded by the capital receipt achieved from the sale.

- 3.3 Once the refurbishment is complete they will vacate their existing operations entirely from the premises in Conway Street Hove, freeing up that site for redevelopment. The site forms part of the Hove Station regeneration major infrastructure site that is currently being explored with the relevant partners through the One Public Estate (OPE) programme.
- 3.4 Custom Pharma currently employs 200 full time employees. The conversion of the subject property would create an additional 100% of high specification “state of the art” facilities to provide growth in employment and business revenues. Custom Pharma currently employs a number of graduates and apprentices each year from the local schools and universities to work within their skilled and highly trained workforce.
- 3.5 **Proposal**
Custom Pharma have presented a proposal to sell and leaseback their Moulsecomb premises. The council would acquire the freehold of the premises and simultaneously lease it back to them for a term of 25 years at a market rent.
- 3.6 The proposed transaction will fulfil a number of strategic economic regeneration objectives, these include:
- The retention of a large local employer within the city, thus preventing relocation outside of the City.
 - Supporting employment in the City of high end professional, skilled jobs and R & D linking in with the Universities.
 - Supporting the regeneration of Moulsecomb and the modernisation of a substantial unused building with a footprint of 34,000 sq ft and a total gross internal area of 74,000 sq ft over basement, ground and first floors.
 - Facilitating Custom Pharma’s move out of premises at Conway Street Hove allowing the site to be redeveloped as part of the Hove Station Neighbourhood Plan and OPE project.
 - Provide a substantial and secure income for the Council to support service provision across the city.
- 3.7 Rental income from the Council’s commercial property portfolio supports the provision of city-wide services. However, a large proportion of the portfolio comprises secondary and tertiary retail properties which are increasing in risk as investments due to the emergence of on-line and shifts in consumer behaviour, which has also been heavily impacted by Covid-19. The Council’s proposed asset investment strategy is centred around the need to rebalance the portfolio to reduce its reliance on the retail sector. A core requirement is to invest in commercial property within the City boundary. The industrial market is currently strong, and the Council has a very low exposure to the sector. This opportunity to acquire on a sale and leaseback basis would immeasurably improve the portfolio and its resilience, and importantly, its security of income.
- 3.8 The acquisition price represents market value. Custom Pharma have a good covenant but there are nevertheless low risks attached to the transaction should tenant failure occur. Avison Young our agents have advised the council that in these circumstances alternative options would have to be considered. In the short term the building/site could be marketed in its current bespoke condition or alternatively if demand were limited the building could be converted to create

warehouse/logistics space. The freehold could also be sold, subject to planning for industrial redevelopment. This market is strong and growing and there is a lack of industrial space in the City and along the Sussex coast. In the medium-term occupier interest should still exist or alternatively interest could be expected from developers either commercial or residential especially with the relaxation of planning legislation. Proposed reforms of the Planning Regulations should provide the council with a greater degree of flexibility over potential future uses of the site. This is true of longer-term options where the premises/site could lend themselves to commercial, industrial and residential redevelopment. However, the financial strength of the company is sufficient to ensure it is extremely unlikely to fail. The risks are reflected in the yield. This potential tenant failure scenario is considered low risk, it is a commercial lease and financial due diligence has been carried out by the council's finance team. This is a business that has been running locally for over 40 years and the Council is relying upon the strong company fundamentals and credit rating.

- 3.9 Custom Pharma are taking a 25-year lease on a full repairing basis and will be responsible for meeting the lease obligations throughout the term. They would not be required to return the building to its previous state but would be liable for dilapidations at the end of the lease in 25 years' time on the basis of the refurbished building. The previous state is a half-refurbished building and thus it would not be appropriate to return it to that state from a refurbished building. As it has already been half converted the Council would not be in a position to request the half completed bespoke works were removed
- 3.10 Custom Pharma as a long-standing family business has had incremental growth over many years. Future growth of the business and employment is dependent upon the successful development of the site at Moulsecoomb Way. The development of the site is critical to their business, which is limited by the size of their current manufacturing premises at Conway Street. At present demand is more than existing capacity and business opportunities are being declined, which would otherwise support growth and new jobs. The company strongly believe that the investment in the Moulsecoomb site would allow the business to grow, widen their offer and increase their medium-term supply contract base. Paragraph 6 outlines their future growth plans.
- 3.11 Their business plan is based on increasing turnover although the existing turnover would support the rental payments proposed. Custom Pharma have demonstrated their changing business model including fixed cost reductions as a result of the potential move that would help fund a new rent liability. It is limited company and the ultimate holding company is Custom Healthcare Limited. 80% of the shareholding of Custom Healthcare is held by Cheremy Capital, a Trust established by family members' who are UK citizens based in the USA. Cheremy was established solely for the purposes of holding shares for Custom Healthcare Limited and is incorporated in the USA. As a family business there is no further guarantor for any lease obligations and the council's security would be based on the company's financial performance, however these risks should be taken in the context of the significant wider benefits to the City with economic regeneration being the key driver for this transaction. Custom Pharma is a Key Business supplying medicines to the NHS.

