Rother District Council **Agenda Item: 5.2**

Report to	-	Overview and Scrutiny Committee
Date	-	29 April 2019
Report of the	-	Executive Director
Subject	-	Annual Property Investment Update

Recommendation: It be **RESOLVED**: That the report be noted.

Head of Service: Ben Hook

Introduction

1. On 18 December 2017 (Minute C17/46 refers), Council approved the creation of a Property Investment Strategy with a £7m initial budget as part of the capital programme and the establishment of the Property Investment Panel (PIP) who would oversee and authorise the various investment opportunities.

2. On 26 February 2018 (Minute C17/65 refers), Council approved the capital programme up to 2022/23, which included a revised budget of £35m to enable economic regeneration through property investment which was to be funded through borrowing.

3. On 23 March 2019 (Minute AS18/40 refers), an annual update on the delivery of the strategy and the investments agreed by the panel was reviewed and noted by the Audit and Standards Committee.

The Process for Identifying Investments

4. Property investments that have been considered as part of the Strategy fall into two main categories; investments in existing properties and development opportunities.

5. Investments in existing properties provide an immediate financial return for the authority and are likely to consist of built commercial space with an existing rent-paying tenant. The investment in these properties safeguards them for continued commercial use (thereby protecting employment) and not for conversion into alternative uses. Development opportunities are sites or land that are acquired for the purposes of development/redevelopment and achieving a longer term income. Investments into existing property tend to represent the lower short term risk option by providing greater certainty of income; however returns are generally lower in the long term. Due to the use of borrowing the net yield achieved after costs are taken into account, are likely to be in the 2%-3% per annum and therefore are below what a normal investor would expect. This also means the risk margin is lower than normal in relation to unexpected costs or the impact of vacant periods after losing a tenant.

6. Where properties are purchased for development purposes, additional authorisation is and will be sought from Cabinet and Council for inclusion on to the corporate capital programme.

7. Opportunities are identified through a range of sources including: local and regional agents, existing development partners, commercial developers and Locate East Sussex; as well as properties available on the open market such as auctions and the press.

8. Once opportunities are identified, they are recorded by officers and are then subject to the seven stage acquisition process outlined in Appendix 1. Progress through the various stages is then monitored and recorded onto the spreadsheet at confidential Appendix 2.

The Acquisition Process

9. Following an initial screening, a high level financial appraisal of the site will be undertaken and where necessary a site visit will be conducted and a photographic record taken. Officers have screened 23 properties since the beginning of the programme. The PIP has chosen to exclude retail opportunities from consideration due the high levels of change and uncertainty within the sector at this time.

10. Identified properties will then be progressed for discussion by the officer Property Investment Group. This group meets weekly and consists of the Executive Director, Assistant Director Resources, Head of Service Acquisitions Transformation and Regeneration, Property Investment Manager and other property and finance officers as necessary.

11. The Group will consider the potential return on investment, economic benefit to the district, evaluate the risk and set the parameters for negotiation before confirming that an approach to the vendor can be made. In going forward part of our due diligence is to comment in terms of how many jobs the tenant provides.

12. Negotiations with vendors will be conducted differently depending on the nature of the acquisition. Where there are existing relationships, or where the Council already has an interest in the land, it is more likely that negotiations will be conducted by officers. This has been the case in the successful acquisitions made at Beeching Road, outlined below. Where properties are available and advertised on the open market, a direct approach has been made to the managing agent. In certain circumstances there are opportunities identified that are not openly available, nor are they identified through existing partnerships. In situations such as this, agents have been appointed to approach landowners and conduct negotiations on our behalf. This is a standard industry approach and is used regularly by private investors.

13. Following agreement on purchase price and heads of terms, a report is written for consideration by the PIP.

The Property Investment Panel (PIP)

14. The terms of reference for the PIP was approved by Cabinet (Minute CB17/45 refers) in December 2017. The PIP is made up of five members and is

chaired by the Cabinet Portfolio holder for Finance, Resources and Value for Money. Current members of PIP are Councillors Lord Ampthill, Curtis, Kenward, Kentfield and Mooney.

15. Reports to the PIP provide extensive detail and include: a detailed site description, a rationale for acquisition, details on any existing tenants, details on the valuation agreed through the negotiations, provisional reports on title, the return on investment appraisal; as well as the associated financial, legal, environmental and planning risks.

16. It should be noted that not all legal and conveyancing due diligence will have been carried out at this stage and so should there be any significant changes or risks identified, then Members will be made aware of this at the earliest stage.

17. Following approval of the PIP, officers and legal undertake the necessary due diligence required for exchange and completion. This includes a full site condition survey, a 'Red Book' valuation, a full report on title, tenant strength, as well as a number of other site specific reports such as land contamination.

Acquired Properties

18. The PIP has now approved the acquisition of six properties with a total value of £12.6m. Of these, four have been acquired and are detailed below, one stalled following the implementation of the due diligence process as a result of the site conditions survey and one is currently still being progressed but is nearing exchange.

19. Rother District Council (RDC) owns the freehold for much of the West Trading Estate at Beeching Road and Wainwright Road. The majority of the West Trading Estate is occupied under long ground leases similar to those held at the subject premises. Many of these are approaching their midway point, beyond which the ability of head tenants to raise capital to reinvest will diminish over time; risking a long-term lack of investment and consequent decline in the estate in terms of both its economic potential and its value as an asset.

