

Report to: **Council**

Date: **5 December 2017**

Title: **Commercial Property Acquisition Strategy Update**

Portfolio Area: **Cllr Philip Sanders, Leader of the Council,  
Strategy & Commissioning**

Wards Affected: **All**

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

Date next steps can be  
taken: **Immediately following this Meeting**

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### **Recommendations:**

That Council:

1. **APPROVE & IMPLEMENT** the updated commercial property acquisition strategy as detailed in Appendix A; and
2. **BORROW** funds on fixed rate terms from the appropriate source in order to pursue this strategy. To complete tranche 1 this would require total borrowing of up to £37.45m (£35m plus acquisition costs of 7%).

#### **1.0 Executive Summary**

- 1.1 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 strategy that was adopted.
- 1.2 This report seeks to update Members on that decision and recommends updating the strategy and increasing the size of tranche 1 by £10m, plus the associated acquisition costs.
- 1.3 It is not proposed that the adopted strategy's upper spend limit of £75m is updated. Appendix A shows the recommended changes made to the adopted strategy. Appendix B shows the financial implications of this change.
- 1.4 No purchases have been completed to date. A number of opportunities have been considered by officers and the 'Invest to Earn' group. It has become apparent that in order to secure a property, increased flexibility would be beneficial – the changes proposed seek to provide this flexibility.
- 1.5 The Council is currently forecasting a £0.7m budget gap by 2020/21 as detailed in the Medium Term Financial Position which was reported to Hub Committee on 28<sup>th</sup> November. This has been reduced from the previous figure quoted of £1.1m, due to the savings and income generation initiatives which were identified at the Members' Budget Workshop held in October 2017. An income

target of £200,000 from commercial property acquisitions has been built into the 2018/19 Base Budget. This represents roughly half of the anticipated income from a full £25 million commercial property acquisition portfolio. This income target will be revised as and when commercial property opportunities are realised.

- 1.6 The objective of this strategy is unchanged: generate revenue streams to contribute to the financial sustainability of the Council, enabling it to continue to deliver, and where possible improve, frontline services.
- 1.7 Regeneration efforts within the Borough can be funded from revenue generated by the implementation of the strategy. It will be necessary for officers to continuously review on a case by case basis areas within the Borough which can benefit from the revenue generated from the acquisition of properties.
- 1.8 Revenue generation will be achieved by the focussed acquisition of commercial property assets using predominantly prudential borrowing or any other unallocated or available Council reserve or capital receipt.
- 1.9 Income from this strategy is designed to contribute closing the Council's predicted budget shortfall from 2018/19.
- 1.10 It is important to note that the elected 'Invest to Earn' working group will consider each and every acquisition on its own merits. Building a balanced property portfolio conforming to the proposed strategy could take up to two years. If approved, the Council will implement this strategy with the aid of commissioned property experts, whose costs are included within the financial projections.
- 1.11 Portfolio performance will be closely monitored by the 'Invest to Earn' working group and the Council's Senior Leadership Team. It is also proposed that portfolio performance will be reported to the Council's Audit Committee on a quarterly basis.
- 1.12 The proposed strategy and/or implementation could be updated or ceased at any point prior to the full acquisition budget being expended, if Members determine that market conditions have deteriorated enough to make it financially unattractive. The 'Invest to Earn' working group retain the right to review the acquisition strategy at any time.

## 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.
- 2.2 This report seeks to update Members on that decision and recommends updating the strategy and increasing the size of the first tranche by £10m, plus the associated acquisition costs.
- 2.3 It is not proposed that the adopted strategy's upper spend limit of £75m is updated. Appendix A shows the recommended changes

to the adopted strategy. Appendix B shows the financial implications of this change.

### **3.0 Commercial Property Acquisition**

- 3.1 The Member 'Invest to Earn' working group have reviewed a number of potential acquisitions since the strategy was adopted in July. A purchase has not been possible thus far either due to timescales or properties falling slightly outside the criteria of the adopted strategy.
- 3.2 Many of the most recently reviewed properties have been just out of reach, with lot sizes ranging from £26m - £32m. The revised strategy would enable the Council to consider these opportunities.
- 3.3 It is the intention of this report to increase the flexibility of the strategy, allowing each acquisition to be considered on its own merit.
- 3.4 The upper limit for the overall strategy remains unchanged. This envisages the Council increasing its borrowing to £80.25m to acquire £75m in commercial property, plus a further 7% of that sum (£5.25m) to cover related acquisition costs, in order to build a commercial property portfolio within 24 months.
- 3.5 Originally, the intention was that this strategy would be split into three equal tranches, with the first tranche of spend totalling £25m plus acquisition costs. Subsequent tranches would be approved once Members were satisfied with the success of the strategy.
- 3.6 However, this report recommends that the first tranche budget amount is increased from £25m to £35m. This flexibility will enable the group to consider a wider number of properties.
- 3.7 Whilst there has been wide press coverage that local authority commercial property acquisition may lead to changes in regulations, this has yet to materialise. It is therefore the intention of the 'Invest to Earn' group to continue to seek acquisitions as a means towards closing the predicted budget gap.
- 3.8 The adopted strategy is shown in Appendix A and this shows the updates designed to increase the flexibility of the strategy. All other elements are to remain as per the current strategy (i.e. delegations / governance arrangements). Appendix B shows the financial implications of this change.
- 3.9 Following the budget workshop, held on October 10<sup>th</sup> 2017, a Member survey was undertaken to understand Member appetite for its commercial property acquisition strategy. 17 elected Members participated in the survey. Of those:
  - 3.9.1 53% said the Council should acquire £25m of commercial property portfolio to sustain the Council's revenue position
  - 3.9.2 24% said the Council should acquire £50m
  - 3.9.3 12% said the Council should acquire £75m

- 3.9.4 The remainder chose "other", but did not go on to state what.
- 3.10 These findings suggest that there is support for the strategy both in its current form and in an expanded format.

