



Comptroller and Auditor General
Report on Value for Money Examination

The Provision and Management
of Industrial Property

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Arna fhoilsiú ag Oifig an tSoláthair

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The report was prepared on the basis of information, documentation and explanations obtained from the bodies referred to in the report

The draft report was sent to the Chief Executive Officers of IDA Ireland, Shannon Development and Údarás na Gaeltachta and their comments were requested. Where appropriate, comments received were incorporated in the final version of the report

Report of the Comptroller and Auditor General

The Provision and Management of Industrial Property

I have, in accordance with the provisions of Section 9 of the Comptroller and Auditor General (Amendment) Act, 1993, carried out a value for money examination of the provision and management of industrial property by IDA Ireland, Shannon Development and Údarás na Gaeltachta

I hereby submit my report of the above examination for presentation to Dáil Éireann pursuant to Section 11 of the said Act.

A handwritten signature in black ink, appearing to read 'John Purcell', with a large, stylized loop at the end.

John Purcell
Comptroller and Auditor General

28 August 1998

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Summary of Findings

The availability of industrial property is an important factor in attracting new business ventures to regional locations. In recent years, the private sector has been willing to take on this role in areas where there is a viable market for property and where there is a potential for economic gain. Three public sector Agencies are involved in the provision of industrial property for the purposes of achieving economic growth either nationally or in regional and peripheral areas.

- IDA Ireland provides industrial land and property in the pursuit of national industrial development objectives
- Shannon Development uses industrial property to achieve its primary target of economic growth in the Shannon region.
- Údarás na Gaeltachta (An tÚdarás) provides industrial property to increase employment in the Gaeltacht areas as a means of preserving and extending the use of the Irish language.

At the end of 1996, the Agencies were responsible for portfolios of industrial property with a book value of £274 million, comprising 2,200 hectares of land and 1.2 million square metres of factory space.

The main objectives of the examination were to ascertain

- the extent to which the property portfolios are managed economically and efficiently
- whether industrial property is acquired, developed and disposed of in an economic and efficient manner
- the appropriateness of the performance measurement systems used by the Agencies taking into account their diverse primary objectives

Management of the Property Portfolios

The cost of managing the portfolios and the occupancy rates and rental income achieved were the key indicators of economy and efficiency investigated. Management information to support the analysis of performance was limited. In particular, financial data about costs and revenues was not integrated with property data and little information about the history of occupation or the physical condition of assets was available. The Agencies have acknowledged these shortcomings and are upgrading their systems to improve the situation.

The average holding costs incurred by the Agencies (£3.90 to £5.20 per square metre) was found to be higher than the costs incurred by the private sector (£2.25 to £3.25 per square metre). This was partly explained by the willingness of the Agencies to bear costs which would be passed on to a private sector tenant and the need for a higher

standard of specification to support industrial promotion objectives. Higher costs are also attributable to the age of the buildings in the portfolios.

None of the Agencies set minimum occupancy rate targets. The Agencies view occupancy in terms of the need for some vacant space to show to visiting industrial promoters rather than from the perspective of maximising the occupancy rate. Occupancy levels of 82% to 86% were achieved at June 1998. Despite the current availability of unoccupied space, the Agencies maintain that they have a shortage of space in some areas targeted for development.

The Agencies aim to achieve a market rent based on the age and location of properties and their intended use. Guideline rent rates designed to reflect current market rates are in existence but are not used as formal targets. The average rent achieved by the Agencies did not reach the guideline in 1996. As the guideline rent is exceeded in many cases, particularly in urban areas, this suggests that some properties were let at rates below the market level. As the rent achieved influences the potential disposal price of the properties, this has an effect on the potential realisable value of these properties.

Industrial Land and Infrastructure

The Agencies need to buy and develop land in order to be able to meet the demand for industrial sites. This is an important activity for IDA Ireland which is concentrating on selling serviced land for development by private sector contractors.

Taking the lead time for developing land and the annual demand into consideration, the Agencies were found to hold more land than is required to meet demand in the medium term. Almost one third of the land area held by IDA Ireland and Shannon Development in 1996 was not required because it was in the wrong place or was unlikely to be used in the foreseeable future.

Prices paid for land acquired in 1995 and 1996 were reviewed and found to be reasonable relative to market conditions. The indicative costs of developing land are generally higher for Shannon Development and An tÚdarás than the normal amount the private sector would be willing to pay. In some cases, this is due to the peripheral location of the land and to the level of specification required.

The unit sales prices achieved by IDA Ireland and Shannon Development in 1995 and 1996 for the disposal of land were strong relative to market rates. An tÚdarás had no sales of land in this period.

Industrial Buildings

The demand for industrial buildings can be satisfied either by encouraging the private sector to invest in property or by the acquisition, construction or refurbishment of buildings by the Agencies themselves. The Agencies are market makers in their respective areas and should keep the impact of their policies on the promotion of private sector involvement under review. Since 1996, IDA Ireland has been actively disposing of its buildings and has a long history of assisting the private sector to invest in the provision of industrial buildings. It is more difficult for the other Agencies to encourage private sector involvement due to the peripheral nature of the areas served.

The costs of provision of buildings were reviewed and found to be within a reasonable range, apart from three Údarás projects which had a high specification. The option of refurbishing existing older buildings in the property portfolios is not seen by the Agencies as economic as many of the buildings are in areas where there is no demand.

The Agencies establish the selling price of buildings by reference to independent valuations of prevailing market value. Shannon Development and An tÚdarás achieved good prices for transactions in 1995 and 1996. The prices achieved by IDA Ireland were lower due to the age and condition of the buildings sold and in some cases, to lease conditions which fixed rents at low levels.

Return on Investment in Property

The Agencies do not keep adequate information to use the conventional approach for measuring the return on their investment in industrial property. This approach would determine the economic return achieved by reference to the present value of the cash flows experienced over the period of ownership. Performance would be evaluated by relating the return achieved to the public sector discount rate which takes account of the special market conditions experienced by the Agencies.

In establishing the economic return achieved on property it is important to eliminate all implicit subsidies to tenants in the form of uneconomic rents. These subsidies should be considered when evaluating the performance of the Agencies in their core activities of industrial development and economic growth.

The financial rate of return achieved by the Agencies in 1996 was between 3% and 4.7% which is considerably lower than the public sector discount rate. Apart from the implicit subsidisation of charging rents which did not recover the cost of property provision, the rate of return reflects a lack of economy and efficiency through holding too much land for too long, holding property for which there is no market and a willingness to bear high current property costs.

The Provision and Management of Industrial Property

1 Introduction

- 1.1 IDA Ireland, Shannon Development and Údarás na Gaeltachta (An tÚdarás)¹ are each involved in a major way in the provision and management of industrial property within their respective geographical areas. At the end of 1996, the Agencies held portfolios of industrial property comprising a total of 1.2 million square metres of factory space and almost 2,200 hectares of land zoned for industrial purposes. The combined book value of the industrial property was £274 million.
- 1.2 The Agencies also hold other kinds of property not directly related to industrial development. For example, all the Agencies own buildings which they occupy in the provision of their services. Shannon Development owns tourism-related property in many locations within its region and other properties in Shannon Town. An tÚdarás owns some tourist facilities and property for community activity in many locations.
- 1.3 For each of the Agencies, the main reasons for involvement in the provision of industrial property relate to the achievement of their core objectives (see Figure 1.1), rather than to the achievement of target financial returns on the resources invested in property.

The Role of Property in Industrial Development

- 1.4 The availability of suitable property at a competitive cost is one of several factors which influences decisions about where to locate industrial enterprises. For internationally-mobile investment, the strategic decision about selecting a country to locate in tends to be influenced most by issues such as access to target markets, attractive taxation and grant-aid regimes and the availability and cost of a suitable labour force and raw materials. Once the country is selected, property issues usually play a stronger role in determining the specific area within the country where the enterprise will be located.
- 1.5 The right kind of property for a proposed investment (for example, a site with access to required infrastructure) can stimulate industrial investment and is often decisive in the choice between locations. The time required to provide property, and its cost, can also be influential on industrial location decisions.

Policies on Property Provision

- 1.6 The Agencies became involved in property provision because of a failure by the property market to supply sufficient suitable property throughout Ireland in a timely manner and at a competitive cost, making it difficult to ensure geographically balanced economic development. Property provision is also intended to stimulate a

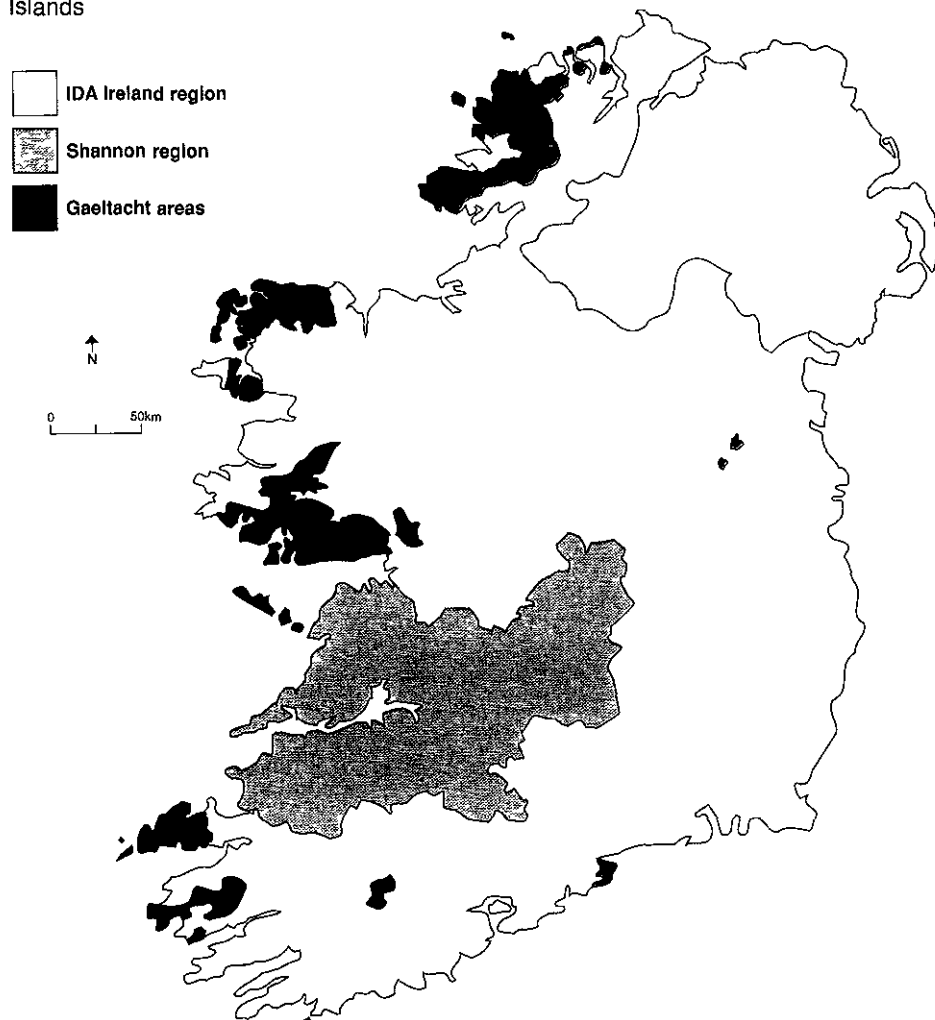
¹ IDA Ireland, Shannon Development and Údarás na Gaeltachta are collectively referred to in this report as the 'Agencies'.

Figure 1.1 Core functions and geographic areas served by the Agencies

IDA Ireland's primary objective is to create employment in Ireland by encouraging internationally mobile projects to locate in Ireland. It also aims to get the best possible spread of such projects around the country. It operates in conjunction with Enterprise Ireland, which is responsible for the development of indigenous business, under the aegis of Forfás and the Department of Enterprise, Trade and Employment.

Shannon Development is responsible for economic development in the Shannon region (see map). It initiates, participates in and supports integrated development activity which aims to achieve sustained economic growth in its region. It operates under the aegis of the Department of Enterprise, Trade and Employment.

