

Committee: **Executive**

Date: **19 July 2018**

Title: **Activities to Support Economic Growth**

Portfolio Area: **Cllr John Tucker, Leader of the Council, Assets**

Wards Affected: **All**

Relevant Scrutiny Committee: **Overview & Scrutiny Panel**

Date next steps can be taken: **27 September 2018**

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Recommendations:

That the Executive:

- 1. RECOMMEND to the Council meeting on 27 September, 2018 to adopt the commercial property strategy in principle but ask the Overview and Scrutiny Panel to review the strategy and report back to the Executive on 13 September 2018; and**
- 2. AGREE that the borrowing limit for the Strategy is a decision which will be part of the Medium Term Financial Strategy (presented to the Executive on 13 September and Council on 27 September), with the Audit Committee being asked to consider the Borrowing Strategy (part of the Treasury Management Strategy) of the Council, and report back to the Executive on 13 September. Depending on the recommendations from the various bodies, an updated Treasury Management Strategy, increasing the Borrowing Limits of the Council, will be presented to Council on 27 September, alongside the final commercial property strategy for approval.**

1.0 Executive Summary

- 1.1 In July 2017, it was resolved that the Council deferred a decision regarding a commercial property acquisition strategy (26/13). At that time, the proposal was to acquire commercial property outside of the District.
- 1.2 Following meetings of the Investment Group in 2018, officers have put together a strategy for commercial property acquisitions and asset developments within the district of South Hams, in line with the "Enterprise" corporate strategic aim of creating places for enterprise to thrive and business to grow.
- 1.3 The proposed strategy would have the following multiple objectives:
 - 1.3.1 To support regeneration and the economic activity of the District
 - 1.3.2 To enhance economic benefit & business rates growth

- 1.3.3 To assist with the financial sustainability of the Council as an ancillary benefit.
- 1.3.4 To help the Council continue to deliver and/or improve frontline services in line with the Council's adopted strategy & objectives
- 1.4 Appendix A shows the recommended commercial property and development strategy in full.
- 1.5 The borrowing limit for the Strategy is a decision which will be part of the Medium Term Financial Strategy (presented to the Executive on 13th September and Council on 27th September), with the Audit Committee being asked to consider the Borrowing Strategy (part of the Treasury Management Strategy) of the Council and report back to the Executive on 13th September. The Council is currently obtaining independent advice on the amount of borrowing that would be acceptable for the District Council, based on the Council's financial status. This advice will inform the recommendation in the Medium Term Financial Strategy on the Borrowing Strategy (and appropriate limits) for the Council. How each acquisition or development scheme is funded will be reviewed on a case by case basis, but the main option for consideration will be borrowing from the Public Works Loan Board (PWLB).
- 1.6 It is important to note that the nominated Investment Group Members will consider each and every proposal as they come forward on their own merits and how each proposal meets the Council's multiple objectives.
- 1.7 It is anticipated that to fully implement the strategy will take at least 5 years to complete and should be kept under review.
- 1.8 The proposed strategy and/or implementation could be updated or ceased at any point prior to the full budget of the strategy being expended (and the funding being borrowed from the Public Works Loan Board), if Members determine that market conditions have deteriorated enough to make it financially unattractive. The Investment Group will retain the right to review the strategy at any time.

2.0 **Background**

- 2.1 Following a Full Council decision to defer a previous commercial acquisition strategy in July 2017 (26/13), officers now present an updated strategy aimed at economic regeneration, investment in District and promoting trade within area.
- 2.2 It includes both property acquisition as well as funding of commercial development (on existing Council land). This is in line with the "Enterprise" corporate strategic aim of creating places for enterprise to thrive and business to grow.
- 2.3 Since the previous proposals were considered by the Council, there have been changes to the rules and guidance around what Councils can and can't invest in, using prudential borrowing.
- 2.4 The MHCLG (Government) guidance on Investments has stated that Councils will need to disclose several recommended indicators in

their treasury management strategies going forward, for reports published after 1 April 2018.

