London South Bank University

| | PAPER NO: Appendix to PC.08(12) |
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| **Committee:** | **Property Committee** |
| **Date:** | **25 April 2012** |
| **Subject:** | **Enterprise Centre - balance sheet carrying value** |
| **Author:** | **Richard Flatman, Executive Director of Finance** |
| **Executive sponsor:** | **Richard Flatman, Executive Director of Finance** |
| **Recommendation by the Executive:** | **That the committee note this proposal** |

**Executive summary**

Policy and Resources Committee will be asked to approve the following recommendations prior to final approval for the project.

1. Excluding the land element, the building should be carried in the University's balance sheet at a cost of £13.5m. This assumes that the project is delivered in accordance with agreed cost estimates.

2. The stabilisation cost of £3.0m incurred in previous years (which was capitalised but not depreciated or impaired) should now be written off in full. This will require write off through the I&E account and will therefore impact the reported result for the year but will be disclosed as an exceptional write off.

Property Committee are asked to note for completeness.

| | **Board/Committee** | **Date** |
|---|---|---|
| Matter previously considered by: | Executive | 17 April 2012 |
| Further approval required? | P&R | 1 May 2012 |

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| Communications – who should be made aware of the decision? | N/A |

## 1. Enterprise Centre project

The University is developing an Enterprise Centre by renovating and extending the Grade 2 listed terraces and the Duke of Clarence public house facing onto St Georges Circus. The Enterprise Centre is a critical part of the University's plan to meet the strategic goal of becoming London's Enterprising University. It will create one of three anchors of the Southwark campus and provide a sustainable opportunity to bring the buildings back into use to create long-term strategic value to the University. The Enterprise Centre will serve to support the improvements the University wishes to achieve in its engagement with businesses and employers. Importantly, it will also have an important role to play in promoting an enterprise culture internally within the University. A prominent Enterprise Centre will promote cultural change and provide a focus for academic engagement in enterprise, building pride amongst both staff and students.

## 2. Investment appraisal

The Capital cost of the planned development is summarised in Appendix 1.

In accordance with the University's accounting policies, the building element of the cost will be a mixture of new build and refurbishment and depreciated over 50 or 15 years respectively.

The total cost of the land and buildings (inc VAT) based on latest cost estimates will be £17.5m analysed as follows:

| | £000's | £000's |
|---|---|---|
| Land | | 1,068 |
| Buildings: | | |
| Previous stabilisation | | 2,944 |
| New building cost | | |
| - heritage | 2,261 | |
| - non heritage | 11,281 | |
| New build cost total | | 13,542 |
| Total building cost | | 16,486 |
| Total cost | | 17,554 |

## 3. Consideration of impairment

The approach to future potential impairment of the Enterprise Centre has already been discussed with the Property Committee and final proposals will be submitted to Board in May for approval.

The approach will be as already agreed for the Student Centre. In accordance with FRS11, and as the Enterprise Centre will not be held for the specific purpose of generating enterprise cashflows, the issue of impairment will be de-linked from the assumed cashflows in the NPV calculations underpinning the business case. Future potential impairment will be linked not to cashflows but to service criteria to be approved by the Board in May. These (*largely*) non financial criteria will determine whether the building is in future deemed fit for purpose and whether or not impairment is required.

## 4. Carrying value of the Enterprise Centre

The value of the asset in the accounts is for the University to determine.

In accordance with the University's agreed accounting policies, freehold land and buildings are included in the accounts at cost or valuation together with subsequent refurbishment expenditure, less any amounts written off by way of depreciation. Freehold land is not depreciated.

Some assets which were acquired before implementation of FRS15 had previously been revalued and continue to be carried at those revalued amounts in the accounts. Upon implementation of FRS15 however the University chose not to revalue assets and hence the carrying value of new assets is cost unless impairment is deemed necessary.

Ignoring the land element of £1.068m (which has an ongoing value and would in any event not be subject to depreciation), the valuation options (as per Appendix 1) are as follows:

| Option | £m | Write down/impairment |
|---|---|---|
| **1** | 16.5 | Full cost/ no write down |
| **2** | 14.2 | Including sunk costs of stabilisation work but excluding heritage aspects |
| **3** | 13.5 | Including heritage aspects but excluding previous sunk costs of stabilisation |
| **4** | 11.3 | Full write down of both sunk costs and heritage aspects |
| **5** | <11.3 | Some other lower value if deemed more |

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| appropriate |

The recommendation is option 3 – with a proposed carrying value for the Enterprise Centre of £13.5m. This option is recommended for the following reasons:

- £13.5m actually represents the real cost of the new building. In the circumstances it would be difficult to justify a carrying value of £16.5m
- There is an element of heritage cost included in the £13.5m but this represents a genuine cost of bringing the asset to its current condition (and hence option 4 is considered inappropriate)
- Stabilisation work, however, whilst also a genuine cost of bringing the asset to its current location and condition, could be argued to be temporary. The cost was essential at the time and the case for no impairment to date was justified on the basis that it added to the value of the asset. Future rental cashflows were deemed to be positive. However, the strategic case has developed/changed over recent months and the link to future cashflows has been broken. There does not seem to be a strong argument to support continued carrying forward of these costs (this rules out options 1 and 2)
- There is no reasonable/logical basis for any other value (option 5). The strategic case has been made and service criteria will be agreed by the Board. Provided those service criteria are met, no impairment will be required and hence option 5 is considered inappropriate.

## 5. Impact on financials

The issue is entirely presentational and will have no impact on the overall cost/future cashflows of the University. In financial accounting terms the impact will be as follows:

- There will be a charge to the I&E account in 2011/12 of £3.0m relating to the write off of the stabilisation costs incurred and capitalised in previous years. The write off will be disclosed as exceptional so as not to distort the underlying operating position

- As the stabilisation work is deemed to be improvements and hence subject to depreciation over 15 years the future charge to the I&E will be reduced each year by £200k.