

Rother District Council

Report to - Cabinet
Date - 8 June 2020
Report of the - Executive Director
Subject - Property Investment Strategy

Recommendation to COUNCIL: That the revised Property Investment Strategy set out at Appendix 2 be approved and adopted;

AND

It be **RESOLVED:** That the revised Terms of Reference for the Property Investment Panel set out in Appendix 3 be approved.

Heads of Service: Ben Hook / Robin Vennard
Lead Cabinet Member: Councillor Oliver

Introduction

1. The Council's current Property Investment Strategy (PIS) was considered by Cabinet and approved by Council in May 2018. It is now timely to review the PIS in the light of the Council's experience over the past two years; having regard to Government guidance and to legal advice. This report sets out the latest position with regard to property acquisitions and makes recommendations relating to revisions to the PIS.
2. This report also proposes changes to the Terms of Reference to the Property Investment Panel (PIP), to reflect changes that have taken place since these were last adopted.

Acquisitions to Date

3. In May 2018, the Council approved borrowing (Minute C18/13 refers) up to a total of £35m to support a programme of property acquisitions. To date a total of £24.696m has been either spent or approved to date (including acquisition costs, professional fees and the cost of demolition works undertaken at 1-7, Wainwright Road): producing a gross income of £886,000 in a full year (£677,000 net of borrowing).
4. All of the properties that have been acquired to date have been located within Rother District, and comprise a mix of retail, industrial and office properties, along with development sites. Properties outside the district have been considered where these met with the criteria set out in the PIS, however none of these have come to fruition so far.
5. The properties acquired so far are as follows:

14 Terminus Road, Bexhill	£850,000
16 Beeching Road, Bexhill	£825,000

18-40 Beeching Road, Bexhill	£825,000
1-7 Wainwright Road, Bexhill	£1
Glovers House, Bexhill	£7,450,000
Land at Barnhorn Green, Bexhill	£600,000
Market Square, Battle	£3,075,000
Total	£13,625,001

6. The above table shows the purchase prices only, net of costs. Acquisition costs such as stamp duty and professional fees, and the total cost of demolition works at 1-7, Wainwright Road amount to a further £1,071,439, met from the original £35m budget. In addition, the Council has committed from the budget £10m borrowing for the development of the site at Barnhorn Green. Approximately £10.304m of the original approved borrowing therefore remains.
7. Further details of the properties acquired are summarised in Appendix 1.

Revised Property Investment Strategy

8. The current PIS was drafted having regard to the statutory guidance and the Council's regeneration ambitions for the Rother area, and these have been at the forefront of the rationale for the acquisitions that the Council has made to date. It places an emphasis on the Council's regeneration ambitions as supporting the rationale for acquiring commercial premises, and regeneration objectives have underpinned the acquisitions that have been made to date.
9. The Council also seeks to make a financial return on those acquisitions however, in order to support its revenue budget in the light of reduced Central Government funding.
10. The Council's Medium Term Financial Strategy (MTFS) identifies the following year-on-year targets for raising additional income through expanding its property portfolio.

2020/21	2021/22	2022/23	2023/24	2024/25
£544,000	£605,000	£605,000	£605,000	£605,000

11. The Council will continue to focus on acquiring properties within the District (or immediate environs) in support of its regeneration aspirations. However, there is a case for broadening the Council's area of search to enable it to consider acquisitions outside the district in order to meet the MTFS targets shown above.
12. 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 resourcing. The opportunities locally for acquisitions that will make a significant contribution to meeting the Council's income targets are few and far between.
13. Other investment activity, such as development of sites at Barnhorn Road and 1-7 Wainwright Road, will yield a return in the longer run but require time to bring to fruition.

