Overview and Scrutiny Report

Ward(s) affected: All

Report of Director of Strategy

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Property Investment Strategy

Executive Summary

At the end of 2019 the Council's budget projections showed that there was a budget shortfall of £10.4m over the next three years (2020-21 to 2022-23). The capital outturn report 2018-19 reported that for the financial year the Council's total investments of £97.32m achieved a return of 1.42%. The Council's direct property investments of £161m, however, achieved a return (net of finance costs) of 6.3%.

At its meeting on 5 February 2020 the Council approved £40million for a new Property Acquisition Fund. The objective of creating the Fund was to help bridge the funding shortfall with the financial aim of investing in property in order to increase the rental income stream for the Council and to stimulate and encourage business growth and sustainable development by investing in key strategic sites.

The Property Investment Strategy ('the Strategy') shown in Appendix 1 provides a robust and viable framework for the acquisition of commercial properties. The strategy sets out the Council's objectives, investment criteria and the process which will be followed when acquiring, disposing and managing property assets for investment purposes.

Recommendation to Overview and Scrutiny Committee

That the Committee considers and comments on the proposed Property Investment Strategy.

Recommendation to Executive [on 22 September 2020]

That the Executive approves:

1. the Property Investment Strategy attached to this report;
2. the transfer of £20,000,000 from the provisional budget to the approved budget; and
3. the delegation of authority for property acquisitions to the Head of Asset Management in consultation with the Director of Strategic Services, the Chief Financial Officer, and the Lead Member for Resources within the set parameters of the strategy.

Reasons for Recommendation to Executive:
To provide a framework and governance that allows acquisition decisions to be delegated to officers within the set parameters of the strategy enabling the timely and decisive decision making that is essential in this type of market to respond to opportunities as they arise.

Is the report (or part of it) exempt from publication?
Yes, Appendix 3 of the Property Investment Strategy [appendix 3 to this report].

(a) The content is to be treated as exempt from the Access to Information publication rules because it is commercially sensitive and is therefore exempt by virtue of paragraph 3 of Part 1 of Schedule 12A to the Local Government Act 1972 as follows: "Information relating to the financial or business affairs of any particular person (including the authority holding that information)."
(b) The content is restricted to all councillors.
(c) The exempt information is not expected to be made public because it will continue to be commercially sensitive.
(d) The decision to maintain the exemption may be challenged by any person at the point at which the Committee is invited to pass a resolution to exclude the public from the meeting to consider the exempt information.

1. Purpose of Report

1.1 The purpose of this report is to ask the Committee to consider and comment on the proposed Property Investment Strategy. The strategy provides the framework and governance for all future investment acquisitions.

2. Strategic Priorities

2.1 Developing a property investment strategy will contribute to the Council's Capital and Investment Strategy 2020/21 – 2024/25 and as such, help the Council achieve financial excellence and value for money. It will enable the Council to make the best use of its resources and it therefore underpins the Council's strategic framework and the delivery of the corporate plan. It was also identified as part of the Future Guildford service challenge.

2.2 The strategy allows for the continual evaluation of the investment portfolio to meet the Council's priorities and to ensure that our property asset portfolio is fit for purpose.

3. Background

3.1 At the end of 2019 the Council's budget projections showed that there was a budget shortfall of £10.4m over the next three years (2020-21 to 2022-23). The capital outturn report 2018-19 reported that for the financial year the Council's total investments of £97.32m achieved a return of 1.42%. The Council's direct property investments of £161m, however, achieved a return (net of finance costs) of 6.3%.

3.2 At its meeting on 5 February 2020 the Council approved £40million for a new Property Acquisition Fund. The objective of creating the Fund was to help bridge the funding shortfall with the financial aim of investing in property in order to increase the rental income stream for the Council and to stimulate and encourage business growth and sustainable development by investing in key strategic sites. A larger and more balanced portfolio will help achieve the Council's aim of increasing income to support the delivery of services throughout the borough.

3.3 Officers often become aware of key potential acquisitions but, with no approved budget or agreed strategy for acquisitions, cannot act quickly enough to compete with institutional investors to secure opportunities. Having a property investment strategy and budget already approved will enable the timely and decisive decision making that is essential in this type of market to respond to opportunities as they arise.

3.4 The strategy provides a robust and viable framework for the acquisition of commercial properties located within the borough (or, exceptionally, the wider LEP regions).

3.5 The strategy also provides for continual evaluation of the property investment portfolio to meet the Council's priorities and ensure it is fit for purpose.

4. Consultations

4.1 The Investment Property Fund Management Group and the Property Review Group (which includes the Leader of the Council and the Lead Member for Resources as well as the Director of Resources) have been consulted on this report and its appendices.