- 2.5 The indicators that need to be disclosed after 1 April 2018 include an indicator on proportionality. This indicator assesses the amount of debt an Authority holds in relation to its Net Service Expenditure (NSE). The purpose of this indicator is to allow the reader to assess how proportional a Council's borrowing is, in relation to its Net Service Expenditure.
- 2.6 The Council is currently obtaining independent advice on the amount of borrowing that would be acceptable for the District Council, based on the Council's financial status. This advice will inform the recommendation in the Medium Term Financial Strategy on the Borrowing Strategy (and appropriate limits) for the Council. There are no Government guidelines on what is an acceptable level of proportionality (the proportion of borrowing as a factor of the Council's Net Service Expenditure) and it is for each Council to assess this level themselves. Hence the Council is obtaining specialist advice on Borrowing Limits, which will include comparative data for other similar sized Councils.
- 2.7 The Council will consider proportionality on a case by case basis for each acquisition as part of the decision making process, with information provided to the Investment group, the s151 officer, the Head of Paid Service and the Leader of the Council.
- 2.8 Investment in area, for the stated aims of this strategy, funded through prudential borrowing is entirely consistent with all other published guidance for Councils on commercial property acquisitions. Legal counsel has been undertaken as part of this process. The legal powers by which the Council can implement this strategy have been confirmed.

3 Commercial Property Acquisition

- 3.0 The adopted strategy is shown in Appendix A has been devised to give the Council, through the Investment Group, a clear set of criteria by which to appraise opportunities that arise.
- 3.1 Officers will provide the Investment Group with a set of data, such as that which is included in Appendix B (example decision template) and Appendix C (example of a Property Acquisition indicative cashflow). These templates would inform the decision required from the Investment Group, which would be approval to submit a bid or not.
- 3.2 In parallel, the Council's Senior Leadership Team (SLT) are required to approve a bid. A bid will be subject to Technical Due Diligence and Legal Searches and occasionally other data as needs arise.
- 3.3 Assuming the acquisition proposal remains as per that authorised at the time of bid, the final sign off prior to exchange and payment of deposit (typically 10%) is made by; Chairman of the Investment Group, the Leader of the Council, S151 officer and Head of Paid Service.

- 3.4 This process of delegated authority (1st stage for the Investment Group to bid on a purchase and 2nd stage for the 4 persons in 3.3 to formally approve to exchange and complete on a purchase) is required because there is often very little time (a number of days) to secure a bid on a property, especially if it is off market. Off market bids can result in the best outcomes for the Council in terms of the objectives of the strategy.
- 3.5 Purely to highlight the practicalities of moving forward with this strategy if the Council is mindful to do so, the Investment Group should be aware that they will be required to process information similar to that in Appendices B and C in a very quick timeframe so as to provide their decision. They will also be asked to attend meetings on similarly short notice.

4 Commercial Development

- 4.0 Commercial development in the context of this report refers to the development of commercial property on Council owned land, such as (by way of example only); the construction of a health and wellbeing clinic in Dartmouth, a harbour workshop and / or employment units in Salcombe.
- 4.1 There are multiple projects being worked on by officers that meet the criteria set out in the strategy and it is proposed that the Investment Group and scheme of delegation be used to facilitate timely and critical appraisal and ultimately approval of these proposals, including the granting of associated leases in excess of 15 years.
- 4.2 The information provided to the Investment Group will be similar for development projects, except that there will be additional risk analysis presented to include the construction phase of the projects.

5 What might success look like?

- 5.0 The adoption of this strategy will facilitate inward investment in South Hams by the Council, promoting and fostering business development. This will help achieve the "enterprise" corporate objective.
- 5.1 Whilst acquisition opportunities cannot be forecast, it is anticipated that one or two commercial acquisitions may meet the Council's criteria within a year of approval. Likely spend may therefore be between £2-6m, generating a net income (after borrowing and acquisition costs) of £20k-£60k/yr.
- 5.2 Over a two year horizon, it is anticipated that commercial development should have started on one or more of the Council's sites. As a guide, each development may cost in the order of £5m.
- 5.3 Over a three – five year horizon, developments will have been concluded and entered the operational / income phase. As a guide, a minimum 1% net yield may be a reasonable assumption for development income, but there will be a variation between projects.
- 5.4 It should be reiterated that the income derived from commercial development and some commercial acquisitions will be secondary to

the economic and social benefit they will bring to South Hams and the strategy anticipates that outcome.