Údarás na Gaeltachta has overall responsibility for the economic, social and cultural development of the Gaeltacht. Its primary objective is to encourage the preservation and extension of the use of the Irish language as the everyday language of the Gaeltacht communities. The establishment and development of job-creating industries and services in the Gaeltacht regions are used as instruments to achieve the primary objective. The Gaeltacht regions are widely dispersed (see map), are situated in some of the most peripheral areas of the country and do not have any major centres of population. The Agency operates under the aegis of the Department of Arts, Heritage, Gaeltacht and the Islands.



higher rate of project start-ups than would otherwise be achieved and to reduce the time elapsing between the decision to invest in an enterprise and the creation of the related jobs.

- 1.7 The Agencies also use the provision of industrial property strategically in relation to the development of small and medium industry through the operation of enterprise centres and 'incubator' space. These are intended to allow new enterprises to develop without the need to invest heavily in property and to reduce the costs of the provision of shared services.
- 1.8 Historically, the provision of advance factories was seen as a critical incentive in attracting inward investment. As a direct result of government policy, an extensive programme of advance factory construction was undertaken in the 1970s and early 1980s in order to facilitate regional development. A 1984 White Paper on Industrial Policy accepted that the availability of industrial sites and factory space was essential for industrial development but concluded that the existing supply of land and buildings exceeded foreseeable demand. It recommended reductions in advance factory construction and in the amount of land held.
- 1.9 In the late 1980s, a significant amount of vacant factory space and land which was unlikely to be used was disposed of by the (then) Industrial Development Authority.² However, the Agency continued to hold a large portfolio of industrial land and buildings.
- 1.10 A detailed examination of the property function in IDA Ireland/Forbairt was undertaken by Jones Lang Wootton and Indecon Consultants (JLW/Indecon) in 1995. In response to the report's findings, there was a major change in policy in relation to industrial property. The main elements of the new policy were
- for the future, the State should minimise its involvement in ownership of individual buildings and should, as far as is practical, dispose of its holdings of industrial property
 - the private sector should be encouraged to take a much more active role in the provision of industrial property.
- 1.11 IDA Ireland is currently actively pursuing the policy of disposing of existing property where appropriate. In 1997, some seventy properties totalling 97,000 square metres of factory space were sold by the Agency. No new factory space is now provided directly by IDA Ireland, which relies instead mainly on private developers and grant assistance to industrial investors to provide their own premises. It still plays a central

² *The Industrial Development Authority and Eolas were restructured with effect from 1 January 1994 to create three new bodies: IDA Ireland, Forbairt (now Enterprise Ireland) and Forfás. The latter is responsible for policy co-ordination and advice on industrial development.*

role in ensuring there is adequate land zoned and developed for industrial purposes in the regions it serves

- 1 12 The JLW/Indecon report and the Minister's response did not explicitly address the position of the other Agencies but the Department of Enterprise, Trade and Employment's position is that the policy decisions are also intended to apply to Shannon Development. That Agency is in agreement with most of the report's findings and recommendations but has strong reservations about the recommendation to sell off as much property as possible. Shannon Development considers that policy to be in direct conflict with its primary objective of regional development, in particular the generation of investment by suitable industrial promoters. Property revenue is also the main vehicle for achieving financial self sufficiency. In general, Shannon Development will only dispose of property assets at replacement cost or market value.
- 1 13 Because of the reluctance of private investors to build in the remote locations of the Gaeltacht, An tÚdarás is directly involved in the provision of almost all the industrial property required for grant-assisted industry. It rarely disposes of property because the sale prices obtainable are very low relative to the costs of replacement of factory space in the regions served. The Department of Arts, Heritage, the Gaeltacht and the Islands (which oversees An tÚdarás) is not involved in policy formulation in relation to property management, responsibility for which is left to An tÚdarás.

Objectives of the Examination

- 1 14 There are a number of reasons for carrying out a value for money examination of the Agencies' management of their industrial property portfolios
- The existing property portfolios represent a very significant investment of tax payers' money
 - Because the Agencies' property functions are subordinate to the achievement of their core objectives, there is a risk that they may not achieve economy and efficiency in the acquisition, use and disposal of property assets
 - There is a very clear divergence in the operational policies adopted by the Agencies in relation to the management and holding of industrial property
 - The extent of private sector involvement in property provision and the existence of a viable commercial market for industrial property differs in the areas served by each Agency. This has important effects on the methods for measuring the performance of the Agencies
- 1 15 The objective of the examination was to establish the extent to which the Agencies manage the provision of industrial property to meet demand in an economic and

efficient manner. In particular, the examination sought to address the following issues.

- Are the property portfolios managed economically and efficiently?
- Is industrial property acquired, developed and disposed of in an economic and efficient manner?
- Do the Agencies have appropriate performance measurement systems taking into account their diverse primary objectives?

Scope of the Examination

- 1 16 The examination focused on the provision and management of industrial property by the Agencies and on how those activities are related to their primary roles
- 1.17 When the examination was undertaken, the latest available complete information about expenditure on property activities related to the calendar year 1996. For this reason, the data analysis carried out relates to the period 1995 and 1996. However, the Agencies' current practices in relation to industrial property were also reviewed and are reported here
- 1.18 The examination did not include reviews of the project management of specific capital contracts by the Agencies or of the economy, efficiency or effectiveness of the Agencies' industrial project assistance activities. The management of other forms of property (e.g. the Agencies' own administrative buildings or tourism or community facilities) was not reviewed

Examination Methodology

- 1 19 The examination was conducted by staff of the Office of the Comptroller and Auditor General with the assistance of Lisney, consultant chartered surveyors
- 1 20 Detailed discussions were held with key property and other executives in the three Agencies to ascertain current policies, practices and procedures. Meetings were also held with relevant officials in the Department of Enterprise, Trade and Employment, the Department of Arts, Heritage, Gaeltacht and the Islands and the Department of Finance.
- 1 21 Relevant reports, documents and databases were examined and analysed, including the 1995 review carried out by JLW/Indecon and a 1994 study of State support for investment in industrial land and buildings carried out by the Industry Evaluation Unit of the Department of Enterprise, Trade and Employment

2 Management of Current Property Portfolios

- 2.1 This chapter examines aspects of economy and efficiency associated with the use of the industrial property held by the Agencies. The value for money issues related to changes in the capital value of industrial property assets arising from acquisitions, development and disposals are considered in Chapters 3 and 4

Performance Indicators for Property Management

- 2.2 Commercial investors in property assets expect to receive a financial return related to their use while the assets are held and to benefit from appreciation in their capital value when the assets are sold. The benefits derived from commercial property management can be assessed in terms of the profit earned from managing the assets and the gain or loss on its eventual disposal
- 2.3 The primary objective of the Agencies is to use their property assets to achieve wider industrial promotion and job creation objectives and this involves making decisions to invest in areas where it may not be possible to earn the level of returns which would attract private sector investors. Accordingly, in measuring the value for money achieved by the Agencies, it is important to separate the costs and benefits associated with the promotion of economic or regional development from those purely associated with property management. Any comparison between the performance of the Agencies and the private sector must also take into consideration the unwillingness of the private sector investor to invest in some of the areas served by the Agencies
- 2.4 The level of costs associated with holding, maintaining and administering property asset portfolios is a measure of the economy achieved by the Agencies in managing the assets. The appropriateness of the property relative to its intended use is a further measure of economy which is beyond the scope of the examination

Figure 2.1 Value for money indicators in property management

Economy indicators	<ul style="list-style-type: none">• Costs of holding, maintaining and administering property assets• Suitability of property for its intended use
Efficiency indicators	<ul style="list-style-type: none">• Nature and extent of the use of property (occupancy)• Life time occupancy rate• Unit cost of holding property• Revenue per unit of property
Effectiveness indicator	<ul style="list-style-type: none">• Optimal usage of property assets to achieve primary objectives of the Agencies

- 2.5 The Agencies provide industrial property not for their own direct use but for use by their clients. Ideally, the effective use of the property assets would be achieved when the property in the portfolios would be actively in use all the time. In practice, this is not achievable, for a variety of reasons. For example, a certain amount of vacant property is required for promotional purposes. The extent to which individual property units and the overall portfolio are in use and the nature of the use of property are primary indicators of efficiency in managing the assets. Since the operational objective is to rent out property to tenants, the revenue per unit of property is a further measure of efficiency.

Management Information

- 2.6 Each of the Agencies uses a number of property databases to record information about their property holdings. None of the databases satisfy the entire information requirements for performance management analysis. This impedes their ability to evaluate how economically and efficiently the portfolios are being managed and to make appropriate changes to improve the value for money achieved.
- 2.7 The major deficiencies in the existing databases are
- Important information about the current condition of buildings and the state of development of sites is not always available on the property databases
 - There is very little information readily available about the life cycle of property assets e.g. the history of occupation of a unit since its acquisition
 - The Agencies' financial management systems contain some information about property (e.g. capital values, rents received, costs of property operations) but the information is not integrated with the property databases. In addition, a factory unit may be defined differently in the separate systems within each Agency. As a result, it is very difficult to establish the costs and revenues associated with individual property assets.
- 2.8 New property information systems are being developed by both Shannon Development and An tÚdarás. The new systems are intended to integrate financial and property information and are expected to provide information which will facilitate performance analysis, eliminating the identified deficiencies. The IDA Ireland database is the most comprehensive and is subject to ongoing enhancements.
- 2.9 The deficiencies in the Agencies' property databases created difficulties in carrying out this examination. A further difficulty arose in making comparisons between the Agencies because of differences in definitions and in the level of detail available. Where possible, the data presented in this chapter is based on common definitions. In a few cases, the required data was not available and this is indicated where appropriate.
-

Composition of the Property Portfolios

- 2 10 Table 2.1 shows summary details of the factory space held by each of the Agencies at the end of 1996. In addition, each of the Agencies had substantial holdings of land intended for industrial use. The combined net book value of the land and buildings portfolio for all three Agencies was £274 million.

Table 2.1 Summary of industrial property holdings, by Agency, at end 1996

	Factory space 000 m ²	Number of factory units
IDA Ireland	582	807
Shannon Development	399	550
Údarás na Gaeltachta	246	379
All Agencies	1,227	1,736

Source: Annual reports and management reports of the Agencies

- 2 11 Most of the property included in the portfolios is owned outright by the Agencies. The IDA Ireland portfolio includes 93 factory units totalling over 113,000 square metres of factory space (almost 20% of the total space held by the Agency) which were leased from private developers in the period 1981 to 1985 on 35 year leases.
- 2 12 IDA Ireland has a higher proportion of large industrial units (i.e. more than 3,600 square metres) in its portfolio than either Shannon Development or An tÚdarás (see Table 2.2). The latter two Agencies have substantially more mid-sized units (i.e. between 900 and 1,800 square metres). Many of the smaller units (450 square metres or less) in IDA Ireland and Shannon Development are grouped in incubator units, cluster units and enterprise centres, sharing common facilities.
- 2 13 A substantial amount of the factory space held by the Agencies is quite old. At the end of 1996, the average age of the units in IDA Ireland's portfolio was 17 years and very little of the space had been built after 1985. The average age of the units in Shannon Development's portfolio was around 20 years while the units in the Údarás portfolio were, on average, 15 years old. Further detail on the age profile of the portfolios is given in Appendix B.

Current Property Costs

- 2 14 The Agencies incur substantial current costs in managing their industrial property portfolios. Total expenditure in 1996 is estimated to be £7.9 million (see Table 2.3).