3.12 Planning advice

Under the new planning use classes that were introduced this month the current use of the site would be *Use Class E(g) - Uses which can be carried out in a residential area without detriment to its amenity*, which is broken down into:

- **E(g)(i)** Offices to carry out any operational or administrative functions,
- **E(g)(ii)** Research and development of products or processes
- **E(g)(iii)** Industrial processes

If this is the case, then changes to other uses within Class E would not be classed as development and would therefore not require planning permission for the principle of the change of use. These include retail uses, indoor sport, medical services, nurseries, financial/professional services and the sale of food and drink for consumption on the premises

In terms of redeveloping the site for other uses, the City Plan Part One seeks to protect sites in employment use by requiring them to be demonstrated to be redundant and incapable of meeting the needs of alternative employment uses before they can be released for other uses such as housing. It is difficult to provide specific advice over a 25-year time period as the City Plan will shortly be reviewed. We hope to have a revised City Plan Part One in place in five years' time, and that is then likely to be reviewed at least a couple more times within 25 year period.

The government is also proposing significant changes to the plan-making system through the recently published Planning White Paper. It is envisaged that we would seek to maintain the industrial estate on Moulsecoomb Way as an identified location for business use, subject to any changes to national policy and legislation that may limit our ability to do so.

4. ANALYSIS & CONSIDERATION OF ANY ALTERNATIVE OPTIONS

- 4.1 In the absence of the proposed acquisition and leaseback transaction Custom Pharma would seek additional finance from alternative sources secured against the premises but would be limited to achieving a maximum loan of 75% of the property's value. The conversion of the subject property and expansion of the business would be stalled, impacting on their plans for expansion. Whilst the sale of the building to the council would result in a loss of ownership for Custom Pharma it would provide them with a cash injection equal to 100% of the property's value.
- 4.2 This would impact on the delivery of strategic objectives identified in paragraph 3.6 and benefits identified in paragraph 6.1.
- 4.3 The opportunity to diversify the council's commercial property portfolio, reduce risk and improve income would also be forgone.
- 4.4 Custom Pharma would not sell the site to the council without the simultaneous leaseback transaction, for the council to use for an alternative use.

5 COMMUNITY ENGAGEMENT & CONSULTATION

- 5.1 Custom Pharma have been consulted. Consultation with neighbours is not considered applicable as this has been done through the local planning process.
- 5.2 Relevant internal teams and members have been consulted.

6. CONCLUSION

- 6.1 The proposed simultaneous acquisition and leaseback transaction meets a number of economic regeneration and corporate strategic objectives and benefits, which would be stalled and at risk or forgone should it not proceed. These include:

- Job retention – safeguarding 208 FTE existing jobs.
- Job creation - Potential to add a further 100 FT roles at Custom in the coming 5 years. Many new roles from PhD level to school leavers/apprentices. Currently recruiting 10 new roles in anticipation of demand and business growth.
- Capacity increase manufacturing - New facility will create a 100% increase in capacity to manufacture existing critical medicines.
- Capacity increase clinical trials and product development - 500% increase in capacity in next 5 years.
- University collaboration - Working with both universities to support graduate employment from Life Science courses.
- Local economy - Help drive economic growth in the region.
- Exports - New markets (USA, Israel, Nordic) being targeted for sale of the new capacity.
- Medicines supply chain - Improving supply from within UK of vital medicines rather than from abroad.
- Regeneration in Conway Street, Hove - Moving out releases land for redevelopment and regeneration in accordance with City Plan and Hove Station Neighbourhood Plan for homes and employment.
- Regeneration in Moulescoomb - the modernisation of a substantial unused building with a footprint of 34,000 sq ft and a total gross internal area of 74,000 sq ft over basement, ground and first floors.
- Stalled Investment - The premium payable by the council will clear the existing loan arising from the original acquisition, leaving the balance for investment into the conversion project. Custom Pharma intend to raise additional capital through bank funding or government grant support for the balance of the cash required to buy equipment.
- Covid 19 - Custom is currently involved in clinical trials to support discovery of treatment for Covid 19. and have been appointed by Oxford University to progress these trails.
- Diversify Council's commercial property portfolio into growing industrial/ logistics market - supports income security and growth.