6 Options available and consideration of risk

- 6.0 The overall objectives of this strategy are set out below:
 - 6.0.1 To support regeneration and the economic activity of the District
 - 6.0.2 To enhance economic benefit & business rates growth
 - 6.0.3 To assist with the financial sustainability of the Council as an ancillary benefit.
 - 6.0.4 To help the Council continue to deliver and/or improve frontline services in line with the Council's adopted strategy & objectives
- 6.1 South Hams District Council is a business rates pilot area for 2018/19, which sets out economic objectives of the pilot area. This strategy would help deliver these objectives. Each acquisition or development will be assessed on its fit with meeting the objectives stated above, on a case by case basis.
- 6.2 If the Council decides not to adopt the strategy as proposed, it should still be able to deliver some of its development ambitions, utilising the existing Council approval routes and committees. What will be far more challenging will be to deliver on the commercial acquisition element of the strategy, as that is almost impossible to do without a scheme of delegation in place.
- 6.3 Research shows that where Councils undertake this activity, there is an increasing level of delegation, enabling them to move quickly when properties come to market. This is implicit within the adopted and recommended strategy.
- 6.4 Members could opt to follow, amend or reject the recommendations.
- 6.5 Legal counsel has been undertaken as part of this process. The legal powers by which the Council can implement this strategy set out in Section 8.0.
- 6.6 The strategy looks to mitigate risks by setting specific criteria for purchases and necessary due diligence must be completed before officers and the Investment Group recommend any purchase.
- 6.7 It should be recognised that there is an inherent tension between some of the objectives of this strategy. For example, a decision to purchase or develop business units to lease to tenants will help achieve the first two objectives. However, if the tenant defaults on its rent payments, the third objective would be at risk.
- 6.8 In contrast, purchasing a commercial building with an existing very strong tenant, such as that of a supermarket chain for example, could be seen to meet the first two objectives of the strategy less well, but would expose the Council to less financial risk.
- 6.9 Officers, working with their specialist advisors in the market will sift opportunities and only present to the Investment Group, things that meet the Strategy closely. They will then lead the Investment

Group into debate over the specific benefits and risks of each opportunity before the Investment Group make a decision. In this way, risk will be transparent through the process.

7 Proposed Way Forward

- 7.1 That the Executive RECOMMEND to adopt the commercial property strategy in principle and ask the Overview and Scrutiny Panel to review the strategy and report back to the Executive in September 2018.
- 7.2 That the Executive AGREE that the borrowing limit for the Strategy is a decision which will be part of the Medium Term Financial Strategy (presented to the Executive on 13th September and Council on 27th September), with the Audit Committee being asked to consider the Borrowing Strategy (part of the Treasury Management Strategy) of the Council and report back to the Executive on 13th September. Depending on the recommendations from the various bodies, an updated Treasury Management Strategy, increasing the Borrowing Limits of the Council, will be presented to Council on 27th September, alongside the final commercial property strategy for approval.

8 Implications

Implications	Relevant to proposals Y/N	Details and proposed measures to address
Legal/ Governance	Y	<p>Advice on the relevant powers and appropriate vehicles for delivering these proposals has been sought from external specialist advisers and legal counsel. Legal counsel opinion has been obtained which sets out the various powers available to the Council, which supports the Council's proposed strategy as described in this report.</p> <p>This proposal is consistent with the Council's powers to borrow and invest under the Local Government Act 2003 and section 1 Localism Act 2011 (the general power of competence) and / or section 120 Local Government Act 1972 (power to acquire land).</p> <p>The Council is empowered to buy pursuant to section 120 of the Local Government Act 1972. Section 1 of the Local Government Act 2003 provides a power to the Council to borrow for the purposes of any enactment.</p> <p>Disposal of any of the acquired properties will have to be undertaken in accordance with the provisions of section 123 Local Government Act 1972.</p> <p>In order to lawfully implement the acquisition strategy, each proposal (including the funding strategy for purchases) should be reviewed as part of a decision to purchase or sell, and tested for value for money, and regulatory compliance.</p> <p>There is an overriding duty toward prudent management of risk, and officers, including the Council's section 151 officer owe a fiduciary duty in relation to given transactions.</p> <p>There is a duty on the Council to have regard to Statutory Guidance on Local (the New Guidance) Government</p>