Table 2.2 Industrial property holdings, by Agency and size of unit, at end 1996

Size of unit	IDA Ireland	Shannon Development	An tÚdarás	All Agencies
450 m ² or less	11%	13%	17%	13%
450 - 900 m ²	8%	10%	20%	11%
900 - 1,800 m ²	8%	34%	22%	19%
1,800 - 3,600 m ²	29%	17%	21%	24%
Over 3,600 m ²	44%	26%	20%	33%
All sizes of unit (thousand square metres)	100% (582)	100% (399)	100% (246)	100% (1,227)

Source Analysis of Agencies' databases by Office of the Comptroller and Auditor General

Table 2.3 Industrial property current costs, by Agency, 1996

Expenditure category	IDA Ireland	Shannon Development	An tÚdarás	All Agencies
	£m	£m	£m	£m
Holding costs				
Maintenance and services	1 85	1 31	0 68	3 84
Light, heat, power	0 22	0 37	0 07	0 66
Rates and insurances	0 35	0 40	0 20	0 95
Total holding costs	2 42	2 08	0 95	5 45
Administration costs	1 14 ^a	1 05	0 22	2 41
Total current property costs	3 56 ^b	3 13	1 17	7 86
Holding costs per m²	£4 20	£5 20	£3 90	£4 40

Notes a Excludes cost of negotiating private sector provision of new industrial property

b IDA Ireland also incurred current expenditure of £0.5 million in 1996 in respect of the amount of rental for the properties it holds on 35-year leases not recovered from sub-tenants. See paragraph 2.11

Source Analysis of Agencies' annual reports and management reports by Office of the Comptroller and Auditor General

- 2 15 The property consultants engaged to assist in the examination pointed out that, for private sector property developers, annual property holding costs would normally be in the range £2 25 to £3 25 per square metre. The unit holding costs incurred by all the Agencies were significantly above this range. The cost incurred by Shannon Development was almost 60% higher than the maximum.
- 2 16 Holding costs are higher for the Agencies than for commercial property developers for a number of reasons
- Private sector developers usually insist on lease agreements which transfer responsibility for most current property costs (e.g. maintenance, repairs, security, insurances, up-keep of grounds and local authority rates) to their lessees. The Agencies' policy is generally to recover these costs when agreeing new leases but this was often not done in the past
 - Due to the industrial development role of the Agencies, their industrial properties frequently had a higher specification than the private sector and needed to be maintained to a higher standard. However, the property consultants assisting with the examination were of the opinion that the standard of recent private sector business parks matched that of the Agencies for a lower maintenance cost
 - In a number of cases, the Agencies bear the costs of maintenance, cleaning of common areas, site security and landscaping even though the current leases provide for these charges to be recovered from the tenants
 - All of the Agencies allow units to be occupied on the basis of temporary leases and handover letters pending the finalisation of formal lease agreements. In a limited number of cases, leases are not subsequently agreed many years after occupancy commenced³. As a result, there may be ambiguity over who should bear the maintenance and other holding costs of the property and who bears responsibility for ensuring compliance with health, safety and pollution legislation. This practice would rarely occur in the private sector
 - The age profile of the portfolios indicates that much of the property held is old and would require a high level of repairs and maintenance
 - In certain situations, the Agencies carry out repairs and maintenance work to buildings which are occupied. Such work may, for instance, relate to faults which were not apparent at the time of occupation, for example, roof leaks

³ *In Shannon Development, some 54 property units which were occupied for more than a year in January 1998 were let without formal signed leases being put in place. There are a number of similar cases in each of the other Agencies*

Occupancy of Industrial Property

- 2.17 From an efficiency point of view, it is desirable that expensive property assets are not left unused for long periods. However, minimising the level of property vacancy could conflict with the Agencies' policy of maintaining a bank of advance factory space to facilitate quick start-ups for mobile investment projects, which is a key contributor to their effectiveness. The requirement is to identify the appropriate balance between the efficiency and effectiveness objectives
- 2.18 The property in the Agencies' portfolios is categorised in a variety of ways in terms of its occupancy status (see Figure 2.2). For simplicity, these are reduced to two categories ('occupied' and 'vacant') for the purposes of this report. It should, however, be recognised that once an Agency reserves a vacant premises for a specific project, that property is no longer available for promotion to other potential investors

Figure 2.2 Occupancy status of industrial property

Occupied property	<ul style="list-style-type: none">• long term lease (usually 20 or 21 years)• short term lease (up to 5 years)• temporary letting, typically where small vacant units are let on a short-term basis for use as temporary stores
Vacant property	<ul style="list-style-type: none">• 'reserved' for a specific industrial project• vacant

Occupancy Targets

- 2.19 None of the Agencies have set target occupancy levels although all have pointed out the importance of having some vacant property to show to visiting industrialists
- 2.20 Private sector property companies would expect to achieve at least 90% occupancy over the useful life of the assets. This allows for periods of vacancy before and between lettings
- 2.21 At the end of December 1996, around 83% of the industrial space held by the Agencies was occupied (see Table 2.4). While the overall occupancy rate had changed very little by the end of June 1998, there were significant changes in the rates for the Agencies
- 2.22 The occupancy rate for the IDA Ireland portfolio fell from 87% to 82% because almost all of 145,000 square metres of property sold by the Agency in the intervening period was occupied space. There was a slight increase in the amount of vacant space held by the Agency (up from an estimated 76,000 square metres in 1996 to almost 79,000 square metres in 1998)

Table 2 4 Occupancy rates, by Agency, at December 1996 and June 1998

	Proportion of factory space occupied	
	December 1996	June 1998
IDA Ireland	87%	82%
Shannon Development	77%	85%
Údarás na Gaeltachta	84%	86%
All Agencies	83%	84%

Source Analysis by Office of the Comptroller and Auditor General

Composition of Vacant Space

- 2 23 Much of the vacant factory space held by the Agencies at the end of 1996 was concentrated in a relatively small number of units (see Table 2 5). Around 58% of IDA Ireland's vacant space was concentrated in units in excess of 1,800 square metres. The bulk of vacant space in the other two Agencies was concentrated in mid-size units ranging from 900 to 1,800 square metres.
- 2 24 IDA Ireland's vacant space included some 7,300 square metres of space in 13 privately-owned properties held on 35 year leases. Although vacant, the full liability for holding costs and rental payments for these properties rests with the Agency.
- 2 25 A considerable amount of the vacant property held by Shannon Development and An tÚdarás is quite old and would require extensive refurbishment before it could be

Table 2.5 Vacant factory space, by Agency and size of unit, at end 1996

Size of unit	IDA Ireland	Shannon Development	An tÚdarás	All Agencies
450 m ² or less	21%	15%	18%	18%
450 - 900 m ²	10%	15%	18%	14%
900 - 1,800 m ²	11%	43%	37%	31%
1,800 - 3,600 m ²	33%	16%	9%	20%
Over 3,600 m ²	25%	11%	18%	17%
All sizes of unit	100%	100%	100%	100%

Source Analysis of Agencies' databases by Office of the Comptroller and Auditor General

used. However, as many of the vacant units are located in peripheral regions which are less attractive to project promoters or to private sector property providers, there is no perceived economic benefit to be achieved from refurbishing them. Both Agencies have indicated that these properties are also unsuitable for use for promotion purposes. As a result, while they have relatively lower rates of occupancy than the private sector, at the same time they have little property to use to attract investment projects.

- 2.26 In setting target occupancy rates and monitoring performance, the Agencies should specifically identify property which is unpromotable and state their policies for dealing with it.

Lifetime Occupancy of Industrial Units

- 2.27 The occupancy rate over the lifetime of property assets is an indicator of the efficiency with which a property asset has been used. The Agencies' property databases do not facilitate analysis of the lifetime occupancy rate of the factory space in the Agencies' current portfolios.
- 2.28 The 1995 JLW/Indecon study included an analysis of the IDA Ireland portfolio to establish the lifetime occupancy of the units. The study found that the property held at the end of 1994 had been occupied for only 64% of the time since it had been acquired. Buildings over 1,800 square metres and cluster/incubator type units had the lowest lifetime occupancy rates. In peripheral areas, lifetime occupancy levels of under 50% were achieved.
- 2.29 Low levels of lifetime occupancy of industrial space is consistent with the earlier government policy of providing a large proportion of advance factory space.

Industrial Property Revenues

- 2.30 Because the Agencies provide industrial property assets to their clients on a rental basis, the level of efficiency achieved should also be measured in terms of the revenue realised per unit of property let.

Setting Rent Levels

- 2.31 The rents which new occupiers of property are willing to pay usually reflect the current level of demand for property and the quantity of property which is available. The level of rents paid by existing occupiers reflects market conditions in the past and the duration of the lease arrangements entered into. Commercial property developers will be attracted into the market to the extent that the rents achievable are sufficient to generate the developers' target rate of return on their investments.

- 2 32 The main reason the Agencies became involved in property provision was because the market was failing to supply property in many places at prices which potential occupiers could afford. The economic argument for this approach is based on the belief that the public sector does not need to achieve as high a rate of return as commercial operators would require and so could afford to operate in circumstances where the private sector will not. On that basis, the Agencies could supply property at affordable prices in more places than the private sector would and still achieve acceptable economic returns. If they received a level of rental income which failed to yield the required rate of return on the money invested, they would be subsidising the enterprises occupying the space provided.
- 2 33 Since the Agencies can influence the demand for space through their industrial development activities and are also involved to varying degrees in supplying space to meet that demand, they have effectively become the market makers in many areas and heavily influence the market. In those circumstances, identifying a meaningful market rent level for industrial property is very difficult.

Rents for New Lettings

- 2 34 All of the Agencies state that the rents they charge for new lettings are the best rates achievable given the circumstances of each case (location, age and condition of the property and the type of prospective tenant) and current market conditions. For IDA Ireland and Shannon Development, this involves applying high rentals in their prime areas and estates and lower rents in other letting locations.
- 2 35 For many tenants, the Agencies agree to pay rent reduction grants for a period as an inducement to the tenant to undertake the investment in question. For IDA Ireland and Shannon Development, there is usually a relatively small reduction for a short period. For An tÚdarás clients, there may be a higher level of discount for a period of five to ten years.

Guideline Rents

- 2 36 A set of guideline rent levels which were originally drawn up in respect of the IDA Ireland portfolio evolved over a number of years into what is effectively a shared view of the rent levels achievable in the various market segments. The Agencies test the reasonableness of the proposed rents charged for new lettings or at rent reviews against those guidelines. In 1996, the guideline annual rents were
- £43 per square metre for industrial units in Dublin
 - £32.30 per square metre for large units and £29.60 for smaller units in most areas outside Dublin

- £25 80 per square metre for large units and £23 70 for smaller units in Gaeltacht areas (i.e. a 20% discount on rents charged in other areas outside Dublin)

2.37 The guideline rents were arrived at by the Agencies taking into account their own knowledge of the property market and independent professional advice. The rates are reviewed regularly and while there have been some changes from time to time, the rates set have, in general, been quite stable. For instance, the guide price of £32 30 for larger units outside Dublin has remained unchanged over the period 1991 to 1998 although the price index for industrial property rents increased more than the general rate of price inflation over the same period. IDA Ireland considers that the guideline rents were somewhat above the market level for a number of years but are now more in line with the prevailing rates.

Average Revenue per Square Metre

- 2.38 The guideline rents have not been adopted by the Agencies as formal targets for rents charged. However, since the guidelines are regarded as indicators of the market rate, the average rental revenue per square metre can be compared to the guideline to give some indication of the Agencies' performance in setting rents.
- 2.39 Table 2.6 shows the estimated gross rent received by each of the Agencies in 1996, before allowance is made for rent reduction grants. The average rent received per square metre of occupied property is also shown and is expressed as a percentage of the relevant 'standard' guideline price.

Table 2.6 Rental income, by Agency, 1996

	Rental income	Average rental income per m ² of occupied space	Guideline rent ^a per m ²	Average % of guideline rent achieved
IDA Ireland	£14.2m ^b	£28.06	£32.30	87%
Shannon Development	£9.0m	£28.96	£32.30	90%
Údaras na Gaeltachta	£4.1m	£19.95	£25.80	77%
All Agencies	£27.3m	£26.82	—	—

Notes a If the Agencies' property databases could readily generate profiles of the location and size of industrial units, a weighted guideline could be used here.

b This includes £3.4 million rental received in respect of the property which IDA Ireland holds on 35-year leases.

Source Analysis by Office of the Comptroller and Auditor General

- 2 40 For all three Agencies, the average rent received in 1996 was lower than the standard guideline price. Shannon Development was closest to the guideline. The average rental received by IDA Ireland includes rent from property let in Dublin but was still considerably below the guideline price it set for property outside Dublin. The average for An tÚdarás was substantially below its guideline rate.
- 2 41 This analysis suggests that the rents charged, particularly for the property in the IDA Ireland and Údarás portfolios, are in many cases significantly below market levels. In part, this may arise because some property is occupied on the basis of temporary lettings at low rents, on the principle that some rent is preferable to no rent, if the property was left vacant. (For instance, IDA Ireland has let a very large vacant unit at a rental of £0.43 per square metre.) In some cases, where clients require smaller units than are available in a particular area, they may be allocated a larger unit at a rent level based on the amount of space the client requires. The more significant reason for the shortfall is that, over many years, the rents set for the Agencies' property did not reflect the prevailing market rates and/or that the rent review mechanisms built into the lease agreements have failed to raise the rent roll in line with market prices generally.
- 2 42 The failure to set rents at market levels means that many of the Agencies' tenants, and particularly those of IDA Ireland and An tÚdarás, have benefitted significantly from a form of hidden subsidy. Furthermore, since property values are usually related to the rent generated, the capital value of many of the Agencies' industrial units is also reduced.