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

- 4.1. The Council will not be able to fund its forecast budget deficit through normal efficiency savings or transformation alone, nor is continuous service reduction a realistic option. Therefore, other methods of income generation must be considered as an alternative strategy.
- 4.2. This property acquisition strategy identifies an alternative source of income that could deliver a major share of the required savings. It must be understood that this strategy's principal purpose is not to drive regeneration in West Devon, rather it is income focussed, identifying properties from anywhere in the country that deliver the returns which can be used to help take forward regeneration and contribute to the delivery of other Council priorities.
- 4.3. It must be noted that alternative efficiencies and sources of income still need to be identified to close the Council's budget gap. If pursued, this recommendation presents the Council with significant achievable revenue streams in-year, whereas other opportunities will take longer to realise and are not solely capable of achieving the required quantum.
- 4.4. Property acquisition is a dynamic area which generally does not sit well with traditional officer, committee and Council meeting schedules and structures. Decisions often need to be made quickly otherwise opportunities can be missed. Research shows that where Councils undertake this activity, there is an increasing level of delegation, enabling them to move quickly when properties come to the market.
- 4.5. This report recommends that decisions are delegated to the Head of Paid Service, in line with the strategy detailed in Appendix A.
- 4.6. The current strategy has reduced the flexibility afforded to the 'Invest to Earn' group and this update seeks to address this.
- 4.7. Members could opt to follow, amend or reject the recommendations.
- 4.8. 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.
- 4.9. The Council cannot remove all risk from this strategy, but the strategy is built in such a way to mitigate the risk as much as possible.
- 4.10. The strategy and business plan allow for the costs needed to acquire and manage the portfolio, e.g. acquisition, disposal, maintenance and management.

- 4.11. A revised Treasury Management Strategy is on this agenda for approval if this report's recommendations are approved.

### Proposed Way Forward

- 5.1 It is proposed that if the Council approve this report's recommendations, the new strategy will be adopted immediately. Property specialists have already been commissioned to work on behalf of the Council in relation to the adopted strategy. As and when suitable properties have been sourced, the 'Invest to Earn' group will convene to appraise the available options and recommend action to the delegated parties (as described in Appendix A).

### 6.0 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 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>Given the limited nature of the proposals, the current levels do not suggest that the Council is engaged in commercial work, though this matter will be reviewed as the implementation of this strategy develops before any increase to the approved borrowing level and trading of acquired assets takes place. Concluding that the strategy is commercial work would necessitate conducting business through a separate company.</p>
Financial	Y	<p>The Council will purchase assets directly on balance sheet and therefore the direct costs of purchase and acquisition can be capitalised. This will include costs such as stamp duty, legal fees, due diligence and agency fees.</p> <p>When individual purchase decisions are made, a bespoke business case will be produced alongside a package of due diligence information to</p>

		<p>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 Acquisition Strategy and has proper regard to the following:</p> <ul style="list-style-type: none"> <li>• The relevant capital and revenue costs and income resulting from the properties over the whole life of the asset(s).</li> <li>• The extent to which the property is expected to deliver a secure ongoing income stream.</li> <li>• The level of expected return on the amount spent.</li> <li>• The payback period of the capital expended.</li> </ul> <p>Part of the business case for each commercial property acquisition 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 not exceed its affordable borrowing limit to implement this 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. If this report's recommendations are approved, a revised Treasury Management Strategy will be presented to Council before this strategy is implemented.</p> <p>If successful, the proposed Commercial Property Acquisition Strategy has the potential to make a significant contribution to the current predicted cumulative budget gap for the Council. A £35m commercial property portfolio could deliver a net surplus of £520,000 per annum, as set out in Appendix B of this report.</p> <p>A revised Treasury Management strategy will be required to progress the recommendations of this report – this is also being considered on this Council agenda.</p> <p>Investment interest income is reported quarterly to SLT and Hub.</p>
Risk	Y	<p>The security risk is that the capital value of an acquired 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 properties.</p> <p>The yield risk is that the income derived from the acquired 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 at c.£20m. 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 - Commercial Property Acquisition Strategy & Criteria  
(showing updates to the previously adopted strategy)

Appendix B - Indicative Financial Projections & Borrowing Costs

#### **Background Papers:**

- 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
- Investment in Commercial Property, presented to Hub Committee March 28<sup>th</sup> 2017
- MTFP, presented to Hub Committee October 31<sup>st</sup> 2017
- Treasury Management Strategy, presented to Council July 25<sup>th</sup> 2017