

Appendix B of this report contains exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act 1972

Report to: **Hub Committee**

Date: **11 September 2018**

Title: **Commercial Property Strategy Amendment**

Portfolio Area: **Cllr Neil Jory, Assets**

Wards Affected: **All**

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

Date next steps can be taken: **After Council, 25 September**

Authors: Invest to Earn Working Group, Members:  
**Cllrs Edmonds, Jory & Samuel**  
**Darren Arulvasagam / Chris Brook**  
Business Development / Assets CoP Lead  
[Darren.Arulvasagam@swdevon.gov.uk](mailto:Darren.Arulvasagam@swdevon.gov.uk)

**Recommendations:**

**That Hub Committee RECOMMEND that Council:**

- 1. APPROVE & IMPLEMENT the commercial property strategy as detailed in Appendix A; and**
- 2. RESCIND the currently adopted commercial property acquisition strategy as detailed in Appendix E.**

**1.0 Executive Summary**

- 1.1 On 27<sup>th</sup> March 2018 Council approved the recommendations of a report entitled "Commercial Property Acquisition Strategy Update". This provided an update on the implementation of the strategy to date and Members approved an amended strategy.
- 1.2 Following meetings of the Invest to Earn Group, officers have now formulated a new commercial property strategy (shown in Appendix A), which combines the ability to make property acquisitions with in-borough asset developments, in line with the "Enterprise" corporate strategic objective of creating places for enterprise to thrive and business to grow.
- 1.3 The proposed strategy would have multiple objectives as stated below:
  - 1.3.1 Support regeneration and the economic activity of the Borough, the LEP area and the South West Peninsula (in that priority order)
  - 1.3.2 Enhance economic benefit and create business rate growth
  - 1.3.3 Assist with the financial sustainability of the Council as an ancillary benefit
  - 1.3.4 Help the Council continue to deliver and/or improve frontline services

- 1.4 Each acquisition or development opportunity will be assessed on its fit with meeting the objectives stated above and should deliver one or more of the following desired outcomes (benefits):
  - 1.3.5 Job creation or safeguarding
  - 1.3.6 Health & Wellbeing
  - 1.3.7 Town centre regeneration
  - 1.3.8 Tourism / Increased footfall
  - 1.3.9 Business rate growth
  - 1.3.10 Improved asset utilisation
  - 1.3.11 A minimum Net yield of 1%
- 1.4 This strategy will be achieved by acquisitions and developments within the South West Peninsula. This will include the focussed acquisition of existing commercial property assets and the development of new properties which are to be let to third parties.
- 1.5 It is recommended that the total borrowing limit for the Council is increased to £50m, but this sum is to include all current borrowing and borrowing that has already been committed. Any surplus will be available to implement this strategy. This Council limit is based on the independent borrowing advice shown in Exempt Appendix B which recommends a total borrowing limit of £50m for the whole of the Council's operations, based on the Council's specific financial status. Appendix C shows an example of the Council's borrowing requirements and a summary of its current borrowing.
- 1.6 This strategy replaces the Commercial Property Acquisition Strategy, but those delegated authorities (to the Invest to Earn Group and the Head of Paid Service, in consultation with the S151 officer and the Leader of the Council) would carry over to this strategy in order to implement this strategy operationally. The committee are asked to support these recommendations.
- 1.7 The Invest to Earn Group Members will consider each and every proposal on its own merits and specifically how each proposal meets the Council's multiple objectives and delivers the required outcomes.
- 1.8 The proposed strategy and/or implementation can be updated or ceased at any point prior to the full budget of the strategy being expended (and the required funding being borrowed), if Members determine that market conditions have deteriorated enough to make it financially unattractive.
- 1.9 Borrowing will not be undertaken in advance of need and only on a project by project basis. Projects and their outcomes will be kept under constant review by the Invest to Earn Group.
2. **Background**
- 2.1 On 25<sup>th</sup> July 2017 Council approved the recommendations of a report entitled "Commercial Property Investment". This agreed borrowing of up to £26.75m to implement the first tranche of the adopted Commercial Property Acquisition Strategy. On 5<sup>th</sup>

December 2017 Council approved increased borrowing of up to £37.45m and increased the flexibility of the approved strategy.