Conclusions

- 2 43 The Agencies' capacity to appraise the economy and efficiency of their property operations is impeded by deficiencies in their current property information systems. All the Agencies are working on improving their systems.
- 2 44 While the availability of a stock of vacant promotable factory space in a range of locations is regarded by all the Agencies as being of strategic importance, none of them have set target occupancy levels for their portfolios. All the Agencies have significant amounts of property which they regard as unpromotable for industrial purposes.
- 2 45 The Agencies effectively subsidise the property costs of many of the enterprises which occupy the industrial units in the portfolios. The main ways in which this is done is through the Agencies bearing some property holding costs which commercial operators would pass on to their tenants and in setting rent levels below prevailing market prices. Recent practice in the Agencies suggests that this subsidisation is being phased out but existing lease agreements mean that the subsidy element will continue to be borne for some considerable time.

3 Industrial Land and Infrastructure

- 3 1 The Agencies acquire land with the intention of developing it to ensure that they can satisfy the demand for land for industrial development within a reasonable period ⁴ An undersupply of land would be a serious impediment to industrial and regional development but holding more land than is required would be an inefficient use of capital resources There could also be a risk to economy and efficiency if the cost of acquiring and developing land is too high or if the proceeds achieved on disposal are too low

Figure 3.1 Performance measures for acquisition, holding and disposal of land

Acquisition	<ul style="list-style-type: none"> • Total purchase cost • Purchase cost per hectare • Development cost per hectare
Holding	<ul style="list-style-type: none"> • Land held as a multiple of annual demand
Disposal	<ul style="list-style-type: none"> • Revenue from sale of land • Sale price per hectare • Capital gain/loss on disposal • Economic yield achieved on disposal

- 3 2 Table 3 1 sets out the amounts spent by the Agencies in 1995 and 1996 in acquiring and developing land It also shows the amount realised through land sales

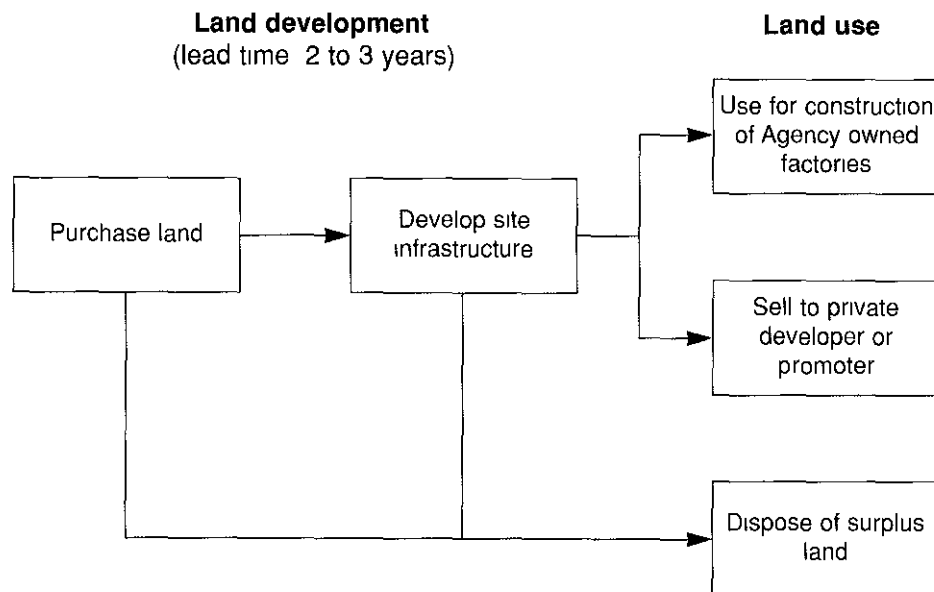
Table 3.1 Value of land acquisitions and sales, in 1995-1996

	IDA Ireland	Shannon Development	An tÚdarás	All Agencies
	£m	£m	£m	£m
Land purchases	11 6	0 1	0 1	11 8
Expenditure on land development	5 1	2 8	1 3	9 2
Total cost of land development	16 7	2 9	1 4	21 0
Revenue from land sales	13 5	4 5	—	18 0

Source Analysis by Office of the Comptroller and Auditor General

⁴ Shannon Development considers that the availability of developed infrastructure can be used strategically to generate demand from industrialists in specifically targeted sectors and investment by the private sector in the provision of speculative space, for example, through the development of technology parks

Figure 3 2 Land acquisition and disposal activities



Acquisition and Development of Industrial Land

- 3 3 The Agencies aim to ensure that there is an adequate supply of serviced land suitable for building factories or other industrial units within their respective regions. Because of the long lead times in acquiring land and installing infrastructure, most industrial land development is performed by the Agencies themselves. In some cases, they also provide and manage on-going services such as sewage treatment works. Local authorities in many non-Gaeltacht areas have also undertaken some land development but on a much smaller scale.
- 3 4 Figure 3 2 outlines the range of activities involved in the development and use of industrial land.
- 3 5 JI/W/Indecon estimated that the minimum lead time for acquiring land and installing basic infrastructure such as water, sewerage, service roads and utilities is between two and three years. Ideally, services would only be installed when a use for the land has been identified but this is not usually practical for the Agencies, who must undertake development in advance of identifying end-users. As a result, they may strategically hold some land for a period without performing any development work. They may also have land which is fully serviced but which is not utilised for long periods. Unfortunately, the current property databases do not permit the land bank to be analysed from these perspectives.

- 3 6 The development of infrastructure for land is not an end in itself. It only has value when the land is used for the purpose intended, which in this case is the construction of industrial units by the Agencies, the industrial project promoters themselves or private developers or local authorities. Due to the long lead times, changes in strategy and in external circumstances can mean that some of the land in the portfolio may effectively become unsuitable for industrial purposes. The most efficient action in these cases may be to dispose of the surplus land where it is economically beneficial.

Changes in the Agencies' Land Holdings

- 3 7 At the end of 1996, the total amount of land held by the Agencies for industrial purposes amounted to almost 2,200 hectares (see Table 3 2). In the years 1995 and 1996, the Agencies used an estimated 10 hectares for building factories and sold a further 153 hectares. In the same period, they bought over 200 hectares, with the result that the total amount of land held increased slightly.
- 3 8 Most of the activity consisted of land acquisitions and disposals by IDA Ireland. The provision of serviced land in suitable locations for private sector development is becoming an important activity of IDA Ireland, particularly since the programme for the disposal of industrial buildings commenced in 1996.

Table 3 2 Industrial land bank additions and deletions, 1995-1996

	IDA Ireland	Shannon Development	An tÚdarás	All Agencies
	hectares			
Land used in Agency building programme in 1995 and 1996	1	4	5	10
Sales of land in 1995 and 1996	115	37	1	153
Total deletions from land bank	116	41	6	163
Land acquired in 1995 and 1996	195	1	6	202
Net change in landholding	79	(40)	—	39
Land held at end 1996	1,160	896	110	2,166

Source: Analysis by Office of the Comptroller and Auditor General

Efficiency in Land Holding

- 3 9 The efficiency with which the Agencies hold land can be evaluated in terms of the overall amount of land held and the suitability of the land for the intended purposes

Size of Land Holding

- 3 10 The amount of land which the Agencies hold at any point in time (i.e. the supply of industrial land) can be expressed as a multiple of the annual demand for industrial land (i.e. the amount of land used or sold each year)
- 3 11 The J.L.W./Indecon report explored the issue of how much land was needed to meet demand from new and expanding enterprises and recommended that the target supply of industrial land should be around ten times the annual level of demand. Their approach (described in Appendix C) recognised that the regional policy objectives of the Agencies required that land should be acquired and developed in more locations than would otherwise be necessary. They also pointed out that there needs to be provision for internal roads and other 'unusable' land and to allow for the lead time to develop land. The computation of the multiple for the target supply of land was reviewed by the property consultants engaged to assist with the examination and was found to be a reasonable approach
- 3 12 The total amount of land held by the Agencies at the end of 1996 was almost 27 times the average annual amount of land developed or sold in the preceding two years. IDA Ireland's supply of land was 20 times the annual demand. Supply was in excess of 40 times the level of annual demand for the other Agencies
- 3 13 In drawing up its 1996-1998 property plan, IDA Ireland identified its target overall land holding at 1,085 hectares. The target was derived from an analysis of the demand for land and the likely requirements in each of the centres identified for development throughout the region served. Based on the estimated average annual demand for land in the years 1995 and 1996, the target land holding was equivalent to 19 times demand, compared to the multiple of ten times demand envisaged in the J.L.W./Indecon report. The Agency made greater allowances for unusable land and for regional dispersion and assumed the demand for land would be significantly higher than experienced historically. It believes that its target is justified and essential to deliver on its regional remit. At the end of 1996, the Agency's actual landholding, at 20 times demand, was slightly higher than the target

Composition and Location of Land Holdings

- 3 14 Despite holding quantities of land which are many times the amount of land used for industrial purposes each year, all of the Agencies consider that they need to acquire more land in certain key locations. IDA Ireland and Shannon Development also

Case study 1 Ballylongford site

Shannon Development's land bank includes a large site at Ballylongford (County Kerry) comprising 245 hectares of undeveloped land. The land was originally acquired in a number of lots over the period 1978 to 1981 by the (then) Industrial Development Authority as a strategic site for heavy industry/chemicals.

The land was transferred to Shannon Development in 1988. The Agency has carried out an analysis of the potential uses for the land and concluded that it could be used for projects in the bulk commodities sector but that, for the foreseeable future, that market is already well supplied with land. Most of the site (213 hectares) is now let on conacre, generating an income of £25,000 a year. The rest of the site (32 hectares) has been planted with trees.

The site was originally acquired at a cost of £4.5 million, equivalent to £18,400 per hectare. Shannon Development has conceded that, if it were to dispose of the land, it would be unlikely to recover the original investment since the current cost of agricultural land is around £5,000 to £7,500 a hectare.

recognise that they have considerable amounts of land which they are unlikely to be able to use for industrial purposes in the foreseeable future. This includes:

- land purchased by the Agencies as being strategic to longer term development needs but no longer required under current development strategies
- land purchased cheaply in the past which would not realise an appreciable amount if disposed of now but which may, in the very long term, have development potential.

- 3 15 In its 1996-1998 property plan, IDA Ireland identified 270 hectares of its land holding which is not considered to be 'promotable' and which is now being disposed of. They also identified eight locations where the amount of land held was substantially more than they estimated was likely to be required in the medium term⁵. The excess land in these locations amounted to 114 hectares. Taken together, almost one third of the land area held by IDA Ireland in April 1996 was not required. The total cost of acquiring, and in some cases developing, this land has not been calculated.
- 3 16 Shannon Development's 1995-2000 property plan contains an analysis of land held in terms of its suitability for promotion and identifies a total of 308 hectares (34% of the total) as being in remote locations and for which there is likely to be no demand. This includes very large sites at Ballylongford (see case study 1) and at Askeaton (County Limerick). The book value of the unpromotable land is £6.4 million.

⁵ *This sometimes occurred because of the need to buy a full block of land which was on sale in order to get possession of a strategic site.*

Cost of Land Purchased

- 3 17 Most of the land acquired by the Agencies in 1995 and 1996 was purchased by IDA Ireland, which bought 195 hectares in 12 lots at an average cost of almost £60,000 a hectare. Shannon Development purchased just over one hectare of land in two small lots at an average cost of £87,000 a hectare. An tÚdarás purchased eight hectares in four lots at an average cost of £13,000 a hectare.
- 3 18 The prices paid by the Agencies were reviewed by property consultants to assess the reasonableness of the prices paid, relative to prevailing market rates. They concluded that the prices paid by the Agencies were, in general, in line with market rates and reflected the variation in prices which occurs in different regions (see Table 3.3).
- 3 19 The market price of land for industrial purposes is influenced by many factors, including the buoyancy of the property market, the site location and the existing state of development. The strategic value of the land (e.g. permitting expansion of existing businesses) may be particularly important and can result in very high prices being paid for very small amounts of land. Case study 2 records details of two such transactions where exceptional prices were paid for land. In both transactions, the area of land involved was small but the transactions significantly improved existing holdings.