20. Having acquired the head leases to four sites allows the Council to receive a full market rent from the premises (as opposed to a ground rent) in exchange for its capital investment. It also enables the Council to take a more proactive approach to the future management of the sites, both to stimulate new investment and to protect the value of its asset in the longer term.

21. The sites that the Council have acquired are:

   a. 14 Terminus Road
   b. 18-40 Beeching Road
   c. 16 Beeching Road
   d. 1-7 Wainwright Road

22. The total value of the four properties purchased by the Council as part of the Property Investment Strategy is £2.5m. Members will note as detailed in confidential Appendix 2 that there are a number of properties that are currently under consideration, of which seven are under negotiation, or undergoing the due diligence process.

Cost of Borrowing

23. The Council's policy on borrowing is that we will not borrow more than, or in advance of, need. When the Council borrows, it is not against the asset as you would do as an individual. However, with the property investment strategy, our purchases have been based on investment appraisals using certain rates of interest so it is prudent to lock into the low interest rates and tie in borrowing at or near the time of purchase.

24. For the purchase of 14 Terminus Road we tied the timing of £900K borrowing and borrowed £450k at 2.58% and £450k at 2.59%. For the purchase, in December, of the three sites owned by the mars pension fund, we used internal treasury balances to fund the purchase. This saves interest payments but reduces income from investments. This works well when interest rates on investments are so low at 0.75%. As of 1 April 2019 this was replaced by £1.65m of borrowing at 2.39% on a 50 year annuity loan.

25. In terms of repayment of the borrowing, the loans we have taken out so far are annuity loans and this means you pay more interest at the start and less repayment of principal and then at the end low interest payments and high repayments of principal. This works well with properties where rents will increase over the 50 years' time frame. In terms of the impact on revenue, a charge is made to the revenue budget called minimum revenue provision and this is calculated on an annuity basis so in effect the repayment of loans matches the charge to the general fund.

26. The Authorised Limit is the maximum that the authority can borrow and is agreed by Council each February and the operational boundary is below this. The operational boundary is the level of borrowing the authority expects to borrow within the year. Any changes to these limits would be made at Audit and Standards Committee and then approved by full Council. The authorised limit for 2019/20 is £35 million.

Conclusion

27. Members are asked to note this report and consider the work of officers and the PIP in the delivery of the Property Investment Strategy.

28. The work of the PIP has allowed swift action to facilitate acquisitions that may otherwise have been lost to other investors. RDC is now becoming known to agents that we are in the market for acquiring property and are bringing sites to our attention. As effectively a cash buyer this strengthens our position, but we do need to be cautious in what we seek to acquire. Clearly retail is very precarious at the moment and while a number of sites and buildings have been put in our direction, the due diligence tests have not proved particularly viable.

29. The forthcoming year will require us to make further acquisitions in order to meet our regeneration objectives whilst creating a financial return and the PIP remain focused on these objectives.

Dr Anthony Leonard
Executive Director

Risk Assessment Statement

The risk of acquiring properties is subject to values rising and falling however over the longer period values have grown. The key risk at the moment is the uncertainty of Brexit. However, East Sussex is currently viewed as a growth area due to the success of South East LEP funding strengthening our position.

STAGES FOR ACQUISITION OF COMMERCIAL PROPERTY

Stage 1 – Properties identified and screened	**Week 1**
Regular review of relevant websites, local press and other media.	
Intelligence received from local agents, businesses, landowners.	
Initial discussion with internal Investment Group.	
Properties approved for further investigation or rejected.	
Stage 2 – Viewing & First Level Appraisal	**Week 2**
Potentially viable property viewed by officers. Photographic record taken.	
High level financial appraisal carried out.	
Discussion with internal Investment Group re: suitability, yield and purchase offer.	
Stage 3 – Negotiation	**Weeks 2-3**
Receipt of relevant documentation – leases, evidence of title, trading accounts (where relevant), plans, etc.	
Purchase price negotiated with vendor. All negotiations subject to contract, Property Investment Panel approval, survey and external valuation.	
Purchase price and other relevant Heads of Terms agreed in principle.	
Stage 4 – Report to Property Investment Panel	**Week 3 onwards**
Report to Property Investment Panel, including financial appraisal, risk assessment, planning commentary, recommendations.	
Stage 5 – Due Diligence	**Week 3 onwards**
Arms' length valuation commissioned to RICS 'Red Book' standard.	
Condition survey commissioned.	
Legal team at Wealden District Council instructed - where insufficient capacity exists or unlikely to meet transaction timescales, Wealden will contract out but retain management of the case.	
Receipt of report on Title, Searches, Valuation and Survey reports. Review Heads of Terms or withdraw in the event of prejudicial information coming to light.	
Ongoing progress updates with internal Investment Group.	
Stage 6 – Exchange of contracts & completion	**By Week 8**
Completion Statement received and checked.	
Transfer documents signed and monies transferred.	
Internal administrative systems set up: Estates records updated, Finance briefed.	
Stage 7 – Exchange of contracts/completion	**Week 8**