CAB2872

REPORT TITLE: PROPOSED CREATION OF A STRATEGIC ACQUISITION STRATEGY

CABINET

7 DECEMBER 2016

PORTFOLIO HOLDER: CLLR STEPHEN GODFREY (PORTFOLIO HOLDER FOR FINANCE AND CORPORATE POLICY)

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WARD(S): ALL

PURPOSE

This report suggests the introduction of a Strategic Acquisition Strategy to enable the Council to undertake asset investment through the acquisition of land and/or property to generate income to realise the outcomes of the Community Strategy.

The report seeks to balance the need for high levels of governance with the requirement to introduce a focussed approach that will allow the Council to respond within commercially focussed timescales, accelerate regeneration objectives and/or strengthen the Council's financial position.

This report also details the acquisition process, market and financial implications associated with such a strategy.

RECOMMENDATIONS:

That Cabinet:-

i) Approves the concept of the scheme

ii) Approves the criteria for governance and decision making contained in Appendix A and the minimum scoring level for investment

iii) Approves that the location for commercial investment is within either of the Local Economic Partnership (LEP) boundaries and that investment for regenerative purposes is solely within the District

iv) Delegates authority to the Head of Finance, in consultation with the members of the Strategic Asset Purchase Board (as set out in the Report), to approve purchases under the Scheme.

v) Recommends to full Council the sum of £10m to be included within the Capital Strategy for 2017-18 to be funded from an increase in the Capital Financing Requirement with a maximum limit of £4m per transaction before Cabinet and Council approval.

IMPLICATIONS:

1 COMMUNITY STRATEGY OUTCOME (Detail how this report delivers a Community Strategy outcome(s))

1.1 This scheme would support the effective and efficient outcome through better use of the Council's financial resources, and would have a secondary impact on the prosperous economy outcomes through commercial investment within the LEP boundaries as well regenerative ambitions within the District boundary.

2 FINANCIAL IMPLICATIONS (to be reviewed by s151 officer)

2.1 The initial proposal of £4m investment is already included within the capital strategy approved by full Council in February 2016. This scheme is therefore proposing a governance route by which the Council can achieve its ambitions contained within the capital strategy.

2.2 Investment in commercial property will increase the Council's risk exposure; however, the current financial climate for the Council's investment portfolio is such that retaining investments in financial institutions provides its own financial risks, especially those of 'bail-in' risk.

2.3 By investing in commercial property, the Council is diversifying its investments across a wider range of asset class, risk profile, and the length of investment. These investments will fluctuate in value over the long term and should be seen as long term investments by the Council.

2.4 Those purchases which are regenerative will hold a higher financial risk, as returns from these assets may well not be instant. For these investments there needs to be a robust investment business case that sets out the financial benefits and the wider economic benefits of the Council's investment to satisfy the Council's section 151 officer (Head of Finance).

3 LEGAL AND PROCUREMENT IMPLICATIONS (to be reviewed by Monitoring officer)

3.1 The proposed scheme has already been approved as part of the capital strategy. Some Councils have setup separate companies for investment purposes, others have invested directly through the General Fund. As the proposal is for pure commercial investments to be within the LEP boundaries this is within the Council's overall legal powers to invest for purely commercial return.

3.2 The Council has powers under Section 12 of the Local Government Act 2003 to invest:-

a) for any purpose relevant to its functions under any enactment, or

b) for the purposes of the prudent management of its financial affairs.

This would allow the Council to acquire property inside and outside its area for investment purposes.

3.3 Under Section 120 of the Local Government Act 1972, the Council has powers to acquire land (including buildings) by agreement, for the purposes of

a) Any of its functions; or
b) The benefit, improvement or development of its area.

Land can be acquired both inside or outside the District under this power, provided the purpose is for one or more of the Council's functions, or the benefit, improvement, or development of the District.

Given the different risks and returns on investments for regenerative and wider economic benefits, it is considered that these should be within the District boundaries to justify their return to the local taxpayer.

4 WORKFORCE IMPLICATIONS

4.1 This scheme will increase the activity within the Estates Team. To mitigate the impact of this, it is proposed for the Assistant Director, Estates & Regeneration to utilise existing contractual arrangements with commercial property specialists to propose commercial investments to the Board. On-going collection of income will be consumed within the existing resources of the team *but* if there are significant increases to the scheme above the £4m currently set aside, there could be a requirement for an additional post, to be funded through this income, in the Estates Team to administer the new commercial properties.