Table 3.3 Cost of land acquired by the Agencies, by location, 1995-1996

	Cost per hectare of land ^a		
	Average £'000	Minimum £'000	Maximum £'000
Greater Dublin area	126	55	225
Other major urban areas	62	54	101
Provincial locations	17	10	86
All locations	58	10	225

Note a Excludes the exceptional transactions described in case study 2

Source Analysis by Office of the Comptroller and Auditor General

Cost of Site Infrastructure

- 3 20 Site development involves the installation or construction of basic infrastructure such as internal roads, water, electricity and telecommunications supply and drainage and sewerage systems. Approximately 65% of the IDA Ireland land bank, 45% of the Shannon Development land bank and 25% of the land bank held by An tÚdarás is thought to be fully serviced.

Case study 2 Exceptional land acquisitions

In 1996, IDA Ireland paid £543,000 per hectare for 1.2 hectares of land to be incorporated into a Dublin business park for which it had previously paid £155,000 and £125,000 per hectare for two larger lots of land. The land was acquired to assemble a site of 4.5 hectares with additional road frontage to meet an identified client's needs. The full site was sold on to the client for £1.6 million (equivalent to £362,000 per hectare) which fully covered the overall costs of acquisition.

Údarás na Gaeltachta paid £28,000 for less than 0.2 hectares (equivalent to £175,000 per hectare) in Connemara. This purchase was incorporated into an existing holding and increased the road frontage of the combined site from 10 metres to 46 metres. The average cost of the entire holding is £37,500 per hectare.

- 3.21 The Agencies spent a total of £9.2 million in 1995 and 1996 on the installation of basic infrastructure on the land they held. In most cases, the Agencies are obliged to make substantial capital contributions to local authorities and utility companies for connection to their services.
- 3.22 The unit costs of developing a hectare of land to the required level are even more difficult to determine than the unit costs of purchase. The installation of basic infrastructure typically takes place over a number of years, depending on the availability of funding and the priority of the land for development. The financial records of the Agencies do not facilitate the extraction of a profile of expenditure on infrastructure for individual industrial estates over a period of time. In addition, every site has its own individual requirements and the industry sector which an estate is intended to attract will largely dictate the level or standard of services required. Remote sites are more costly to develop than sites adjacent to existing industrial estates or to other sites which are already developed.
- 3.23 The Agencies were asked to estimate their indicative cost to develop land to the level required for industrial building.
- IDA Ireland estimated that the unit cost of developing land was higher in the eastern half of the country (£50,000 to £110,000 a hectare) than in the western half (£37,000 to £62,000 a hectare)
 - Shannon Development estimated the unit cost of developing a hectare of land at between £100,000 and £125,000
 - An tÚdarás estimated the unit cost at around £125,000 on average
- 3.24 Property consultants have suggested that infrastructure costs for a modern prime industrial development would be of the order of £70,000 to £100,000 per hectare.
-

While precise infrastructure development costs are not available, this appears to be consistent with IDA Ireland's cost experience but is significantly lower than cost estimates for Shannon Development and An tÚdarás. Shannon Development considers that its higher unit cost is related to the specification of the site infrastructure which it provides i.e. low density parkland-type developments. In the case of An tÚdarás, the nature of the terrain and the under-development of local authority infrastructure in many of the areas served add considerably to the costs.

- 3.25 Twelve fully-serviced industrial estates were selected from the Agencies' portfolios and the recorded expenditure on the infrastructure installed was identified. Expenditure was incurred over variable periods, ranging from 18 months to more than 20 years. The data indicated a very wide band of unit costs, ranging from £27,000 to £99,000 per hectare.

Disposal of Land

- 3.26 There were 170 separate sales of land by the Agencies in 1995 and 1996, totalling 153 hectares. Total receipts were £18 million (see Table 3.4).
- 3.27 The unit sales prices achieved by the Agencies were reviewed by property consultants in the light of prevailing market rates. They concluded that the prices received by the Agencies were generally strong relative to market rates. In a few cases, the prices achieved exceeded the going rate.

Table 3.4 Capital gains on land sales, by Agency, in 1995-1996

	IDA Ireland	Shannon Development	An tÚdarás	All Agencies
	£m	£m	£m	£m
Cost of land	4.6	0.9	—	5.5
Cost of development	4.7	3.2	—	7.9
Total cost of land sold	9.3	4.1	—	13.4
Revenue from land sales	13.5	4.5	—	18.0
Capital gain	4.2	0.4	—	4.6

Source: Analysis by Office of the Comptroller and Auditor General

- 3 28 The main value for money concern in relation to sales prices for assets is that the best possible price is achieved and that broadly seems to be the case. However, it is also of interest to establish if the cost of acquiring and developing the land has been recovered through the sale.
- 3 29 In cash terms, the Agencies raised considerably more than the recorded cost of acquiring and developing the land which was sold. However, the use of overall capital gain as a performance indicator needs to be treated with caution as this definition of profit does not take into account the length of time that land was held. For example, if land which cost £1 million to buy and develop in 1985 was sold in 1995 for £1.5 million, the cash profit is 50% but it is more meaningful to view the outturn in terms of the rate of appreciation in the capital value over the period the land was held i.e. just over 4% a year. Unfortunately, data deficiencies preclude an analysis of the Agencies' land sales along these lines.

Conclusions

- 3 30 At the end of 1996 the Agencies held more than 2,200 hectares of land for industrial development purposes. This appears to be considerably in excess of requirements based on past levels of demand for land. At the same time, all the Agencies have identified locations where extra land is needed. Significant parts of the IDA Ireland and Shannon Development land banks are unsuitable for industrial purposes given current development strategies or are surplus to requirements in particular locations. This suggests that the portfolios of land held by the Agencies are substantially unsuitable for the purposes intended.
- 3 31 In monitoring performance in relation to land holdings, the Agencies should set overall efficiency targets in terms of total supply as a multiple of average annual demand. The proportion of the land held which is unpromotable or unlikely to be used in the medium to long term (say, within 10 years) should also be monitored as an indicator of effectiveness of the Agencies in matching the portfolio to the emerging demand for land.
- 3 32 Prices paid by the Agencies for land in the period 1995 to 1996 were generally in line with prevailing market rates. Strong prices relative to market rates were achieved for land sales in the same period. However, it is not possible to identify the average annual economic return (if any) earned on investment in the land which was sold.

4 Industrial Buildings

- 4.1 The value for money considerations in relation to the acquisition and disposal of industrial buildings are similar to those relating to industrial land. The Agencies are effective when they can ensure the timely supply of buildings, either directly or by the private sector, to meet the needs of industrial promoters. An oversupply of buildings would achieve this but would also result in inefficiency in the form of excessive rates of vacancy of property or a low financial return through rental income, as discussed in Chapter 2.
- 4.2 The cost to the Agencies of acquiring industrial buildings and the price realised on disposal are the main indicators of the value for money achieved in making changes to the portfolios. Figure 4.1 summarises the type of indicators that could be used to assess performance in relation to acquisition and disposal activity.

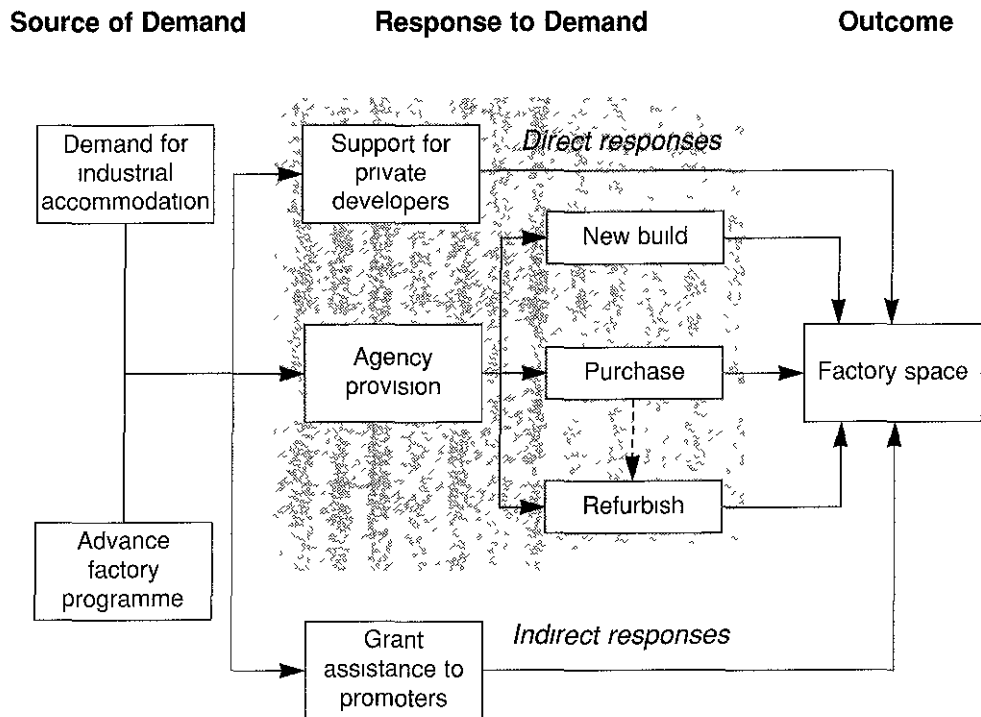
Figure 4.1 Performance measures for acquisition and disposal of buildings

Acquisition	<ul style="list-style-type: none">• Total purchase cost• Cost per square metre
Disposal	<ul style="list-style-type: none">• Total revenue from disposals• Sale price per square metre• Capital gain/loss on disposal

Satisfying the Demand for Industrial Buildings

- 4.3 There are several ways in which the demand for industrial buildings can be met. Figure 4.2 outlines the main approaches, distinguishing between direct provision of industrial buildings by the Agencies and the alternative option where the private sector provides the required space.
- 4.4 Some industrial promoters have very particular requirements which can only be met by the provision of bespoke facilities. In other cases, where the client's requirements are not specialised, the required facilities can be met quickly by adapting a vacant advance factory. Each of the Agencies recognises the need for a certain amount of advance factory space to be provided speculatively. Thus, the overall demand for industrial property in any year is the sum of the bespoke demand and the estimated advance factory requirement.
- 4.5 National policy in relation to the provision of industrial buildings is that the Agencies should only intervene where private sector provision is not occurring (i.e. where there is a clear market failure). It was accepted in the Operational Programme for Industrial Development 1994-1999 that the availability of serviced industrial land and suitable

Figure 4.2 Satisfying the demand for industrial buildings



factory space is essential to industrial development. The Operational Programme further recognises that State support in this sector is particularly necessary and relevant in the peripheral areas where private sector investment is non-existent, as, for example, in the case of the Gaeltacht areas. However, the national policy also specifies that in all cases where there is direct provision of industrial buildings by the Agencies, the investment should only be undertaken where it is likely to yield significant beneficial results.

4.6 In implementing national policy on the public provision of industrial property, the Agencies have developed different approaches and this is reflected in the pattern of expenditure on provision of industrial buildings by the Agencies (see Table 4.1)

- IDA Ireland satisfies most of the demand for extra industrial space in its region by encouraging clients, with grant assistance, to provide their own premises or by arranging for private sector property developers to provide buildings. Since 1996, the Agency has also pursued a policy of disposing of a large amount of existing industrial space to sitting tenants or to third-party investors, thereby releasing capital for other purposes.
- Shannon Development also provides grant assistance to industrialists to provide their own property. In other cases, the Agency meets demand for property by encouraging the private sector to provide space, by commissioning the

Table 4 1 Cost of provision of industrial buildings in 1995-1996, by Agency and method of provision

	IDA Ireland	Shannon Development	An tÚdarás	All Agencies
	£m	£m	£m	£m
Construction by Agency (contract or in-house)	0 9	2 7	5 2	8 8
Purchased by Agency	0 1	—	—	0 1
Refurbishment of existing buildings	3 7	3 2	4 5	11 4
Total Agency provision	4 7	5 9	9 7	20 3
Support for private sector developers	0 5	—	—	0 5
Total cost of direct provision	5 2	5 9	9 7	20 8
Indirect provision capital grants ^a	53 0	15 7	8 9	77 6

Note a Capital grants includes amounts for plant and machinery as well as for buildings
Source Analysis by Office of the Comptroller and Auditor General

construction of new premises or by renovating existing vacant property in the portfolio, sometimes in joint ventures with private sector developers. Shannon Development only disposes of industrial property assets which are unlikely to be let or where they receive a sale price sufficient to replace the property disposed of.