		<p>Investments. As such, as part of the due diligence, officers consideration of each particular investment will need to include consideration of all the legal circumstances of the particular case, including, with respect to the utilisation of the investment power, whether having given due regard to the New Guidance, there is, exceptionally, scope for nonetheless borrowing in order to make the investments.</p>
Financial	Y	<p>The Council will purchase assets, or develop existing assets and hold these directly on its balance sheet and therefore the direct costs of purchase and acquisition or development can be capitalised. This will include costs such as stamp duty, legal fees, construction, planning, due diligence and agency fees.</p> <p>When individual purchase decisions or asset developments are made, a bespoke business case will be produced alongside a package of due diligence information to support the decision making process. The delegated authorities approving a purchase will need to be satisfied that any proposed acquisition not only delivers best value but also meets the criteria contained within the Commercial Property Strategy and has proper regard to how the acquisition or development meets the Council's multiple objectives of the strategy.</p> <p>Part of the business case for each commercial property acquisition or asset development will be an assessment of the Internal Rate of Return (IRR) calculation.</p> <p>Any PWLB borrowing to fund the acquisition of commercial property is not secured on the property acquired.</p> <p>PWLB borrowing rates are fixed for the term of the loan. Individual borrowing decisions will be taken prudently in line with the Council's treasury management strategy and by officers within that function. The Council will need to approve a revised Treasury Management Strategy which would increase the borrowing limits of the Council (depending on the recommendations from the various bodies), to facilitate implementation of the strategy.</p> <p>The Council has adopted the CIPFA Code Of Practice for Treasury Management and produces an Annual Treasury Management Strategy and Investment Strategy in accordance with CIPFA guidelines.</p>
Risk	Y	<p>The security risk is that the capital value of an acquired or developed property falls. Whilst this would have an effect on the Council's balance sheet, this loss will only be realised if the Council chooses to sell the property and incurs a capital loss. The liquidity risk is the risk of failure of a tenant within one of the acquired or developed properties.</p> <p>The yield risk is that the ancillary income derived from the assets will alter during the life of the asset. This will be actively managed; with specialist agents commissioned to manage the asset and its tenants. Properties will only be acquired if they have a minimum of 5 years unexpired lease term and are located in areas deemed to be attractive for future lettings / sales, limiting the risk to the Council's portfolio.</p> <p>The Council already owns and operates a property estate valued</p>

		at circa £75m. It therefore has experience of managing such an estate and can act as an intelligent client to fulfil the proposed strategy, with the aid of commissioned property experts. The cost of these experts has been included in the financial projections from this strategy.
Comprehensive Impact Assessment Implications		
Equality and Diversity	N	Not Applicable
Safeguarding	N	Not Applicable
Community Safety, Crime and Disorder	N	Not Applicable
Health, Safety and Wellbeing	N	Not Applicable
Other implications	N	Not Applicable

Supporting Information

Appendices:

Appendix A – Recommended Commercial Property Strategy & Criteria

Appendix B – Example of decision template to be presented to the Investment Group

Appendix C – Example of a Property Acquisition indicative cashflow

Background Papers:

- Commercial Property Acquisition Strategy, presented to Council July, 2017
- Statutory Guidance On Local Government Investments (3rd Edition)
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/678866/Guidance_on_local_government_investments.pdf
- Proposed Changes To The Prudential Framework Of Capital Finance
<https://www.gov.uk/government/consultations/proposed-changes-to-the-prudential-framework-of-capital-finance>