5. Key Risks

Investment Risk

5.1 Investment properties have a very different balance of security, liquidity and yield from most financial investments – the potential volatility of income will be particularly important when balancing the revenue budget on an annual basis. Property acquisitions should, therefore, be subject to enhanced decision making and scrutiny as a result of the additional risk being taken on and the potential impact on the sustainability of the authority.

5.2 The strategy provides a robust and viable framework for the selection of investment properties that will help to mitigate the risks involved.

Risk of project

5.3 Lack of properties available - Demand for good quality, income producing assets is very high. Officers will try to overcome this by maintaining strong relationships with external agents, building credibility as a good performing purchaser and paying introductionary fees on successful acquisitions. Officer have considered the use of a retained investment consultant, but this would prevent the Council from hearing about deals from introductionary agents unless it is willing to pay a double fee.

5.4 Inability to act quickly enough - Many acquisitions are completed on very tight timescales. By having approvals and resources already in place, officers hope that the Council will be able to compete with institutional investors to take advantage of opportunities.

5.5 Lack of resource to asset manage portfolio – Additional resource will be required to deliver the Property Investment Strategy if the Council is to take advantage of opportunities. Subsequently, increasing the Council's investment portfolio will also have an impact on workloads within the Asset Management service. All assets need to be managed and maintained correctly in order to protect the Council's investment.

6. Legal Implications

6.1 Guildford Borough Council has a long history of land ownership. Acquisitions have been made for a wide range of reasons including projects relating to urban regeneration, planning enforcement, economic development and to generate rental income that helps support the wider financial position of the Council.

6.2 In 2012, the Council implemented and organised a programme of investing, which included acquiring properties or re-purchasing long leases on properties where the Council held the freehold title.

6.3 In the last five years other local authorities have also entered the market and there has been an increasing trend to purchase property solely to make an investment return. Often these acquisitions have been supported by borrowing cheaply from the Public Works Loan Board (PWLB).

6.4 The Ministry of Housing, Communities and Local Government's (MHCLG) Statutory Guidance on Local Government Investments and CIPFA's Prudential and Treasury Management codes have all been updated recently to address the implications of investment in property. In addition, CIPFA has issued guidance on *Prudential Property Investment*. The scope of the guidance extends to all acquisitions of land and/or buildings where rental income and/or capital appreciation are a substantial consideration in the decision whether to enter into the transaction.

6.5 The guidance provides a helpful framework in which to consider the legal implications, and the matters relevant to an authority prior to a decision on acquiring commercial property. There are three basic questions that need to be addressed:

- Can we acquire? The identification of the legal powers that support the proposed transactions
- Should we acquire? Demonstration that the exercise of these powers would be reasonable
- Will we acquire? Confirmation that the authority wishes to take the proposed course of action

Can we acquire a property for commercial or investment purposes?

6.6 Any action taken by a local authority must be in accordance with an express legal power. Those legal powers may have express restrictions, limiting the circumstances in which they can be applied. Specific legal powers all have restrictions on the circumstances in which they can be applied.

6.7 The power to invest exists in section 12 of the Local Government Act 2003, which provides that a local authority may invest *for any purpose relevant to its functions, or for the purposes of the prudent management of its financial affairs.* Relevant (and recently revised) CIPFA guidance advises against borrowing in advance of need: this is widely interpreted as guiding against the utilisation of Public Works Loan Board funding for the purpose of property investment.

6.8 Other relevant powers include section 120 of the Local Government Act 1972, which allows the Council to acquire land for any of its functions or for the benefit, improvement or development of its area.

6.9 The general power of competence, under section 1 of the Localism Act 2011 gives local authorities power to do anything that individuals generally may do, subject to certain constraints. anything done for a commercial purpose must be done through a company (Section 4). Clearly, in the instance of property investment, the company would need to hold the property interest, and the Council would be required to consider the source of its funding: the restrictions on borrowing in advance of need would continue to apply whether funds were raise to use by the Council directly, or by a company owned by it, on a loan facility provided by the Council.