4.2 There will be additional work for Legal Services to complete the contractual documentation on transactions.

4.3 The costs of the activities above will be taken from the overall income returned from this scheme to provide additional resources to these teams if required to not impact on other Council business.

5 PROPERTY AND ASSET IMPLICATIONS (*to be reviewed by Assistant Director; Estates & Regeneration)*

5.1 The implementation of this scheme would increase the Council's asset base and the investment return. This will require additional administration (depending on the variety and scale of the acquisitions) to collect rents and liaise with tenants.

5.2 The Council will need to ensure that its commercial investments are, wherever possible, balanced across asset classes and location to maximise their diversity and reduce the risk and being exposed to declines in asset class.

6 <u>CONSULTATION AND EQUALITY IMPACT ASSESSMENT (*include comments from other committees)*:</u>

n/a – already included within the capital strategy in February 2016.

7 <u>RISK MANAGEMENT</u>

7.1 The proposed scheme complies with the Council's risk appetite except for the proposal to invest up to £4m being delegated to the proposed Board. The Council's current risk appetite would limit this figure to £2m.

Risk (Detail specific risk under these headings)	**Mitigation**	**Opportunities**
Property		
Community Support – pressure for purchase of specific assets	*Asset purchases to be inline with criteria contained within report and to a business case to satisfy the s151 officer*	*Ability to purchase assets that will enhance the local area as well as deliver a financial return to the Council*
Timescales – Inability to complete purchases within commercial market timescales	*The Strategic Asset Board can meet as regularly as necessary to make quick decisions on asset purchases*	*Can take opportunities not presently available to the Council by making faster decisions*
Project capacity – n/a		
Financial / VfM – Poor yield *Tenant ceases trading*	*All investments would be subject to a criteria matrix to balance yield, covenant and acquisition cost. This risk cannot be eradicated however.* *See the above*	*The Council currently has substantial sums (£18m at the time of writing) of funds in Money Market Funds which are subject to bail in risk. Diversifying investment holdings can decrease the investment risk overall that the Council has.* *The Council could have greater control over the tenants coming forward ot assist with local economic development.*
Legal –legal duties to invest in the District	*Councils, including Winchester, have held investment property and land for a number of years. Investing outside of the District but within the LEP boundaries is new for the Council but can be done under the Local Government Act 2003 Section 12, and/or Section 120 of the Local Government Act 1972 (see Section 3 of the Report above for more details)..*	*Investments in a wider area allow for greater diversity of investment as well as potentially higher yield*

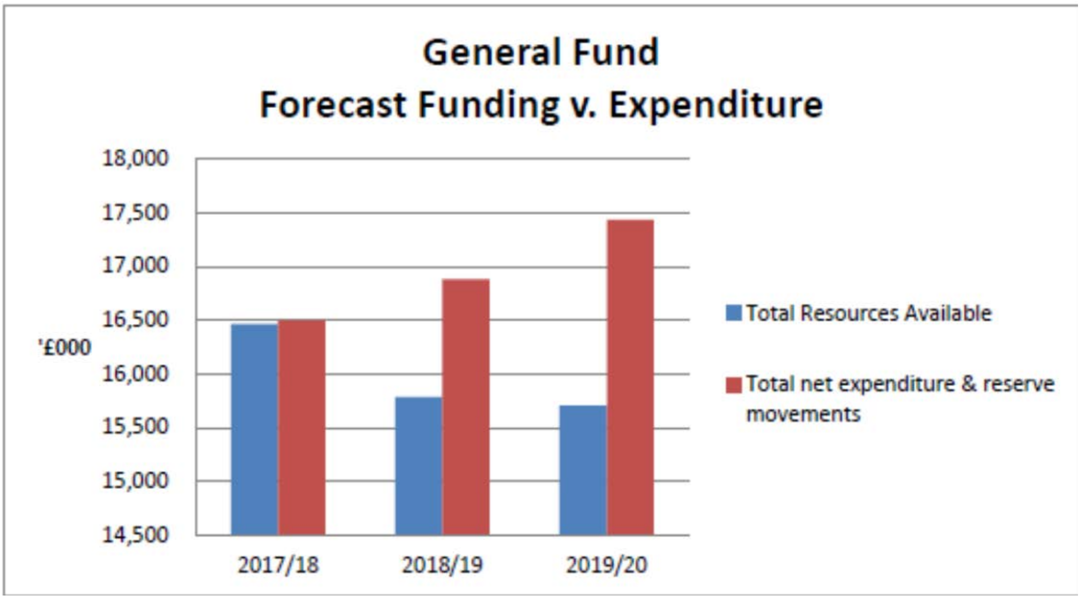
Risk (Detail specific risk under these headings)	**Mitigation**	**Opportunities**
Innovation -		
Reputation – returns from the scheme do not match the notional capital borrowing	*Robust business cases for the respective investments*	*Reputation enhanced through a more commercially minded approach to property management.*
Other		