14. It is unlikely therefore that the Council will be able to meet the Council's MTFP income targets through property acquisitions under the current PIS, for the reasons given above.
15. From time to time however opportunities arise to acquire properties beyond the district boundaries, which may represent good financial investments (subject to the usual due diligence); and there is a case for considering these on that basis. Many local authorities are acquiring commercial property to generate a revenue stream in this way.
16. HM Treasury has however expressed concern at the extent to which local authorities are using their powers of borrowing to undertake commercial investment activity. These concerns focus on the level of financial risk taken, the extent of borrowing relative to the authorities' turnover, and the level of expertise available to local councils to ensure prudent investment. There is also concern that local authorities may be inflating prices artificially, with examples in some cases of local authorities actively bidding against each other for assets.
17. Legal advice has been sought on the ability of the Council to acquire property for this purpose and whether it may borrow to do so. The advice suggests that if the Council wishes to acquire commercial property purely as an investment (for capital and/or revenue returns) for the prudent management of the Council's financial affairs under a Commercial Investment Strategy (CIS) then it may do so; and it may borrow to acquire such property. Acquisitions where there is no link to local regeneration (i.e. outside of Rother and its immediate environs) would therefore have to be justified by their contribution towards an adopted CIS.
18. Government guidance states that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. However, it goes on to suggest that where authorities do this there needs to be explicit justification of the reasons for so doing; hence the need for an adopted CIS. In addition, where money is borrowed to invest, the Guidance states that the Council must explain:
 - Why the Council has decided not to have regard to the Ministry of Housing, Communities and Local Government Guidance or to the Prudential Code in this instance; and
 - The local authority's policies in investing the money borrowed, including management of the risks, for example, of not achieving the desired profit or borrowing costs increasing.
19. To date the Council's investment activity has been focused on property acquisitions however, the Council may also wish to consider other forms of investment activity which can contribute towards meeting the Council's income targets. These could include:
 - Energy generation.
 - Lending to Council-owned companies (such as the Housing Company).
 - Other commercial lending (e.g. to support projects led by third party bodies).
 - Joint Venture arrangements.
 - Land acquisitions for retention for future development.

20. Such activities may also help to support other Council priorities, such as the delivery of housing and the emerging Climate Change Action Plan, by enabling the Council to enter into commercial relationships where necessary or appropriate. Any borrowing to invest should be proportionate, sustainable and affordable and the proposed investment supported by due diligence and professional advice that identifies and addresses the likely risks involved (along with undertaking sensitivity analysis on prospective returns).
21. In order to provide a policy framework to accommodate these types of commercial activity it is proposed that the Council will develop a CIS, which would act as a companion strategy to the PIS.
22. At present a CIS for the Council has yet to be developed; however it is recommended that the PIS be amended in readiness, in order to set the parameters under which the Council will consider the acquisition of property in pursuance of investment objectives. Until such time as a CIS has been formally approved however, all acquisitions will still need to be justified by their contribution to local regeneration.
23. A revised draft PIS is shown at Appendix 2. The proposed revised strategy extends the area of search to a radius of approximately 40 miles from the Rother boundary, which is sufficiently wide to offer purchasing opportunities in active property markets but close enough to facilitate prudent ongoing management of the asset. It is also evident that some Rother residents commute those sorts of distances for work purposes.

PIP Terms of Reference

24. Currently the PIP's Terms of Reference allow for two Executive Councillors, one of whom must be the Portfolio Holder with responsibility for Finance: and three other Councillors.
25. Following the Council Elections in May 2019 membership of the PIP changed as a consequence of the appointments process. The current appointments to the PIP include three Cabinet members; and a change is needed to the Terms of Reference to accommodate this.
26. It is now proposed to add a further Member to the Panel, to comprise three Executive Councillors and three non-Executive Councillors and to remove the requirement for the Cabinet Portfolio Holder for Finance to be a mandatory Member of the PIP. Approval of the extended PIP will therefore ensure that the PIP continues to operate within its Terms of Reference it is recommended that these be amended accordingly.
27. A revised draft Terms of Reference is attached as Appendix 3.

Risk Management and Governance

28. 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 PIP 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.
- It was recommended that Members on the PIP 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.

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

Conclusion

30. It is recommended that the revised PIS (Appendix 2) be adopted and a CIS be prepared for a future Cabinet meeting. The Terms of Reference of the PIP be amended and the recommendations of audit report be implemented.

Dr Anthony Leonard
Executive Director

Risk Assessment Statement

The role of the PIP in considering potential acquisitions will remain critical and it is important therefore that members of the Panel are familiar with property matters and that they receive relevant training to support their role.

Expanding its area of search may increase the Council's exposure to risk; through insufficient knowledge of local market conditions and by virtue of distance which may limit the Council's ability to respond to changing circumstances (such as voids).

These risks may be offset by careful consideration of assets to be acquired, guided by the PIS, and by undertaking necessary due diligence at the time of purchase. Ultimately the Council has ownership of a capital asset which it may sell.