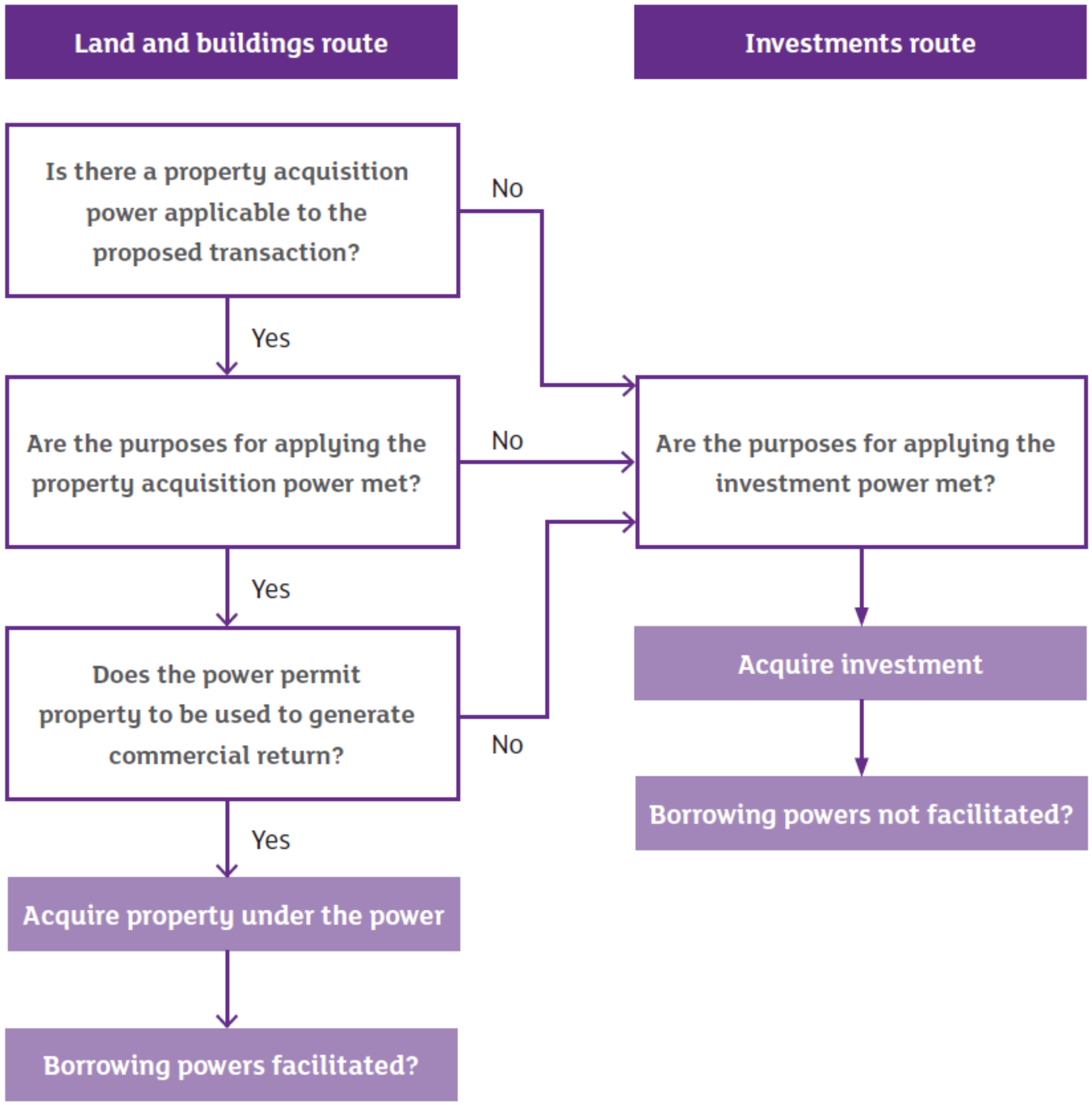

Figure 1: CIPFA Prudential Investment 2019

Should we acquire a property for commercial or investment purposes?

6.10 As with all decisions, the Council must not act ultra vires. I.e. in addition to the relevant legal power, it must act reasonably, on full information, and under appropriately expert advice.

This involves:

- consideration of the Wednesbury principles of reasonableness, i.e.that it had regard to relevant considerations, disregarded irrelevant ones, and was not *so unreasonable that no reasonable authority could ever have come to it*. This includes, therefore, regard to guidance (including statutory guidance), and the advice of expert officers, and consultants:
- regard to the MHCLG's Statutory Guidance on Local Government Investments, including:

- not borrowing more than or in advance of need

- transparent reporting about the implications of an acquisition for the security, liquidity and proportionality of the investment and the authority's risk exposure
- the need for appropriate capacity, skills and culture

- regard to the CIPFA Prudential Code, which requires any acquisition to be:
- affordable – taking into account the extent to which expenses will be covered by income, including any need to make provision for capital expenditure consistently with the MHCLG's Statutory Guidance on Minimum Revenue Provision[1]
- prudent – maximising the reliability of the elements of the affordability analysis and ensuring risk is controllable within acceptable limits
- proportional – ensuring that the authority's revenue budget is not over-reliant on income from commercial property and that property does not constitute an inappropriate proportion of the overall investment portfolio.

- acting on appropriately expert advice, and ensuring that provision is in place to properly manage the investment asset (including maintenance, and or the marketing and selection of tenants (where appropriate))

6.11 These matters are covered in the Council's Capital and Investment Strategy 2020/21 – 2024/25.

Will we acquire a property for commercial or investment purposes?

6.12 Where a proposal to acquire property as an investment is confirmed to be reasonable, an authority will determine whether the plans are consistent with its strategies and policies.