- As the areas serviced by An tÚdarás are peripheral, most of the industrial property required is provided directly by the Agency which consequently has extensive industrial building and refurbishment programmes

- 4 7 The Agencies are effectively market makers in their respective areas and have a scale of operation against which private sector developers could potentially find it difficult to compete. Consequently, all the Agencies should periodically review their industrial property policies to ensure that the level of public sector provision of industrial buildings is a required response to genuine market failure and not simply the result of a continuation of existing practices
- 4 8 The Agencies could relatively easily estimate how much industrial space is provided by the private sector in each of their regions because they are the main suppliers of industrial land and/or provide grants to many owner/occupiers acquiring their own premises. While this kind of information would be useful for operational planning purposes, the Agencies have not tried to build up databases of this kind

Support for Private Sector Developers

- 4.9 Private sector property developers have traditionally been reluctant to get involved in the provision of industrial space outside Dublin or other large urban areas. In general, this reflected the low level of economic return on such investments in provincial locations due to the poor level of demand for property and the low rents available. The accelerating rates of economic growth and lower interest rates in recent years have improved the level of returns available throughout the country. The availability of increasing rent levels and a reduced level of direct competition with IDA Ireland in the provision of industrial units have also made investment in industrial buildings more attractive.
- 4.10 IDA Ireland's approach to the provision of property by the private sector has evolved over a long period and is marked by a progressive reduction in the level of subsidy provided by the Agency to the developers involved
- Between 1981 and 1985, a Private Finance Property Portfolio was assembled. Private developers invested in industrial buildings which were then leased to the Agency, generally for 35 years. The portfolio consists of 93 individual properties comprising 113,000 square metres of space. Almost two-thirds of the space is located in four main cities (Dublin, Cork, Galway and Waterford). The rents payable by the Agency are subject to review every five years, based on the open market rental value or linked to prime industrial estate rents. The total rent paid by IDA Ireland in respect of the leases in 1996 was £3.9 million (£34.50 per square metre) but it only recovered £3.4 million in rents charged to sitting tenants. Around 6.5% of the space (14% of the units) is unoccupied. The Agency has considered buying out its liability under the leases but concluded that very substantial funding would be required.
 - Up to 1996, IDA Ireland offered short-term rent guarantees to private sector property developers to encourage them to invest in industrial buildings. Typically, the guarantees were for one to two years and only involved a cost to the Agency while vacant during the guarantee period. A total of £396,000 was paid out in respect of 15,000 square metres of space provided in 1995 by the private sector under guarantee agreements. Payments in respect of a similar amount of space provided in 1996 amounted to £63,000. The reduction in the level of payments reflected shorter vacancy periods for property provided in 1996.
 - Since 1996, IDA Ireland has generally been able to find private sector developers willing to invest in industrial property in urban areas without the need to provide rent guarantees.
- 4.11 Shannon Development's success rate up to 1996 in attracting private sector developers to invest in industrial buildings was limited. It occasionally encouraged private sector involvement in property provision by matching specifically identified property requirements with interested developers and by establishing a number of joint
-

ventures with private sector developers for the refurbishment or construction of industrial units, often in industrial parks. It does not offer rent guarantees to developers. When this report was being finalised, Shannon Development pointed out that there was a significant increase in 1998 in the amount of advance factory space being provided by the private sector in two of its development areas.

- 4.12 An tÚdarás has not been able to attract any private investment in industrial property.

Construction of Industrial Buildings

- 4.13 Eight new industrial buildings were constructed by the Agencies in 1995 and 1996 at a total cost of £8.8 million. This included a very large building in Donegal built by An tÚdarás at a cost of £4.1 million for an industrial project which subsequently failed to proceed (see case study 3) and a major extension to a premises in the National Technology Park (Limerick) built by Shannon Development at a cost of £2 million. Only one of the factories was built by IDA Ireland.
- 4.14 The construction of seven of the buildings was contracted out to private sector building firms. The remaining building was a small project which was constructed by An tÚdarás using its own in-house construction/maintenance unit.
- 4.15 According to the property consultants engaged to advise on the examination, the standard cost of construction of modern advance factories is in the range £320 to £430 per square metre. The cost of five of the eight buildings constructed fell within this range.

Case study 3 Textile factory at Dungloe, County Donegal

In 1995/96 An tÚdarás undertook the construction of a bespoke factory for a multinational clothing company in their industrial estate in Dungloe, County Donegal. The new factory was intended to facilitate an expansion of the company's existing operations. The factory (almost 6,000 square metres) was completed in late 1996 at a total cost of £4.1 million but was never occupied by its intended tenants due to a change in their business strategy. A five year rental agreement had been agreed prior to construction and the company is paying an annual rental for the unoccupied building.

In 1997 An tÚdarás sourced an alternative company in the pharmaceutical industry for the factory. The Agency issued a letter of offer to the prospective new tenants in November 1997 which included modifying the factory at an additional cost of £1.75 million to meet the needs of the new industry. If the new project proceeds, a supplementary rent will be charged to recover the cost of this extra work.

- 4.16 The remaining three buildings, all of which were An tÚdarás projects, cost from £620 to £740 per square metre, which is within the standard order of cost for buildings of a high specification such as those with a high office content. Two of the projects in question were small units (about 500 square metres). The other was the factory in Dungloe containing almost 6,000 square metres of space where the development costs were thought to be justified by the significant employment potential of the project.

Purchase of Existing Industrial Buildings

- 4.17 There was only one instance of a purchase of an industrial building in 1995-1996. This was a small unit (588 square metres) which was already in the IDA Ireland portfolio under a private lease arrangement. A purchase option in the lease was used to acquire the factory so that it could be sold on to an interested party. The purchase price of £200 per square metre was fully recovered in the onward sale and the net result was that the Agency was able to disengage from its long term lease commitment at no cost.
- 4.18 A factory purchased in 1994 for £5 million as part of a company rescue deal is still held in the IDA Ireland portfolio. Apart from temporary lettings, it has remained unused and is now valued at £1.6 million (see case study 4).

Case study 4 Gillogue factory, County Clare

In 1994, Forfás purchased an empty factory (28,000 square metres) in Gillogue from a multinational textile company as a mechanism for financing the company's plant in County Kerry which employed 350 workers. The £5 million purchase price was equivalent to £178 per square metre. A potential tenant which IDA Ireland had earmarked for the Gillogue factory failed to materialise and the factory remained vacant for an extended period. The book value of the factory was written down to £3 million (£108 per square metre) by Forfás in its 1995 financial statements. After the Forfás portfolio transferred to IDA Ireland, there was a further write down of the value of the property to £1.6 million (£57 per square metre).

This matter was raised in the Comptroller and Auditor General's 1995 report on non-commercial State-sponsored bodies and was debated by the Public Accounts Committee prior to the latest revaluation.

The factory has been let on a temporary basis for storage purposes at a low rental, with the tenant covering the bulk of the factory's annual maintenance costs.

At the time of the examination, Shannon Development were considering a proposal from IDA Ireland that the factory be transferred into its portfolio along with an accompanying land bank of 47 hectares.

Refurbishment of Existing Buildings

- 4 19 The option of refurbishing existing buildings to meet specific clients' needs or to provide advance factory space can be more cost-effective than new building. There is usually a shorter lead time in bringing space into use and the amount of funding required is less. Refurbishment also means that vacant property comes into use. However, taking the asset value of the existing building into account, the total cost of providing a unit of accommodation may not be materially less than the unit cost of newly built space. In 1995 and 1996, the Agencies spent a total of £11.4 million in refurbishing existing buildings in their portfolios.
- 4 20 IDA Ireland carries out inspections of buildings as they become vacant and re-instatement and refurbishment work is carried out as required.
- 4 21 Much of the maintenance work for vacant buildings is carried out on an irregular basis in response to random inspections and the local knowledge of the relevant clerk of works. The outcome of the inspections is not recorded centrally as there is no facility on the property databases for noting information on the condition of buildings.

Grant Assistance for Industrial Buildings

- 4 22 All the Agencies have schemes under which promoters of new or expansion projects are provided with capital grants towards the cost of acquiring land, buildings, plant and machinery. A breakdown of the funding by type of asset supported is not readily available. The amount of property provided by promoters benefitting from these grants is also unknown. There is also valuable information on the grant application forms about the unit costs for the various specifications of factories which would be useful to the Agencies in maintaining an awareness of private sector cost structures. However, this information is not used in a systematic way.
- 4 23 Projects which received grant assistance from IDA Ireland in recent years were reviewed to establish the cost of the property put in place and the contribution made by the Agency. The projects were in the medical supplies, pharmaceutical and computer assembly sectors, all of which require facilities of a very high specification. The project proposals indicated a cost for acquisition of buildings in the range £1,000 to £3,000 per square metre. The grants provided by the Agency were from 13% to 34% of the acquisition cost.
- 4 24 Decisions about grant assistance to industrial promoters are usually handled by the relevant industrial development or finance divisions rather than by the property divisions. However, the latter may assist with technical advice and in locating or providing suitable sites.

Disposal of Industrial Buildings

- 4.25 The Agencies have very different policies in relation to the disposal of industrial buildings held in their portfolios
- IDA Ireland have a policy of actively disposing of as much as possible of their portfolio of buildings through sales to sitting tenants, in the first instance, or to private investors. In 1995 and 1996, the Agency sold 31 buildings, realising £9.5 million in sales revenue.
 - Shannon Development policy on the sale of buildings is to sell only when the current cost of replacing the space can be recovered or where the space is surplus to requirements and will realise market value based on an independent valuation. The Agency generally aims to retain property which is earning an acceptable rate of return in the form of annual rental. In 1995 and 1996, Shannon Development realised £600,000 from the sale of three buildings.
 - An tÚdarás sells relatively few assets because the market in Gaeltacht areas is negligible and very few assets would achieve their replacement cost. The Agency sold a total of seven buildings in 1995 and 1996, raising £1.4 million.
- 4.26 The main value for money concern in relation to disposal of assets is that the best possible price (relative to market value) is achieved in the sale. The Board of IDA Ireland have set price guidelines for disposal of buildings which reflect differences in the property markets in different locations. In addition, because the level of accommodation and condition of buildings can vary so much, independent valuations are also obtained for disposals of buildings. Specific Board approval is required for any proposed sale which fails to achieve the guideline price or the valuation amount.
- 4.27 Shannon Development and An tÚdarás also require independent valuations of all buildings before sale. In Shannon Development, Board approval is required if the proposed sale price is less than the independent valuation and the original cost of the building.

Unit Sales Prices

- 4.28 A review of market conditions in the period 1995-1996 by property consultants suggested broad ranges for sales prices for industrial buildings reflecting the location, age, specification and condition of buildings. These were
- £320 to £540 per square metre in the greater Dublin area
 - £160 to £430 per square metre in other major urban areas
 - £55 to £320 per square metre in provincial locations (including peripheral areas)

The minimum guideline prices set by IDA Ireland are within these ranges, close to the lower limits

- 4 29 In general, the unit prices achieved by the Agencies in the disposal of buildings in 1995 and 1996 were within the range of normal market prices. In line with their policies on disposals, the prices achieved by Shannon Development and An tÚdarás were generally at the higher end of the range. The prices achieved by IDA Ireland tended generally to be at the lower end of the ranges in all locations but this is due to the age and condition of the properties sold.

Cost of Buildings Sold

- 4 30 The market value of capital property assets may be very different to the costs incurred by the investor when the assets are acquired. Commercial investors require their assets to appreciate in value relative to the acquisition cost, thereby generating a capital gain and increasing the return on the investment. However, industrial property assets can also lose value due to normal wear and tear while they are held in productive use. Accordingly, the timing of disposal decisions can be critical to the achievement of value for money.
- 4 31 Most of the buildings sold by the Agencies in 1995 and 1996 were originally acquired in the 1970s or 1980s. The total cost of the buildings, according to the Agencies' asset registers, was £14.1 million. Since the amount raised on the sale of the buildings was £11.6 million, a total capital loss of £2.5 million was incurred. As Table 4.2 shows, Shannon Development had a capital gain on the properties it sold while An tÚdarás broke even on its sales. The total capital loss incurred by IDA Ireland on the buildings it sold was £2.7 million — 22% of the original cost.