- 6.2 More recently Custom Pharma have confirmed that they are developing and will licence a range of Dexamethasone tablets which were recently trialled successfully with Covid 19 patients. They are receiving government support to establish export markets in USA and the wider EU currently.

- 6.3 Their forecasts for export growth require the business to increase sales and new high-quality jobs are expected to reach a total of 300+ by 2025.
- 6.4 In conclusion to support regeneration in a deprived area, protect a major local company providing growth and jobs in the City it is recommended that the council proceed with the sale and lease back proposal to Custom Pharma. The proposal will also help to free up part of the Hove Station major regeneration site.

7. FINANCIAL & OTHER IMPLICATIONS:

Financial Implications:

- 7.1 The lease is for 25 and the annual rental income is in excess of the annual cost of borrowing from the Public Works Loan Board (PWLB). The rent is index linked to RPI and so will increase over time; the repayments to PWLB would be fixed.
- 7.2 The councils Minimum Revenue Provision allows for the repayments to be spread over the life of the asset to a maximum of 50 years, however given the length of the lease and bespoke nature of the asset it is prudent to repay over a shorter period.
- 7.3 The Treasury are currently consulting on potential restrictions to local authority access to PWLB borrowing. This is in response to the significant increase in Local Authorities using relatively cheap PWLB borrowing rates to finance commercial activities in pursuit of yield. The likely outcome will mean councils will no longer be able to access PWLB debt if the capital plans include investment purely for commercial gain. However PWLB loans will continue to be available to support service delivery, housing and regeneration.
- 7.4 The council's role in the proposal with Custom Pharma is to facilitate regeneration in a deprived area, protect and grow jobs within the city and is not the pursuit of yield. Therefore, should new regulations be implemented the council will be able to demonstrate to Treasury that it is complying with the restrictions in this instance. It is likely the Treasury will rely on the Chief Finance Officers view on the substance of the transaction.
- 7.5 The proposed sale and lease back arrangement does include a level of risk given the bespoke nature of the building and its location. Custom Pharma's financial position has been reviewed using external credit agencies, a review of their accounts, financial business plans and meetings with their Chief Executive and Chief Finance Officer. The company have been operating for over 40 years and have seen steady growth year on year but have been restricted with their current operation. The transfer to the Moulsecomb site will deliver revenue savings to offset the cost of the new lease and they are financially sustainable without relying on the growth expected from the new facility. A proportion of the purchase price will only be released once the initial works to the building are completed to provide assurance the investment in the facility takes place.

Finance Officer Consulted: James Hengeveld

Date: 20/08/20

Legal Implications:

- 7.6 S120 of the Local Government Act 1972 allows local authorities to acquire land either for “the benefit, improvement or development of their area”. For the reasons set out in the report this acquisition will benefit the area. The council has the power to borrow pursuant to s111 of the Local Government Act 1972, s1 of the Local Government Act 2003 and s1 Localism Act 2011. The Council is paying the market value so there is no risk that it might be regarded as state aid.

Lawyer Consulted:

Alice Rowland

Date:20/8/20

Equalities Implications:

- 7.7 The proposal offers local valued employment opportunities in terms of high-end specialist jobs, apprenticeships and graduate jobs linking with the Universities.

Sustainability Implications:

- 7.8 The future growth implications of the proposal in terms of specialist jobs and commissions indicate the sustainability of this company within a growing market. The Covid19 trials and other commissions potential will contribute to the health and wellbeing of the City, region, nationally and internationally. Custom Pharma does not test on animals.

Brexit Implications:

- 7.9 Custom Pharma could be affected by supply chain of materials however given the nature of their work these risks are likely to be minimised nationally/internationally. Custom does not export to EU. Some raw materials are imported from EU, Brexit would post the same risk as any other business in the UK post Brexit. Opportunities are being explored to collaborate with Belgium based clinical research organisation to expand EU business, also Switzerland and Nordic countries. The business plans are to export to USA post completion of the new facility phase 1 starting in 2022 as this is a large and wealthy market for drug development services.

SUPPORTING DOCUMENTATION

Appendices:

1. Site Plan

Background Documents:

None