Particular attention will be paid to the following areas:

- corporate strategy – managing the expectations of interested parties in relation to the transactions being undertaken
- capital and investment strategy – ensuring that the longer-term nature of property investment and the different balance of security, liquidity and yield fit into the authority's overall strategy for making investments
- property strategy – ensuring that the property can be managed effectively and sustainably with the correct resources made available
- competence to take effective decisions – ensuring that the experience and expertise available to the authority (internal and external) is robust enough to support decisions about acquisition and continuing management of property and allow appropriate scrutiny.

6.13 The property investment strategy seeks to cover the above matters.

Procurement

6.14 The strategy allows for the Council to pursue opportunities introduced by external property agents. The Council will be expected to pay the normal introductory fee on successful completion equating to 1% or less of the agreed purchase price. In

[1] The Council must make provision for the repayment of such loans by establishing a Sinking Fund Reserve which will be credited with the statutory annual Minimum Revenue Provision ("MRP") in respect of each unfunded capital decision. Each MRP will be an annual revenue charge to the General Fund and form part of the annual funding cost used to calculate the net return on each investment.

addition, solicitors, independent external Valuers and building surveyors will be appointed to undertake valuations and conditions surveys as part of the due diligence. In order to react quickly enough to opportunities a blanket exemption to the procurement rules will be required.

Inquiry on local authority commercial investment

6.15 The National Audit Office has commissioned a report on local authorities' investments in commercial property, the outcome of which is that the Commons public accounts committee has launched an inquiry into the issues raised.

This inquiry will focus on certain questions:

- Is commercial property a safe investment?
- Have local authorities fully considered the potential risks involved in such acquisitions?
- Are local authorities receiving value for money? Are local authorities meeting their Best Value Duty?
- Do local authorities have the commercial skills and abilities to properly manage these investments in a way that yields a decent return? Local authorities are increasingly appointing consultants and agents to manage their property portfolios.
- In the light of COVID-19, will local authorities be able to meet their borrowing obligations, or will the Government need to bail them out? In addition, will the pandemic impact on the markets they have invested in?
- Concerns over out of area (or LEP region) acquisitions for purely commercial purposes.

6.16 As the COVID-19 pandemic takes hold, the effects on the economy bring into even more focus the potential pitfalls of local authority commercial property investment being investigated by the inquiry.

6.17 While we await with interest the outcome of the inquiry, a pragmatic and sensible approach to managing the recommendations from the inquiry will need to be taken as part of the nationwide battle to keep public services running at the required level.

7. Financial Implications

7.1 A £40 million Property Acquisition Fund was approved by full Council on 5 February 2020.

7.2 Allowing for costs and potential capital expenditure of refurbishments, etc, a service challenge target has been set to achieve an additional £850,000 per annum in rental income by 2023.

7.3 The Council's Capital and Investment Strategy 2018-19 to 2021-22 outlines the Council's strategy for overall investments and treasury management. The Property Investment Strategy is in line with the aspirations set out in that strategy.

8. Human Resource Implications

8.1 To deliver the Asset Investment Strategy and associated service challenge will require the provision of an additional Asset and Property Manager, there is an allowance for this already provided in Reserves.

8.2 All assets need to be managed and maintained correctly, increasing the Council's portfolio will have an additional impact on workloads within the team.

8.3 There will be also be a resource implication for the legal team. Whilst it is anticipated that the legal work will be outsourced the internal legal services will be required to instruct the external solicitors.

9. Equality and Diversity Implications

9.1 This duty has been considered in the context of this report and it has been concluded that there are no equality and diversity implications arising directly from this report.

10. Climate Change/Sustainability Implications

10.1 The Council declared a climate emergency on 23 July 2019. This strategy supports the Council's position regarding this. Consideration will be given to the ethical position and impact on climate change of any acquisition or disposal. In addition, an assessment of any strategic value contribution will be considered, i.e. if the acquisition will contribute to the Council's strategic objectives or add other strategic value (economic, social or environmental). Examples are:

- Economic propositions - (jobs, business, community, etc.)
- Social Value - (health, wellbeing, sustainability, community, etc.)
- Environmental measures - (carbon footprint/emission impact, recycle/reuse profile, air quality, etc)

11. Conclusion

11.1 This report outlines the strategy for investing in property in line with the Council's Corporate and Regulatory Framework.

11.2 The report details the criteria required for selecting properties and additional conditions to purchase.

12. Background Papers

Capital and Investment Strategy 2020-21 to 2024-25

13. Appendices

Appendix 1 – The Property Investment Strategy (excluding selection criteria)
Appendix 2 – The 2019/20 Funding Bid for the Property Investment Fund
Appendix 3 – The Property Investment Strategy's selection criteria NOT FOR PUBLICATION