8 SUPPORTING INFORMATION:

Background

8.1 The Council continues to operate in a very challenging financial environment. In the next three years the Council needs to close over a £1.5m gap in the financial strategy. To put this into the context of the Council's overall budget, this is half of the waste collection budget, or the entirety of the cost of development control.

Chart 1.1: Funding gap



8.2 The Council's response so far to the funding reductions since 2010 has enabled core services to continue to be provided across the district to a good standard and to support the Community Strategy. In the medium term the financial pressure is such that the Council needs to move forward with further activities that support the Community Strategy and that are in line with the Efficiency Plan. The Efficiency Plan approved by Cabinet in September 2016 articulated four key themes.

Chart 1.2: Core efficiency plan

8.3 A number of Councils across the country have already entered into schemes such as this. The New Local Government Network sets out why Councils are investing, sometimes for revenue but also for social value and highlights a number of interesting case studies[1] on how Council's have invested and why. In 2016 to October, it is estimated that Local Authorities will have invested over £850m in commercial property, accounting for 2.5% of all activity (compared to 0.2% the previous year)[2].

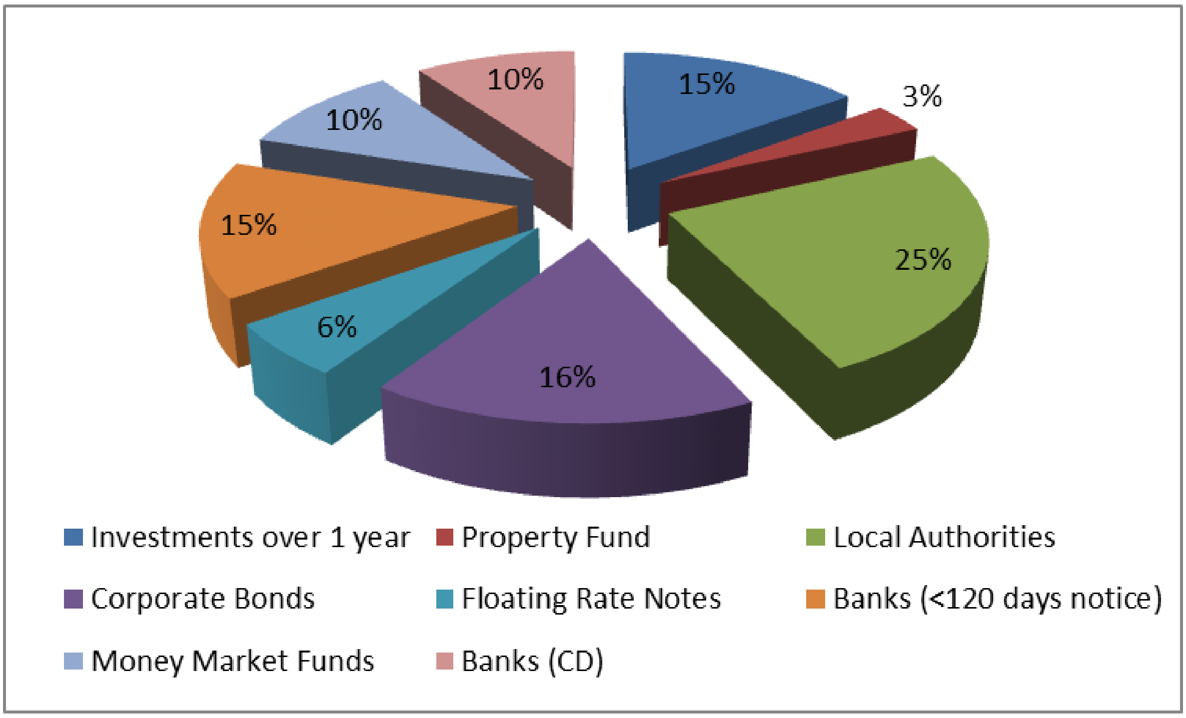
8.4 Within Hampshire there have been a number of Councils who have investigated and created asset purchase schemes with significant investments being set aside.