- 2.2 Since that decision was made, the Council has acquired three properties, at a total cost of £20m and these have delivered economic benefits to the Borough, LEP area and the wider South West Peninsula. The ancillary income delivered has exceeded the budgeted amount for 2018/19.
- 2.3 Based on Invest to Earn group discussions, a new Commercial Property Strategy has been prepared and is shown in Appendix A. The current adopted strategy is shown in Appendix D. This new strategy if approved will replace the existing strategy, but the delegated authorities would remain and transfer to enable the delivery of the new strategy. The new strategy includes both commercial property acquisition as well as funding of commercial development on Council land. This proposal is in line with the "Enterprise" corporate strategic aim of creating places for enterprise to thrive and business to grow.
- 2.4 In the period between now and the original July 2017 proposals, there have been changes to the rules and guidance around how Councils can use prudential borrowing. 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. 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.
- 2.5 The Council has obtained independent advice on the amount of borrowing that would be acceptable for the Borough Council, based on the Council's own financial status. This advice is confidential is therefore treated as an exempt appendix as it is the intellectual property of a third party. The indicators themselves will be public information when they are published. The advice has been analysed in order to inform the recommendations within this report and the Borrowing Strategy (and appropriate limits) for the Council within the Medium Term Financial Strategy. Members can view this advice in Exempt Appendix B.
- 2.6 As a result of this advice, it is recommended that the Council does not agree borrowing above £50m. As at the time of writing, the council has already taken on £26.285m of borrowing. This leaves a further £23.715m available for the implementation of this strategy or any other borrowing requirement.
- 2.7 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. Proportionality is considered in the advice shown in Exempt Appendix B.

- 2.8 The Council will consider proportionality on a case by case basis for each borrowing decision 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.
- 2.9 Investment in Borough, for the stated aims of this strategy, funded through borrowing is entirely consistent with all published guidance for Councils. Legal counsel has been undertaken as part of this process. The legal powers by which the Council can implement this strategy have been confirmed.

### **3.0 Commercial Property Acquisition**

- 3.1 The recommended strategy shown in Appendix A has been devised to give the Council, through delegated powers to the Invest to Earn Group, a clear set of criteria by which to appraise opportunities that arise.
- 3.2 As now, officers will provide the Invest to Earn Group with a set of data and an indicative cash flow for each project under investigation. These would inform Members and aid their decision making on whether to proceed or not.
- 3.3 In parallel, the Council's Senior Leadership Team (SLT) are required to approve any bid or development. Any project will be subject to Due Diligence and Legal Searches and occasionally other data as need arises.
- 3.4 For acquisitions, assuming the bid remains as per that authorised at the time of sign off, the final sign off prior to exchange and payment of deposit (typically 10%) is made by; Chairman of the Invest to Earn Group, the Leader of the Council, S151 officer and Head of Paid Service.
- 3.5 This process of delegated authority (1<sup>st</sup> stage for the Invest to Earn Group to bid on a purchase and 2<sup>nd</sup> stage for the 4 persons in 3.4 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 avoid price inflation caused by competing bidders.
- 3.6 The Invest to Earn Group should be aware that they will be required to process information in a very quick timeframe so as to provide their decision. They will also be asked to attend meetings on similarly short notice. These meetings may be held virtually to expedite decision making and substitutes can be nominated by the relevant parties, subject to discussion at the next Invest to Earn Group meeting.

### **4.0 Commercial Development**

- 4.1 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 residential scheme in West Devon, where some properties would be let on an ongoing basis, some would be sold at open market levels and some would be sold at a discount to open market rate.

- 4.2 There are multiple projects being worked on by officers that meet the criteria set out in the strategy and it is proposed that the Invest to Earn 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 (which ordinarily would need to be a Full Council decision). Not all acquisition, development or housing projects currently being investigated by officers can be completed within the proposed borrowing limit. However, other financing methods are available which would deliver different financial outcomes. Each acquisition or development decision will consider the most appropriate financing method and return on investment.
- 4.3 The information provided to the Invest to Earn Group will be similar for development projects, except that there will be additional risk analysis presented to include the construction phase of projects.

