

Committee: **Full Council**

Date: **27 September 2018**

Title: **Commercial Property Strategy**

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: **Immediately after meeting**

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RECOMMENDATIONS

That Full Council:

- 1. ADOPT the commercial property strategy as shown in Appendix A;**
- 2. AGREE a total borrowing limit of £60m for the Commercial Property Strategy (capped at no more than £30m borrowing before 30th April 2019);**
- 3. DELEGATE the authority and decision making function relating to 'Development on Council Owned Land' to the Executive (assuming that the proposed expenditure complies with the Council approved total borrowing limits). This delegation is to include the granting of associated leases in excess of 15 years as and when required.**
- 4. DELEGATE the authority and decision making function relating to 'Commercial Property Acquisitions in the South Hams' to the Head of Paid Service and Section 151 Officer, in consultation with Members of the Executive as detailed in Appendix A;**
- 5. REQUEST that when South Hams District Council acquire a Commercial Property in line with this strategy, a report will be presented (for noting purposes) to the subsequent meeting of the Executive, and;**
- 6. DISBAND the Investments Member Working Group with immediate effect.**

1.0 Executive Summary

- 1.1 On 19 July 2018, Executive received a report entitled "Activities to Support Economic Growth", which proposed a Commercial Property Strategy. Executive approved the recommendations, subject to feedback and scrutiny by the Council's Audit Committee and Overview and Scrutiny Panel.

- 1.2 Both Committees met on 6 September 2018. Based on the feedback received around governance arrangements (refer to minute reference: O&S.34/18: Activities to Support Economic Growth), an updated strategy is shown in Appendix A and is recommended for adoption.
- 1.3 The proposed strategy has the following multiple objectives:
 - 1.3.1 Support regeneration and the economic activity of the District
 - 1.3.2 Enhance economic benefit
 - 1.3.3 Grow business rate income
 - 1.3.4 Assist with the financial sustainability of the Council as an ancillary benefit.
 - 1.3.5 Help the Council continue to deliver and/or improve frontline services in line with the Council's adopted strategy & objectives
- 1.4 The following outcomes are desired by the application of this strategy. 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 outcomes (benefits):
 - 1.4.1 Job creation or safeguarding
 - 1.4.2 Health & Wellbeing
 - 1.4.3 Town centre regeneration
 - 1.4.4 Tourism / Increased footfall
 - 1.4.5 Business rate growth
 - 1.4.6 Improved asset utilisation
 - 1.4.7 A minimum net yield return of 2% is targeted. However, in some circumstances, e.g. where community benefit are likely to be achieved, a lower return may be acceptable.
- 1.5 It is recommended that the borrowing limit for the Strategy is £60m (capped at no more than £30m before 30th April 2019), based on independent borrowing advice received. This advice recommended a total borrowing limit of £75m for the whole of the Council's operations, based on the Council's specific financial status.
- 1.6 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).
- 1.7 Executive Members, along with the Head of Paid Service and S151 officer, will consider each and every proposal on its own merits and specifically how each proposal meets the Council's multiple objectives and desired outcomes.
- 1.8 Projects and their outcomes will be kept under constant review by officers and reports to Executive and Audit Committee.

2.0 **Background**

2.1 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.

On 19th July 2018, Executive received a report entitled "Activities to Support Economic Growth", which proposed a revised strategy.

Based on subsequent feedback received from the Council's Overview & Scrutiny Panel and Audit Committee, an updated strategy is shown in Appendix A. It includes both commercial property acquisition as well as funding of commercial development on Council land.

2.2 This proposal is in line with the "Enterprise" corporate strategic aim of creating places for enterprise to thrive and business to grow.

2.3 In the period between the original July 2017 proposals and now, there have been changes to the rules and guidance around what Councils can invest in using prudential borrowing.

2.4 MHCLG (Government) guidance on Investments states that Councils need to disclose several recommended indicators in their treasury management strategies going forward. 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 District Council, based on the Council's own financial status. This advice is confidential was therefore treated as an exempt appendix to the Audit and O&S report as it is the intellectual property of a third party.

2.6 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. As a result of the advice, it is recommended that the Council does not agree borrowing above £75m – with £60m for this strategy and a further maximum of £15m for 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 was considered in the external independent advice.

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 Executive Members, the s151 officer, the Head of Paid Service and the Leader of the Council.

