Rother District Council

Report to	-	Audit and Standards Committee
Date	-	18 May 2020
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 (PIS) 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.

The Process for Identifying Investments

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

4. 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. 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 region of 2% 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. When considering the return on investment our financial appraisals therefore factor in the likelihood of voids and other outgoings.

5. Development opportunities are sites or land that are acquired for the purposes of development/redevelopment and achieving a longer term income. 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.

6. 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.

7. 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

8. Following an initial screening, a high level financial appraisal of the site is undertaken and where necessary a site visit is conducted and a photographic record taken. Officers have screened 39 properties since the beginning of the programme and 16 since the last report to this Committee in March 2019.

9. The PIS sets out the type of properties that may fall under consideration. Identified properties are progressed for discussion by the Property Investment Group (PIG). This group meets weekly and consists of the Executive Director, Assistant Director Resources, Head of Service Acquisitions Transformation and Regeneration, Property Investment and Regeneration Manager and other property and finance officers as necessary.

10. 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 compliance with the PIS part of our due diligence is to comment in terms of how the acquisition contributes towards the wider regeneration of the district.

11. The PIG will report informally and seek views from the PIP members at an early stage, in cases where a potential bid looks likely.

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. Where properties are available and advertised on the open market, a direct approach has been made to the selling 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 Strategy

14. The current PIS was adopted by the Council in May 2018 and is attached as Appendix 3. The objective of the PIS is to support and safeguard the economy of the Rother area through the long-term protection of existing and the creation of new employment space, through investment in land and property in the Rother economic area.

15. The PIS sets out the types of property that the Council will seek to acquire and the factors that will be considered when assessing the suitability of potential acquisitions. It also describes how purchases may be funded and how the Council will manage risk.

The Property Investment Panel

16. 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 Leader of the Council. Current members of PIP are Councillors Mrs Bayliss, Curtis, Dixon, Oliver, and Vine-Hall.

17. 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 purchase price provisionally agreed through the negotiations, provisional reports on title, the return on investment appraisal; as well as commentary on associated financial, legal, environmental and planning risks.

18. 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.

19. 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 relevant site specific reports such as land contamination.

Acquired Properties

20. Since the previous report in March 2019 the Council has acquired a further three properties with a total value of £11.125m. The properties that the Council have acquired since March 2019 are:

Glovers, House, Bexhill Enterprise Park	£7.45m
Development Land at Barnhorn Green, Bexhill	£0.60m
Market Square, Battle	£3.075m

21. The total value of the properties purchased by the Council as part of the PIS is £13.625m, with a further £10m approved from borrowing to implement development at Barnhorn Green. Members will note as detailed in confidential Appendix 2 that there are a number of properties that are currently under consideration, negotiation, or undergoing the due diligence process.

Internal Audit

22. The Council's internal auditors have recently reviewed the Council's processes for acquiring properties and identified no serious risks. However, some recommendations were made to assist the process in future, as follows:

- Management should consider adopting a weighted scorecard approach to better quantify the relative merits of each acquisition. This would make it is easier for the Property Investment Panel to see the strengths and weaknesses of each proposal and help to ensure consistency of approach.

- Whilst risk registers are produced for development projects after the sites have been acquired, it was recommended that a risk register is produced prior to a decision being made to proceed with the purchase, to ensure that any risks identified during the acquisition process are considered and mitigating action put in place.
- The Property Investment Panel currently consists of three Cabinet Members and two non-Cabinet Members. This conflicts with the Panel's terms of reference which state that it should be made up of three non-Cabinet Members and two Cabinet Members.
- It was recommended that Members on the Property Investment Panel should receive further property investment training to help them fulfil their role.
- The report recommends a checklist be produced to record all the key stages of the due diligence process, to confirm that all necessary due diligence checks have been carried out prior to completion taking place.

23. Officers have taken on board the recommendations of internal audit and these are being actioned.

Risks and challenges

24. In response to the rise in local authority borrowing to fund property acquisitions, and the perceived risks associated with this, in the autumn of 2019 the Treasury placed a 1% increase on the Public Works Loan Board rate. This has narrowed the viability margin for investment acquisitions. By contrast the majority of private sector investors are cash buyers who do not need to factor in the cost of loan repayments when considering bids for properties.

25. This has the result of rendering the Council less effective when competing in the marketplace, particularly for investments which offer the greatest security and lowest risk. The unintended consequence of the Treasury's action, far from reducing risk to the public purse, is to force local authorities to consider less attractive investments with higher yields but attracting greater risks and potential costs in terms of covenant strength, management costs, obsolescence, etc.

26. In general the UK investment market has been slow in recent years, largely as a result of the uncertainty surrounding Brexit; with relatively few properties coming to market and few transactions taking place. This means that there is keen competition for good quality investments when they do come up for sale; particularly in certain property sectors such as light industrial where investor confidence and demand is high. The Council has direct experience of this when bidding for local investments; where the eventual sale price has been significantly in excess of a level that would be affordable to the Council.

27. As stated above, the Council's PIS is explicit in referencing local economic benefit as the basis for acquiring properties, which points towards properties

within the District or its immediate environs, where the case for local economic benefit can be made. However, Rother does not have a significant commercial property market and in general transactions are small-scale. Whilst in theory the Council could acquire large numbers of small properties, the acquisition process is heavily resource intensive and the ongoing management of such properties would also require significant resourcing. The opportunities locally for acquisitions that will make a significant contribution to meeting the Council's income targets are few and far between.

28. Other investment activity, such as development of sites at Barnhorn Road and Blackfriars, will yield a return in the longer run but require time to bring to fruition.

29. It is unlikely therefore that the Council will be able to meet the Council's Medium Term Financial Plan (MTFP) income targets through property acquisitions under the current PIS, for the reasons given above.

Conclusion

30. Members are asked to note this report and consider the work of officers and the PIP in the delivery of the PIS.

31. 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. However, opportunities that meet the criteria of the PIS are few and far between and a more proactive approach may be required to identify premises. Both the officers and the PIP will continue to assess each opportunity on its own merits.

32. 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
Internal Audit have identified areas where the Council's processes and procedures can be improved, and these should be followed up to ensure that the Council does not make poor investment decisions.

As with all investments the property market is subject to fluctuation and an economic recession would affect the Council's ability to generate revenue through rental income.

The opportunities to acquire good quality investments locally are limited, putting achievement of the Council's MTFP target at risk