## **5.0 What might success look like?**

- 5.1 The adoption of this strategy will facilitate inward investment in West Devon, promoting and fostering business development. This will help achieve the “enterprise” corporate objective. It will also help to stimulate and maintain investment within the wider South West Peninsula.
- 5.2 Whilst acquisition or development opportunities cannot be forecast, it is anticipated that two or three developments may meet the Council’s criteria within a year of approval. Likely spend may therefore require a total of £18.5m of finance, generating a net income (after borrowing and acquisition costs) of £200k-£300k per annum (equivalent of a 1.1 – 1.6% yield after borrowing, management, maintenance and capital repayment costs).
- 5.3 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 - £10m. Over a three – five year horizon, developments will have been concluded and entered the operational / income phase. As a guide, a 1% net yield (after borrowing, management, maintenance and capital repayment costs) 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 West Devon and the strategy anticipates that outcome.
- 5.5 Invest to Earn Group Members may opt to accept a net yield return of less than 1% if the benefits of job creation or safeguarding, tourism, town centre regeneration, business rate growth or effective asset utilisation are deemed more important by the Invest to Earn Group than a purely financial return.
- 5.6 For illustrative purposes only, an example of the borrowing requirements for the Council are shown in Appendix C.

- 5.7 How each acquisition or development scheme is funded will be reviewed on a case by case basis. It is envisaged this will predominantly be funded through prudential borrowing or any other unallocated or available Council reserve or capital receipt, as determined by the Council's Capital Financing Requirement (CFR).

## **6.0 Options available and consideration of risk**

- 6.1 West Devon Borough 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 strategy and Council approval routes and committees.
- 6.3 Members could opt to follow, amend or reject the recommendations.
- 6.4 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.
- 6.5 The strategy looks to mitigate risks by setting specific criteria for purchases and necessary due diligence must be completed before officers and the Invest to Earn Group recommend any purchase.
- 6.6 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.
- 6.7 In contrast, purchasing a commercial building with an existing very strong tenant, could be seen to meet the first two objectives of the strategy less well, but would expose the Council to less financial risk.
- 6.8 Officers, working with their specialist advisors in the market will sift opportunities and only present to the Invest to Earn Group, opportunities that meet the strategy closely. They will then lead the Invest to Earn Group into debate over the specific benefits and risks of each opportunity before the Invest to Earn Group make a decision. In this way, risk will be transparent through the process.

## **7.0 Proposed Way Forward**

- 7.1 It is proposed that if the Council approve this report's recommendations, the new strategy will be adopted immediately.
- 7.2 Full Council will consider the borrowing limit for this Strategy as part of the Medium Term Financial Strategy on September 25<sup>th</sup> 2018. It is envisaged in December 2018, Council will consider approving a revised Treasury Management Strategy which would increase the borrowing limits of the Council, to facilitate implementation of this strategy. As part of this report, the Council

will also include the new proportionality indicators to address the Government guidance issued in February 2018.

## 8.0 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 strategy, each proposal (including the borrowing 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 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.</p> <p>Appendix B of this report is exempt from publication because it contains confidential information provided to the Council as defined in Paragraph 3 of Schedule 12A to the Local Government Act 1972.</p> <p>The public interest test has been applied and it is considered that the public interest lies in not disclosing this report at this time because it contains commercially sensitive information which could prejudice the Council if such information was disclosed at this time.</p>
Financial	Y	<p>Approving this amended Commercial Property Strategy does not create an immediate direct financial impact. However, decisions made as a result of the strategy's adoption, alongside an approval of a revised treasury management strategy, could result in the Council taking on upto £50m of borrowing; whereas the currently approved total borrowing is £37.45m, plus the</p>

		<p>existing borrowing commitments of £2.1m for Kilworthy Park, £2.65m for Waste and £1.5m for Leisure, £43.7m in total. This is an overall increase in commitment of £6.3m.</p> <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>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 would need to approve a revised Treasury Management Strategy which would increase the borrowing limits of the Council, 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 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 now owns and operates a property estate valued at circa £40m. 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.</p>
<b>Comprehensive Impact Assessment Implications</b>		
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  
Appendix B – Exempt Appendix B West Devon Benchmarking Report  
Appendix C – Illustrative Borrowing Requirements for WDBC  
Appendix D – Currently Adopted Commercial Property Acquisition Strategy

### **Background Papers:**

- Commercial Property Acquisition Strategy Update, presented to Council March 27<sup>th</sup>, 2017
- Commercial Property Acquisition Strategy Update, presented to Council December 5<sup>th</sup>, 2017
- Investment in Commercial Property, presented to Council July 25<sup>th</sup> 2017
- Investment in Commercial Property, presented to Hub Committee June 20<sup>th</sup> 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](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>