Table 4.2 Capital gains/(losses) on buildings sold in 1995 and 1996

	IDA Ireland	Shannon Development	An tÚdarás	All Agencies
	£m	£m	£m	£m
Cost of buildings sold	12.3	0.3	1.5	14.1
Receipts from sales	9.6	0.6	1.4	11.6
Capital gain/(loss)	(2.7)	0.3	(0.1)	(2.5)
Gain/(loss) as % of cost	(22%)	100%	(1%)	(18%)

Source: Analysis by Office of the Comptroller and Auditor General

- 4 32 The examination of the capital gains and losses on individual disposals of buildings revealed some further interesting findings
- Eleven of the buildings sold by IDA Ireland generated prices at or over the cost incurred by the Agency in acquiring them. The remaining 20 were sold at prices below cost
 - Some IDA Ireland buildings appreciated in value by an average of 5% per year e.g. a building which cost £62,000 in 1983 was sold in 1995 for £105,000. A building which cost £665,000 in 1975 was sold in 1996 for £1.25 million — an average appreciation of 3% per year.
 - Six of the buildings sold by IDA Ireland declined in value at a rate in excess of 5% per year. Four of these were located in provincial areas and two were in Cork. In one case, a building which cost £958,000 in 1982 was sold in 1996 for £377,000. In another case, a building which cost £532,000 in 1981 was sold for £168,000 in 1996.

Value of Portfolios of Buildings

- 4 33 While location, age and condition are the primary factors which influence the market value of a property, the value of an individual property is also closely related to the yield it produces, which typically is the rent paid by the sitting tenant. As the rents negotiated with IDA Ireland and An tÚdarás tenants have tended to be lower than prevailing market rates (as indicated in Chapter 2), the open market value of many of the Agencies' buildings is likely to be lower than for similar buildings where the tenants pay rents at full market rates.
- 4 34 IDA Ireland commissioned consultants in 1996 to estimate the current market value of the buildings in its portfolio. This showed that, based on the rental being achieved and current property market conditions, many of the buildings were significantly overvalued on the Agency's books. A total of £10 million was written off the value of industrial property in the 1996 financial statements to reflect a permanent diminution in value. The scale of the write-offs for accounting purposes is consistent with the level of capital losses incurred on sales of property.
- 4 35 The fact that Shannon Development and An tÚdarás have not incurred significant capital losses on sales of property is a function of their policies on the disposal of property assets and gives no indication of the current market value of their portfolios relative to the cost of acquisition. Neither Agency follows a policy of periodic revaluation of property assets in their financial statements. The rents charged do not recover the full cost of providing buildings. As a result, the accounting book value of their portfolios of industrial buildings is likely to exceed the estimated current market value of the portfolios.

- 4 36 The value of the portfolio is an important element in the analysis of the performance of the Agencies' property function. Neither historical cost nor accounting write downs to market value are wholly appropriate bases for measuring performance in relation to economy and efficiency. For that purpose, the property values used should not include the additional amounts over market value (i.e. subsidies) which the Agencies are willing to pay to attract industrialists to locate in peripheral areas.

Conclusions

- 4 37 National policy stipulates that direct public sector provision of industrial property to meet the emerging demand should only be undertaken where and to the extent that the private sector is unwilling to do so. This should mean that taxpayers' resources are not tied up in industrial property more than is necessary to meet industrial and regional development needs. The Agencies should periodically review the extent to which they need to be involved in the provision of industrial space and cost-effective options available for encouraging private sector provision.
- 4 38 Where the Agencies were involved in direct provision of industrial space, the cost of acquisition generally appeared to fit within the normal ranges for cost of property provision. However, there have been a number of cases where excess property acquisition costs were incurred to support jobs in particular locations. Effectively, these were cases where property was used as a vehicle to subsidise the core activities of the Agencies concerned.
- 4 39 Prices achieved by the Agencies on disposal of industrial buildings in 1995 and 1996 were generally in line with market values. However, since the market value of a property takes into account the value of the rental stream from sitting tenants, the widespread practice in the past of setting rents below market rates probably depressed the sales prices achieved.
- 4 40 A review of IDA Ireland's industrial building portfolio by consultants in 1996 found that many of the Agency's buildings were significantly over-valued in its books. The Agency has, however, a policy of providing for the permanent diminution in the value of its property assets.
- 4 41 Shannon Development and An tÚdarás do not revalue their industrial property assets in their financial statements. Given their respective rental charges and the extent of vacant property held, the estimated market value of their portfolios could be considerably less than their book values might suggest.

5 Return on Investment in Property

- 5.1 In a value for money context, it is not sufficient for the Agencies to engage at any cost in property activity which is effective in meeting the needs of their core development roles. They must also ensure that they achieve economy and efficiency in how they use the very substantial amount of resources invested in property assets.
- 5.2 In the private sector, movements in market value reflect changes in economy and efficiency and performance can be assessed through the financial rate of return and the economic yield achieved. The absence of market forces in some of the areas served by the Agencies and the use of property, to varying degrees, as a means of subsidising the Agencies' clients indicates the need for a robust model of performance measurement which takes account of the unique operating circumstances of the property functions of each of the Agencies. This chapter considers issues associated with the overall measurement of the performance of the property management function of the Agencies.

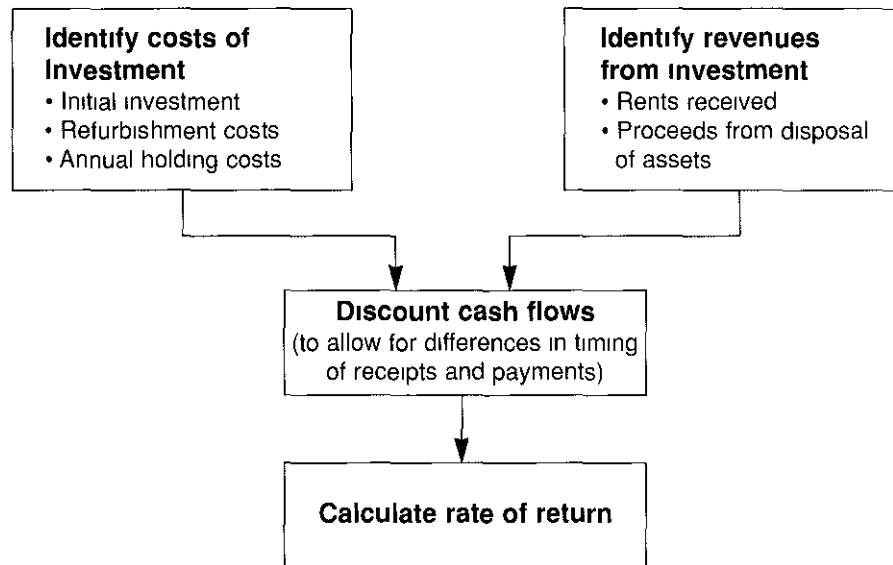
Rate of Return on Investments

- 5.3 In commercial property operations, a primary measure of performance is the economic return (yield) on investment. Failure to achieve economy and efficiency in the various activities involved in acquiring, holding and disposing of property reduces the rate of return earned. Consequently, the setting of a target rate of return also sets a context for achievement of economy and efficiency.
- 5.4 The economic return on investments is calculated by comparing the full costs and revenues over the life of the investment, taking into account the different times at which moneys are paid or received. Figure 5.1 presents the steps in developing a simple discounted cash flow (DCF) model for an individual property investment.

The Public Sector Discount Rate

- 5.5 DCF models are used in both private and public sectors to assess investment proposals so as to identify and prioritise those which are likely to yield an acceptable rate of return. The models require that a target rate of return (the threshold discount rate) must be set. In commercial situations, this is usually based on the rate at which the investor can borrow money, with an allowance for the risk profile of the investment. In the public sector, the discount rate has been set centrally for all kinds of investments and is usually lower than for equivalent private sector investments.
- 5.6 The lower public sector discount rate compensates for the requirement for the Agencies to provide services in less economically viable areas. A specific discount rate which would take account of the unique environmental circumstances of operating in peripheral areas could be set. However, the discounted cashflow model assumes the existence of a market for the services provided and the model may not be

Figure 5.1 Model for calculating the economic return on a property investment



appropriate for some of the remote areas where no market for industrial property exists

- 5 7 The current public sector discount rate is 7% to 8% (The rate varies depending on the level of inflation) Capital investments which yield less than this rate of return are classified as uneconomic
- 5 8 All the Agencies are aware of the existence and usefulness of this kind of analysis and use it in assessing proposals for grant aid to industrial promoters. However, the examination found that proposals for investments in property are not subjected to this kind of analysis in any of the Agencies There is no record of the computation of an expected economic return from any of the property investments undertaken.

Economic Rent

- 5 9 DCF models can be used to measure performance in terms of a comparison between the rents actually charged by the Agencies for individual industrial buildings and the 'economic' rent i.e the rent which would have to be charged to allow the investment to meet the target discount rate and be deemed economic. For example, the proposal by An tÚdarás in relation to the industrial project referred to in case study 3 (page 30) envisaged a basic annual rent of just under £26 per square metre As the facility cost £4 1 million to construct, the economic rent for the premises (based on the public sector discount rate) would have been over £60 per square metre. This indicates the extent of the subsidy implicit in the proposal

- 5.10 In order to assess the economy and efficiency of property management activities by the Agencies, the implicit subsidies should be considered as part of the costs of industrial promotion and not costs of property provision. This would be achieved if the historical cost of the property provided is adjusted to take account of the implicit subsidy element calculated by reference to the public sector discount rate and the guideline rent.

Monitoring Agency Performance

- 5.11 None of the Agencies manage their property functions in the purely commercial manner. To do so would require the improvement of their information systems to identify the extent of subsidisation involved in property activity and to facilitate the establishment of meaningful targets for economy, efficiency and effectiveness against which the performance of the Agencies' property divisions could be meaningfully assessed. This is a prerequisite for a comprehensive performance measurement system.
- 5.12 The Agencies identify subsidies when monitoring performance in their core areas of activity. The performance measures used focus on establishing the cost per job created and the ratio of project benefits relative to project costs. When decisions are being made (often by the Government) about which projects to fund or to reject, cost per job and cost benefit ratios are presented in support of recommendations.
- 5.13 In general, cost per job and cost:benefit ratios take into account any explicit property subsidies given to industrial promoters. For example, the rental income forgone because of rent subsidies in the first years of a property letting are estimated and included in the calculations. However, no account is taken of the fact that the basic rent itself may be below the economic rent level. As a result, the cost per job associated with some proposals can be underestimated and the cost benefit ratio overestimated, giving rise to a risk that some industrial projects which would otherwise be rejected are given funding.
- 5.14 There is no particular technical difficulty in arriving at a reasonable estimate of the extent of subsidies associated with the property aspects of industrial proposals. If implicit subsidies were recognised in the cost per job and cost:benefit calculations, an equivalent amount could be written off the value of the capital assets (subject to professional valuation advice). If this were done on a consistent basis, it would allow the setting of a meaningful target financial rate of return for property investments by each of the Agencies.
- 5.15 The use of a target rate of return in spending decisions would be likely to place an economic limit on the extent to which the Agencies buy and develop land and acquire advance factory space before they are required and could encourage them to increase rental costs. Moving too far in these directions could threaten the effectiveness of the

Agencies in terms of meeting industry requirements in a timely way and at reasonable cost. In practice, the industrial development divisions within the Agencies provide a counterbalance to any such deterioration in the service to clients.

Financial Rate of Return on the Property Portfolios

- 5 16 Apart from the rate of return achieved on individual property assets, the overall financial rate of return on the portfolios as a whole should also be monitored. Financial returns are generated in the form of rents and the capital gains (or losses) on the value of the portfolio. None of the Agencies uses estimates of returns in either of these respects in setting performance targets or for monitoring achievements.
- 5 17 The current financial rate of return can be derived by relating current net rental income (after deduction of property holding costs) to the historic cost of the assets. Table 5.1 sets out the calculation for 1996.
- 5 18 In Shannon Development and An tÚdarás, where very few assets are disposed of, the expectation would be that the current financial rate of return should average out at or above the minimum required rate of return on property investments (i.e. the public sector discount rate). For both Agencies in 1996, the rate achieved was considerably below that benchmark. Part of the reason for the shortfall is that assets have been provided in the past at a cost to the Agencies which was greater than could be recovered through renting them out at the agreed rates i.e. implicitly subsidising

Table 5 1 Estimated current financial rate of return on property investment for 1996

	IDA Ireland	Shannon Development	An tÚdarás	All Agencies
	£m	£m	£m	£m
Rental revenue	10.8 ^a	9.1	4.1	24.0
less property holding cost	(3.6)	(3.1)	(1.2)	(7.9)
Net rental revenue	7.2	6.0	2.9	16.1
Cost of property assets ^b	196.0	128.6	97.0	421.6
Rate of return on investment	3.7%	4.7%	3.0%	3.8%

Note a Rental income from IDA Ireland owned property only. Excludes rent received in respect of the 35-year lease properties.

 b Historic cost. Average for year based on end 1995 and end 1996 figures.