A Strategic Asset Purchase Scheme

8.5 To deliver against the financial challenge the Council needs to become more risk aware in line with the corporate risk appetite. One area that the Council has not exploited fully, but has clearly set out in its Capital Strategy, concerns the purchase of strategic assets. The Council currently receives returns of approximately 0.75% on its investments (standing at circa £60m at present). Though this is a comparatively good return, it represents a low yield at a time of increasing financial pressure on the Council. If the Council was to approve £10m of investment with a yield of 5%, this would increase the Council's overall returns on £60m to 1.5%.

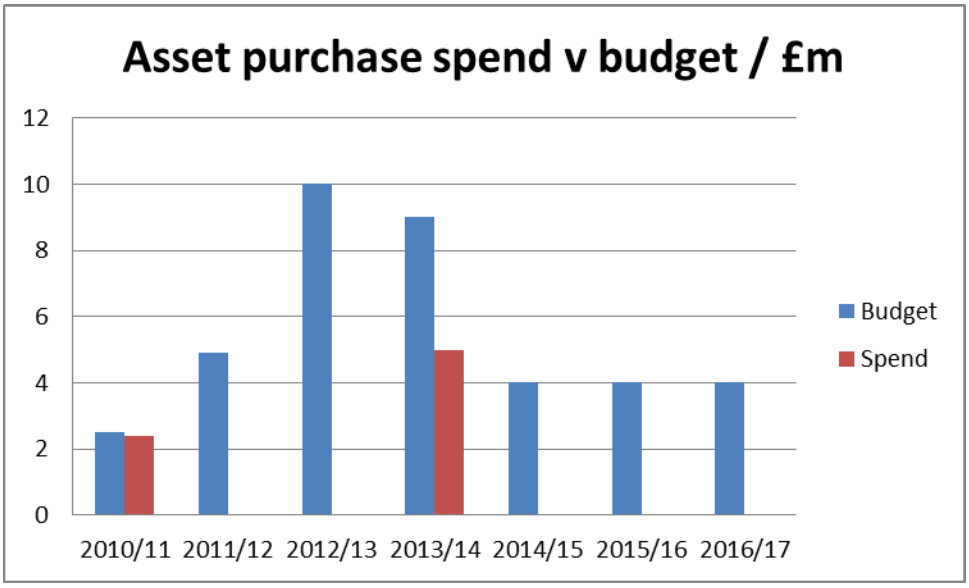
Chart 1.4: Current investment portfolio

[1] http://www.nlgn.org.uk/public/2016/councils-emerging-as-one-of-the-countrys-biggest-property-investors/
[2] http://www.room151.co.uk/funding/local-authority-property-deals-to-hit-1bn-in-2016/



8.6 In the past seven years the Council has set aside various funding in the capital strategy for buying assets with a view to making a financial return and / or to provide for regeneration of key parts of the district. This part of the capital programme has not been spent in full in recent years and therefore the Council has been re-investing this money through its overall Treasury Management Strategy.

Chart 1.5: WCC strategic asset purchases



8.7 The Council also has substantial investments at present totalling circa £60m and providing a return at 0.8%. Though the Council has pursued a lower risk strategy and returns, in the comparative context have been above average, this is still a low level of financial return for the Council when risk within financial institutions has been high.

8.8 Given the amount of investment return and the Council's desire to purchase strategic assets, this paper sets out a Strategic Asset Purchase Scheme (SAPS) and supporting governance mechanism that can support the Council's objectives and ensure that the Council can respond quickly enough to prevailing market conditions.