- 2.9 Investment in District, 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 Commercial Acquisitions

- 3.0 The recommended strategy shown in Appendix A has been devised to give the Council, through delegated powers to the Executive and the Head of Paid Service and the S151 officer, a clear set of criteria by which to appraise opportunities that arise.
- 3.1 Officers will provide Members of the Executive with a set of data, such as that which is included in Appendix B (example decision template) and an indicative cash flow for each project under investigation. These aid decision making on whether to proceed or not. In the event of three or more Executive Members expressing their opposition to the proposal, then the matter will proceed no further.
- 3.2 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.
- 3.3 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 S151 officer and Head of Paid Service. If anything has changed, the Executive Members will need to vote again in order to proceed.
- 3.4 This process of delegated authority 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.
- 3.5 The Executive Members have been made aware that they will be required to process and respond to information similar to that in Appendix B in a very quick timeframe (minimum two working days) so as to provide their decision. They may also be asked to attend meetings on similarly short notice. These meetings may be held virtually to expedite decision making.

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.
- 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 decisions on progressing & committing borrowing or funding to these projects becomes a delegated function of the Executive (assuming that the proposed expenditure complies with the Council approved total borrowing limits). This delegation is to include the granting of

associated leases in excess of 15 years (which ordinarily would need to be a Full Council decision).

- 4.2 The information provided to the Executive will be similar for development projects, except that there will be additional risk analysis presented to include the construction phase of projects.

What might success look like?

- 4.3 The adoption of this strategy will facilitate inward investment in South Hams, promoting and fostering business development. This will help achieve the "enterprise" corporate objective.
- 4.4 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 £40k-£120k per annum (equivalent of a 2% yield after borrowing, management, maintenance and capital repayment costs).
- 4.5 Over a two year horizon, it is anticipated that commercial development would have started on one or more of the Council's sites. As a guide, each development may cost between £5m-£10m.
- 4.6 Over a three – five year horizon, the first developments will have been concluded and entered the operational / income phase. As a guide, a target net yield return of 2% (after borrowing, management, maintenance and capital repayment costs) has been assumed, but there will be a variation between projects.
- 4.7 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.
- 4.8 Executive Members may opt to accept a net yield return of less than 2% if the community benefits of job creation or safeguarding, tourism, town centre regeneration, business rate growth or effective asset utilisation are deemed more important.
- 4.9 For illustrative purposes only, an example of how the borrowing requirements may add up to £75m are shown in Appendix C.

5 Options available and consideration of risk

- 5.0 The overall objectives of this strategy are set out below:
- 5.0.1 To support regeneration and the economic activity of the District
- 5.0.2 To enhance economic benefit & business rates growth
- 5.0.3 To assist with the financial sustainability of the Council as an ancillary benefit
- 5.0.4 To help the Council continue to deliver and/or improve frontline services in line with the Council's adopted strategy & objectives
- 5.1 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.

- 5.2 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 in a timely manner without a scheme of delegation in place.
- 5.3 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.
- 5.4 Members could opt to follow, amend or reject the recommendations.
- 5.5 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 7.0.
- 5.6 The strategy looks to mitigate risks by setting specific criteria for purchases and necessary due diligence must be completed before officers and Executive Members recommend any purchase.
- 5.7 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.
- 5.8 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.
- 5.9 Officers, working with their specialist advisors in the market will sift opportunities and only present to Executive Members, opportunities that closely meet the Strategy. They will then lead the Executive Members into debate over the specific benefits and risks of each opportunity before the Executive Members make a decision. In this way, risk will be transparent through the process.

6 Proposed Way Forward

- 6.1 This report was discussed at the Overview & Scrutiny Panel and Audit Committee on 6th September. Their recommendations were discussed by the Executive Members and the resulting recommendations were discussed at Executive on 13th September. These have informed this report and the revised strategy in Appendix A.
- 6.2 Full Council considered and approved the borrowing limit for this Strategy as part of the Medium Term Financial Strategy on September 27th 2018. It is envisaged in December 2018, Council will consider a revised Treasury Management Strategy which would

increase the borrowing limits of the Council, to facilitate implementation of this strategy. As part of that report, the Council will also include the new proportionality indicators to address the Government guidance issued in February 2018.

7 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 Investments. As such, as part of the due diligence, consideration of each particular investment will need to include consideration of all the legal circumstances of the particular case.</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</p>

		<p>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 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 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 4 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 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.</p>

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

Appendix B – Example of decision template to be presented to Executive Members

Appendix C – Illustrative Borrowing Requirements for SHDC

Background Papers:

- "Activities to Support Economic Growth presented to O&S Panel, September 2018
- "Activities to Support Economic Growth presented to Audit Committee, September 2018
- MTFS presented to Executive, September 2018
- "Activities to Support Economic Growth presented to Executive, July 2018
- "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>