Source Agencies' annual accounts for 1996.

the tenants. The rest of the shortfall can be viewed as a summary indicator of the extent to which property activities in isolation fail to achieve economy and efficiency, for example, by holding too much land for too long, holding assets for which there is no potential market or by a failure to control current property costs.

- 5.19 The current financial rate of return shown for IDA Ireland is more difficult to interpret because of its current policy in relation to the disposal of industrial space. The policy is likely to impact heavily in future years on the Agency's rent roll, which will fall as sitting tenants buy out their leases and other space is sold to third parties. In the medium term, this policy will also change the balance of the Agency's portfolio, with the result that a higher proportion of the value of the portfolio will be made up of industrial land which is not held for the direct purpose of generating a current income. This is likely to result in the current financial rate of return declining further. In those circumstances, the Agency should differentiate in its accounts between costs and revenues associated with industrial space (which has the potential to generate a current income) and with land holding and development costs (which only generates a return on disposal). This would permit estimation and benchmarking of the returns achieved in both parts of the portfolio.

Revaluation of Property Assets

- 5.20 IDA Ireland's current accounting policy of adjusting the book value of assets to reflect a permanent diminution in value has the effect of writing off some of the subsidy accumulated in its property portfolio. The estimated rate of return in 1996 increases from 3.7% to 4.4% when the historic cost of the assets held is adjusted to take account of such revaluations. Assuming that the accumulated devaluation can be used as an estimate of the extent of past subsidisation, this suggests that there was still considerable scope for improvement in the economy and efficiency of property activity.
- 5.21 The other Agencies do not revalue their property assets. Were they to do so, it is likely that substantial devaluations would be required, much of which would relate to implicit subsidisation of industrial projects in the past. On that basis, the estimated financial rate of return they achieve on property investments could be greater than shown in Table 5.1.
- 5.22 There are inherent limitations in using any single performance measure like the rate of return on investment or the economic return to reflect the end result of the complex set of activities involved in property management. Both the return earned and the investment made are affected by a range of factors and any meaningful interpretation of the ratio would require a decomposition into its constituent elements and an investigation of the impact of each element on the end result. The measurement problem becomes more complicated when applied to an activity which has both a commercial and a public service dimension.

Portfolio Planning

- 5 23 The scale of acquisition and disposal activity by the Agencies has the potential over a relatively short period to alter significantly the composition and location of their property portfolios and the financial performance achieved in relation to property activity. This reinforces the need for a strategic portfolio planning process
- 5 24 An analysis of trends in the supply and demand for industrial property should form the basis for planning the provision of the industrial property required to meet current and likely future needs. This analysis should also be useful for the development of appropriate strategies for the Agencies, for the source of supply and for the development of the Agencies' own portfolios.
- 5 25 Information about the supply of industrial property is gathered from a variety of sources
- Property division staff of the three Agencies meet three or four times a year to discuss property market trends.
 - Each Agency periodically meets with the local authorities in their regions to discuss the adequacy of the supply of land zoned for industrial purposes and the provision of infrastructure. As many local authorities are also directly involved in the provision of industrial property, the co-ordination of the respective programmes is also discussed at those meetings.
 - General information about trends in the property market is gathered through informal contacts within the industry and the review of literature
- 5 26 The main source of information about emerging demand for industrial property is the industrial development divisions of the Agencies. Information is supplied to the property divisions on a regular basis through on-going inter-division contacts. In each Agency, formal meetings are also held between the property, industrial development and finance divisions to discuss how best to use the resources available for property
- 5 27 Both IDA Ireland and Shannon Development have drawn up multi-annual plans for their property divisions. The plans set out statements of operational policies in relation to industrial property and contain some analyses of existing portfolios and market trends. The property plans are supplemented by annual business plans setting out annual targets for activities and related spending. An tÚdarás produces a multi-annual property plan incorporating building, refurbishment, infrastructure and land purchases. Again, this plan is supplemented by an annual budget based plan which is monitored through the monthly inter-divisional meetings

Conclusions

- 5.28 While the Agencies are generally considered to be effective in meeting the demands of industry for suitable industrial property, the performance measures examined in this report would suggest that they are under-achieving in economy and efficiency terms. Part of the reason for this is that the provision of property is used as a means of subsidising the accommodation costs of their clients.
- 5.29 Although the Agencies acknowledge the usefulness of models for measuring the expected and achieved economic return for industrial projects, the examination found no indication that these models are used in practice in relation to property. The data required to determine the economic return on an asset is not maintained in an accessible format.
- 5.30 The Agencies monitor their performance in relation to job creation through cost-per-job measures and cost-benefit ratios. The use of these measures can be misleading as the implicit subsidisation of clients' property costs is not taken into account.
- 5.31 The Agencies need to develop their management information systems to allow them to monitor performance in relation to the acquisition, management and disposal of property assets in a meaningful way. This should facilitate the devaluation of assets to remove implicit subsidies and allow target rates of return to be set.

Appendices

Appendix A

Summary Profile of the Industrial Development Agencies

IDA Ireland

IDA Ireland is a State sponsored agency responsible for creating employment in Ireland by encouraging overseas companies to start new businesses or expand existing businesses in this country. The Agency operates in the context of the national objective of promoting regional industrial development. It is funded through Government grant-in-aid and is also supported by European Union programmes. The Agency carries out its activities under the terms of the Industrial Development Acts 1986 to 1993 and reports to the Minister for Enterprise, Trade and Employment.

Forbairt

Until incorporated into Enterprise Ireland in 1998, Forbairt was a State sponsored agency operating under the aegis of the Department of Enterprise, Trade and Employment. Its remit was to assist the development of indigenous industry including facilitating new start-up companies and developing existing companies. The Agency provided a range of services and support facilities which focused on the business and technology requirements of firms. These functions are now included in the remit of Enterprise Ireland.

Forfás

Forfás is the policy advisory and co-ordination board for industrial development and science and technology in Ireland. It is the body through which powers are delegated to Enterprise Ireland for the promotion of indigenous industry and to IDA Ireland for the promotion of inward investment.

Shannon Development

Shannon Development (Shannon Free Airport Development Company) is the regional economic development company for the mid-west region with responsibility for industrial, tourism and rural development. Its regional mandate embraces the wider Shannon region spanning Counties Clare, Limerick, North Tipperary, South Offaly and North Kerry. The company is responsible for a series of initiatives in industry, tourism, airport promotion and rural and local development. The company reports to the Minister for Enterprise, Trade and Employment.

Údarás na Gaeltachta

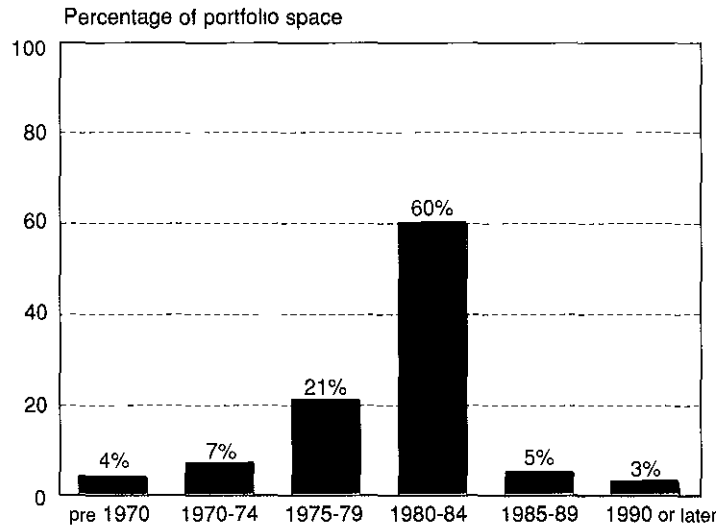
An tÚdarás is responsible for developing the economy of the Gaeltacht so as to facilitate the preservation and promotion of the Irish Language as the principal language of the region. In order to achieve this, it is involved in developing local

resources and skills and in attracting mobile investment to the Gaeltacht. An tÚdarás also promotes community development and pursues a range of language and cultural activities. The Gaeltacht covers extensive parts of Counties Donegal, Mayo, Galway and Kerry and also parts of Counties Cork, Meath and Waterford. An tÚdarás reports to the Minister for Arts, Heritage, the Gaeltacht and the Islands.

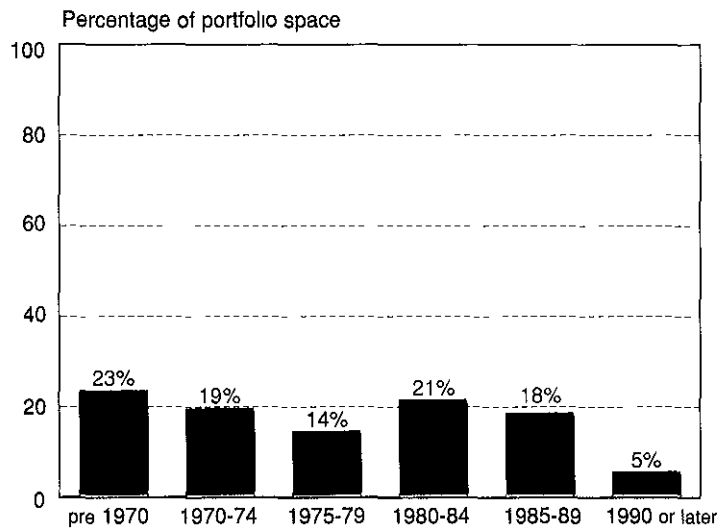
Appendix B

Age Profile of Agencies: Property Portfolios at End-1996

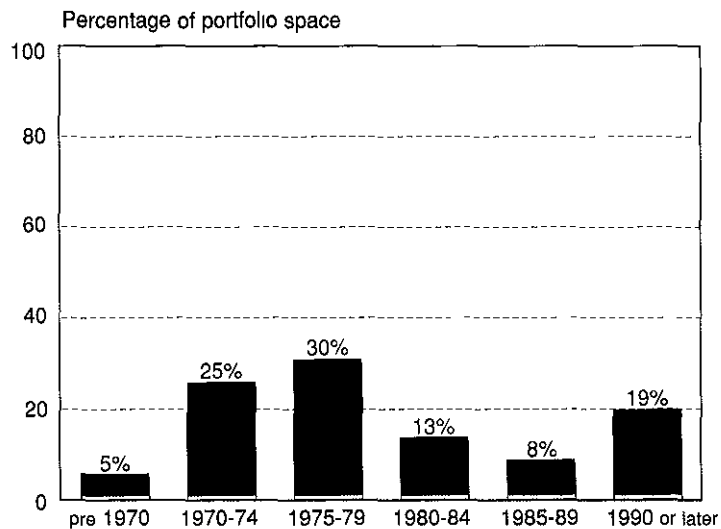
IDA Ireland (582,000 sq metres)



Shannon Development (399,000 sq metres)



Údarás na Gaeltachta (246,000 sq metres)



Appendix C

Formula for Estimating the Size of Land Holdings Required by the Agencies

In their 1995 Review of Industrial Property held by Forfás, JLW/Indecon made an estimate of the extent of land holdings required by the Agencies for industrial development purposes.

The methodology they used in arriving at an estimate of requirements was as follows

- The average annual demand for land (D) was calculated based on the Agencies' experience over the period 1989 to 1993.
- An increase of 10% was applied to the average demand figure to provide for unusable land within industrial estates, internal roads etc.
- A further increase of 75% was suggested to provide fully for advance factories, adequate regional dispersion of sites and economies of scale in land purchases.
- Finally, JLW/Indecon recommended that a five year 'rolling stock land bank' should be held by the Agencies to ensure that lead times, arising from the need to acquire and develop land, could be met

These factors can be summarised in the following formula

$$\text{Required land holding} = D \times (1.1 \times 1.75 \times 5) = 9.6D$$

This implies that the target supply of land for industrial development purposes should be just under ten times the average annual demand