9 The outcomes the scheme can support

9.1 The purpose of the scheme is to support the Community Strategy and Efficiency Plan through the effective use of assets and finance to enhance the local economy and make most effective use of the Council's assets. As noted above in the NLGN report, the Council could decide to move into more regenerative investments though must accept a potential lesser financial return if this was proposed.

9.2 Another benefit would be the links with economic development to assist the Council in targeting

9.3 The current market position and the long term trajectory for commercial property is clearly unknown at present. The stock market has shown resilience to the vote to leave the EU and, though commercial property funds shut in the aftermath of the vote leave, the fall in comparative value of sterling has led to continued interest and value in the UK commercial property market[3] though how sustainable this investment is will depend on wider macro economic factors and clearly presents a risk to factor in when considering investments.

10 The types of investments proposed

Commercial property Investments

10.1 Under commercial investment objectives, a strategic acquisition would typically:

- Generate income through a satisfactory level of return, with a net initial yield range between 5% and 9%, and/or
- Improve investment value of commercial assets over time in addition to the level of returns through rental growth.

10.2 The type of property assets that are likely to fall within this definition will include (but not be limited to) properties let to local businesses including retail, finance, professional services and other public sector bodies. Assets already

[3] http://www.telegraph.co.uk/business/2016/07/28/property-funds-set-for-boost-from-brexit-sterling-fall-says-hend/

owned by the Council that are subject to long-term leases to third parties will also fit with this strategy subject to there being a strategic, financial or economic development benefit to buy back the lease.

10.3 The location of these assets would ideally be within the District's boundaries as this would help the local economy. However, many residents of the District do travel outside the District for work opportunities and so it is proposed that the commercial investments must be within either of the Local Economic Partnership (LEP) boundaries.

Regenerative investments

10.4 Under regeneration objectives, a strategic acquisition will typically assist at least one of the items below:

- Support economic development strategic objectives of increasing business activity in the District
- Deliver large scale development that will provide attractive, accessible places to live and work and do business
- Allow the redevelopment of smaller development sites in key locations that have stalled
- Enable the Council to acquire land required to deliver infrastructure projects
- Enable collaborative working with adjoining owners to maximise land value to the Council's projects
- Generate additional capital and revenue income to support the financial projections set out in the Medium Term Financial Plan.

10.5 Whilst the acquisition of strategic regeneration sites will typically be dependent on land becoming available for sale, the Council will be proactive and will consider off-market acquisitions and the use of Compulsory Purchase Orders as required. The location of regenerative investments would only be within the District boundaries. Any investment outside the District would be for purely financial investment purposes unless for exceptional reasons.

11. The Governance framework for the scheme

11.1 It is fully recognised that any approval for the SAPS will change the governance process for the Council as articulated in the constitution. The SAPS will need to have a clear governance structure as articulated below. The SAPS will need to have a Board which oversees the potential purchase of property, and will consider reports from officers, as well as make property decisions. It is proposed that the section 151 officer has the final approval or veto on property purchases and is advised by the Board in doing so. Key to the Board will be recommendations on potential purchases from external advisors on commercial property acquisitions.

11.2 The remit of the Board itself should include the following key areas:

- Consider acquisition recommendations put forward by the Assistant Director (Estates and Regeneration) on the advice of independent commercial property advisors
- Review proposed land acquisition and/or property investment proposals, taking into account the extent to which the proposition fulfils the Council's policy objectives against a set of agreed criteria.
- Make strategic acquisition and investment decisions on behalf of the Council.
- Oversee and monitor the performance of approved acquisition and investments.
- Report acquisitions retrospectively to the Cabinet.

11.3 The maximum cap on individual purchases should be **£4m** before Cabinet and full Council approval is sought. The Assistant Director (Estates and Regeneration) should formally report to Cabinet when a property transaction has been completed.