The Covid-19 pandemic is most likely to have an impact upon the property market, although as yet the effects are hard to predict and it takes time for market data to filter through and reflect any changes within market sentiment. The Council will continue to monitor this in consultation with its advisors.

SUMMARY OF PROPERTIES ACQUIRED SINCE MAY 2018

PROPERTY ADDRESS	USE TYPE	DATE ACQUIRED	PURCHASE PRICE (NET)	TOTAL COST (GROSS)	VALUE AS AT 31/03/20
14 Terminus Road, Bexhill	Car showroom, workshop and filling station	July 2018	£850,000	£887,485	£1,072,100
16 Beeching Road, Bexhill	Light Industrial	Dec 2018	£825,000	£877,885	£1,213,300
18-40 Beeching Road, Bexhill	Light Industrial	Dec 2018	£825,000	£877,885	£1,638,880
1-7 Wainwright Road, Bexhill	Development site	Dec 2018	£1	£342,561*	£600,000
Glovers House, Bexhill Enterprise Park	Office	April 2019	£7,450,000	£7,843,952	£5,734,500
Land at Barnhorn Green, Bexhill	Development Site	July 2019	£600,000	£610,487	£0
Market Square, Battle	Retail	Dec 2019	£3,075,000	£3,256,184	£3,120,400

* cost of demolition and associated fees

PROPERTY INVESTMENT STRATEGY**June 2020****Objective of the Strategy**

1. The Council is committed to supporting and safeguarding the economy of the Rother area through the long-term protection of existing and the creation of new employment space. This objective will in part be achieved through the investment in land and property in the Rother economic area. For this strategy to be sustainable the investments must make a net positive return for the Council. For new developments this may not occur in the early period but must by the medium term be making a positive return. The Council will review this strategy as the portfolio develops and as the Council's business needs evolve.
2. In addition, the Council will acquire land and properties for the prudent management of the Council's financial affairs under its Commercial Investment Strategy. Properties acquired for this purpose may not necessarily be situated in the Rother economic area.

What will the Council invest in –

3. The Council will seek to maintain a diversified and balanced portfolio of property assets, having regard to the considerations set out below. The general principle is that properties will be acquired in order to protect their current or desired use and/or generate a stable revenue income for the Council.
4. Established property investment practice has evolved based on long standing markets for assets in mainstream sectors such as offices, retail, industrial and residential. Investing in these traditional asset categories in a balanced fashion, allows for a lower risk investment when compared to emerging markets such as Student Accommodation, Nursing Homes and Medical Centres. However, opportunities will be considered on their respective merits.
5. Where a case can be made on the basis of local benefit the Council will consider opportunities within the Rother District or within its immediate environs.
6. Where the acquisition is not linked to local benefit the Council will consider opportunities within Rother District or within an approximate 40-mile radius.
7. Freehold tenure is preferred to leasehold. Freehold provides for greater levels of security than a leasehold asset that would effectively decrease in value over time. However, the Council may also buy back ground leases on assets where the Council is already the freeholder, in order to gain control over future development and benefit from increased rental income.
8. Properties should preferably be let to a single tenant on a full repairing lease, in order to minimise management input. Properties with more than one tenant may be considered however if the management requirements are considered to be acceptable. Whilst properties let to only one tenant may present a level of risk of a void in the event of tenant failure or at the end of the lease, detailed financial due diligence would be undertaken to ascertain their financial stability.

9. The Council will balance investments that are already producing an income, with existing tenants in place, with properties with vacant accommodation or development sites where the return on investment is expected in the medium term particularly where there are strategic reasons for doing so. The interim funding implications will be considered as part of the business case for investment.

Size of Investment Lots and investment criteria

10. Due to the nature of the local property market the Council will be flexible on lot size and consider investment opportunities on their individual merit; however the ideal suggested lot size is between £1m and £10m. This will be flexible if there is an overriding strategic reason to acquire a property.
11. Opportunities may be sought that lend themselves to a potential to increase rental income than is currently being realised.
12. The following guiding criteria will be applied:
 - A target average annual yield of 2% net of borrowing costs over the expected lifetime of the asset
 - Individual Properties or Portfolios.
 - Flexible lot size but £1m – £10m expected. Larger lot sizes will be considered on their merits, having regard to financial due diligence.
 - Freehold preferred.
 - Single tenanted preferred, or multi tenanted where management input required is at an acceptable level.
 - Asset categories: likely to focus on Industrial, Office, Retail, Leisure, Trade Counter; but others may be considered.
 - Geographically located within Rother District, or immediately nearby where a case can be made on the basis of local benefit.
 - Geographically located within an approximate 40-mile radius of Rother District, where the case is made for investment purposes.