11.4 Membership of the Strategic Asset Purchase Board (quorum to be four individuals with at least one Member) is proposed as follows:-

- Leader of the Council
- Portfolio Holder with responsibility for the Local Economy
- Portfolio Holder with responsibility for Business
- Director of Professional Services
- Assistant Director (Estates and Regeneration)
- Assistant Director (Housing Services)
- Head of Finance (section 151 officer) – final approver of the purchase

Chart 1.1: Potential Flowchart

Property identified as a potential Strategic Acquisition by AD Estates & Regeneration and/or external advisor

Estates to advise SAPS Board members of a prospective asset purchase.

Pre-offer stage: circulate Business Case (to the s151 officer's requirements) of information on full details and cash flow of the potential acquisition to the SAPS Board and Legal Services including full financial implications of purchase are fully understood, before proceeding

Request approval from SAPS & 151 Officer to enter into the bidding process.

To update SAPS Board as necessary and thereafter agree Heads of Terms where bid is successful and commission independent surveys, purchase report and valuation

▼

Subject to any final observations from SAPS Board request their authority to accept the offer subject to contract.

▼

Once the bid is confirmed by SAPS Board, Asset Management to instruct solicitors and when contracts are agreed, seek final approval from SAPS to exchange.

12 Financial implications

12.1 The financial benefit of this scheme would clearly depend upon Members' appetite for risk and the sums proposed. If, for example, Members wished to set aside £10m into this scheme and all of this was invested for commercial purposes, at an expected yield of 6%, this would be a 5.2% uplift against current treasury management returns i.e. an additional £520k per annum gross; and a circa 3% uplift against current PWLB borrowing rates were the Council to externally borrow in the future. This would clearly substantially change the Council's risk profile though in respect of the Treasury Management Strategy. The Council would need to consider the set aside of Minimum Revenue Provision (MRP) where appropriate which would reduce the net yield from the scheme depending upon the asset purchased.

12.2 To commence the scheme, it is proposed to set aside £4m for the remainder of 2016-17 (which is already in the capital programme) and for full Council to approve the new amount for future years at February's Council meeting in respect of the capital strategy.

12.3 To ensure that this scheme would be resourced effectively, there will need to be a maximum top-slice of 2% of the total fund to be utilised to re-invest in estates management and legal services to undertake the relevant work to deliver the scheme.

13 Conclusion

13.1 For members to support the creation of a Strategic Asset Purchase Scheme.

14 <u>OTHER OPTIONS CONSIDERED AND REJECTED</u>

1) Longer term treasury management investments

The Treasury Management (TM) policy could be amended to make longer period investments rather than invest in this scheme. This may enabled an overall return of up to 1% higher by changing the risk profile within the strategy, but would not assist in supporting the local economy or regeneration.

2) Invest in a wider property fund

From a pure investment return basis, investing in a national property fund would diversify the investments made and could decrease the level of financial risk that the Council would be taking as there would be many more assets across a much broader range of assets. This option is included already as part of the treasury management strategy (the Council has an investment in the CCLA property Fund) and the Council may wish in the future to invest in this, and other property funds. However, for this report, this option has been rejected on the basis that it does not allow the Council to make local strategic purchases that would have regenerative benefits to the District.

BACKGROUND DOCUMENTS:-

Previous Committee Reports:-

Efficiency Plan – Cabinet 7th September 2016

Treasury Management Strategy – Council February 2016

Other Background Documents:-

New Local Government Network report - http://www.nlgn.org.uk/public/wp-content/uploads/Securing-a-Resilient-Future_FINAL.pdf

APPENDICES:

Appendix A: Application criteria

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Criteria	Score	5	4	3	2	0
	Weight					
Location	4	Prime	Off prime	Major secondary	Mid secondary	Tertiary
Initial income Yield	4	6% +	5-6%	4-5%	3-4%	Sub 3%
Tenancy Strength	4	Single tenant with strong financial covenant	Multiple tenants with strong financial covenant	Single tenant with good financial covenant	Multiple tenants with good financial covenant	Tenants with poor financial covenant strength
Tenure	3	Freehold	999 year lease			Lease less 999 years
Occupiers lease length (retail only)	3	Greater then 10 years	Between 7 and 10 years	Between 5 & 7 years		Less then 5 years; vacant
Repairing terms (1)	2	Full repairing & insuring	Internal repairing-100% recoverable			Internal repairing-less than 100% recoverable

Therefore the maximum score would be 100. It is proposed that the minimum scoring for any investment would be 65.