Land and Property Disposals

13. The Council's land and property holdings will be reviewed regularly to assess their contribution to the objectives of this strategy and where there is a shortfall may consider disposal. In addition, where there is significant capital appreciation of an asset, disposal may be considered where the capital receipt enables reinvestment in the Rother area.

Funding the Investments

14. Funding for the acquisition of assets will be reviewed on a case-by-case basis from a number of sources:
 - Receipts from previous property disposals.
 - Receipts from proposed land / property disposals in future years.
 - Reallocation of some of the funds currently held in reserves.
 - Borrowing from external lenders – Bank Real Estate Finance, Annuity Funds, Pension Funds.
 - Borrowing from the Public Works Loan Board.
 - Municipal Bonds Agency.

Expert Support and Guidance

15. External specialist property investment advisors will be retained as necessary on each transaction, advising on suitability having undertaken detailed pre purchase due diligence, including valuation, risk analysis and lease / title reviews; including the appointment of introductory agents where appropriate.

Managing Risk

16. The risks of each potential investment will be considered by carrying out due diligence to include the following:
 - Valuation.
 - Market Conditions.
 - Covenant strength of tenants.
 - Terms of leases.
 - Structural surveys.
 - Funding options.
 - Future costs.
17. The subsequent management of the portfolio will be delivered from existing resources within the Council's Estates team, supplemented by specialist external advice as needed. A specific budget provision will be made available to meet these costs. This approach will be reviewed regularly by the Property Investment Panel, including on-going resource requirements, as the portfolio grows.

Monitoring the Strategy

18. Annual reports on activity and performance will be considered by the Council's Audit and Standards and Overview and Scrutiny Committees.

PROPERTY INVESTMENT PANEL TERMS OF REFERENCE

1. PURPOSE

The Property Investment Panel is set up by Cabinet to make recommendations to the Head of Paid Service on matters relating to the Property Investment Strategy under powers as set out in Rother District Council Constitution. These may be to further the aims and objectives of the Council to promote economic growth in the Rother area; or in pursuance of commercial investment objectives in accordance with a formally adopted Commercial Investment Strategy.

The Head of Paid Service has been given delegated powers to acquire properties for economic, regeneration and investment purposes subject to the recommendations of the Panel and as guided by the Property Investment Strategy.

The Panel will:

- i. receive investment prospectuses and evaluations of potential property acquisitions;
- ii. set the parameters, within the overall Property Investment Strategy parameters, for bidding on each property.
- iii. make recommendations to the Head of Paid Service on the acquisitions of properties; and
- iv. oversee the due diligence and acquisition process in accordance with the Property Investment Strategy.

2. CONSTITUTION, DUTIES AND POWERS

- i. The Panel shall comprise six elected Members nominated by the Leader of the Council, with one vote each:
 - three Executive Councillors, ~~one of whom must be the Portfolio Holder with responsibility for Finance~~; and
 - three other Councillors.
- ii. Council Officers attending will be the Executive Directors and Section 151 Officer. Other Council Officers and external advisors may attend the Group, in an advisory capacity (e.g. the Property Investment and Regeneration Manager).
- iii. The Section 151 Officer will attend in an advisory capacity. However, if he/she disagrees with the Panel's recommendation he/she can refer the decision to the next scheduled meeting of Cabinet for further consideration.
- iv. The Panel shall appoint the Leader of the Council ~~Portfolio Holder with responsibility for finance~~ as Chairman. In his/her absence, the Panel can appoint a chairman for that meeting.

- v. The quorum of the Panel shall be three. One Executive Director (who need not necessarily be the Head of Paid Service) and the Section 151 Officer (or his/her deputy) must be in attendance.
- vi. There will be no substitution arrangements.
- vii. Recommendations made to the Head of Paid Service will be made by majority vote of all those present and entitled to vote. In the event of an equal number of votes for and against a proposal, the matter will be referred to Cabinet.
- viii. The financial performance of the investments will be reported to the Audit and Standards Committee as part of its treasury management responsibilities. In addition, the Panel will report its activities through the Overview and Scrutiny Committee to Cabinet.
- ix. The frequency of the Panel meetings will be as and when required.