**EXECUTIVE** **11 MARCH 2019**

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| **SUBJECT:** | **COMMERCIAL PROPERTY INVESTMENT STRATEGY** |
| **DIRECTORATE:** | **CHIEF EXECUTIVE AND TOWN CLERK** |
| **REPORT AUTHOR:** | **JACLYN GIBSON, CHIEF FINANCE OFFICER** |

## 1. Purpose of Report

1.1 To approve a revised Commercial Property Investment Strategy.

1.2 To approve an amendment to the delegation of Executive powers given to the Strategic Property Manager with respect to the acquisition of General Fund commercial property investment opportunities.

## 2. Executive Summary

2.1 This report presents a revised Commercial Property Investment Strategy, which has been updated to reflect recent guidance issued by MHCLG and the Council's latest financial position and desire to achieve further sustainable income through property investment.

2.2 The strategy also includes a strengthened set of assessment criteria by which all proposed commercial property assessments will be scored.

2.3 The report also sets out changes to delegated Executive powers in order to allow the Council to respond to opportunities in a fast paced market place.

## 3. Background

3.1 The Executive at its meeting on 30th August 2017 approved an Asset Rationalisation Strategy including specific criteria for proposed purchases to be assessed against along with the appropriate governance arrangements required.

3.2 Following approval of this policy the Council has undertaken three commercial property investments, totalling £28m and generating annual revenue returns of £1.5m, resulting in additional revenue income of £412k p.a. after the cost of financing.

3.3 Each of these investments have been made in Lincoln demonstrating that the Council is focussed on influencing the regeneration and economic development of the City, whilst also seeking financial returns. This is an approach that has seen the Council being shortlisted for the Entrepreneurial Council of the Year award at the LGC Awards (the winner will be announced on 13th March).

3.4 However, since approval of the original strategy in August 2017 there have been a number of developments in the local authority environment that have triggered both CIPFA and the MHCLG to issue both new guidance and warnings in relation to local authority commercial investments that require an update in the Council's strategy for commercial property investment. Furthermore the Council's financial position has necessitated an increase in the revenue savings required and as such a need to identify further commercial property investment opportunities.

3.5 Early in 2018 MHCLG issued a revised investment code including requirements around the proportionality of commercial investments to the relative size/budgets of local authorities and also attempted to limit what authorities could borrow funds in advance of need for e.g. restricting borrowing to invest purely for a wholly commercial purpose, unless it can be demonstrated that there are service delivery objectives and/or place making role of the authority. However the code also stated that where a Council chooses to disregard the code it's investment strategy should set out why this is the case and what the Council's relevant polices are. As a result some local authorities continued to purse aggressive commercial property investment strategies.

3.6 In response, in October 2018, CIPFA released a statement announcing new guidance to address the failure of the MHCLG's revised investment code to curb some instances of councils borrowing to invest in commercial property. This is set to clarify the definitions of "borrowing in advance of need" and "proportionality". Although details of what is included in the guidance has not yet been consulted upon, the institute's Head of UK Policy & Technical has said that;

- "It may well be that we actually specify and think about what exactly is 'borrowing in advance of need. We are likely to push the parameters of the code and clarify where local authorities could and should be borrowing to invest. "We have to distinguish between those authorities who are taking on debt for regeneration and serving objectives of local authorities, and those who borrow in advance purely to get a return on that investment".

- "We may set parameters of what proportionality looks like"

- We may give guidance on what the appropriate ratios are for commercial income associated with net service expenditure."

There is a real danger that the guidance could reverse freedoms introduced under the prudential code introduced in 2004. CIPFA's response to this has been "the guidance should be within the flexible framework we have all enjoyed and any steps to minimise that flexibility starts to take away from the 15 years of success of the prudential framework and operation of the prudential code. But in the current climate it seems additional guidance is certainly needed".

3.7 The MHCLG's revised investment code has already made property investment less attractive by requiring local authorities to set aside in the revenue account provision for the repayment of the amount borrowed, making the returns on investments significantly lower. It's likely that CIPFA's new guidance will place limits on the level of property investments that we can make through the use of proportionality ratios and clarity of the definition of 'borrowing in advance of need', further reducing our opportunities.

3.8 As a result of the financial pressures the Council's continues to face it has been necessary to increase the savings targets by a further £1m p.a. by 2020/21. A key strand of this will be to continue to explore opportunities to invest in both commercial properties as well as in regeneration and redevelopment schemes that support the local economy; and to optimise usage and commercial returns of the City's property and land portfolio. A specific target of revenue savings of £250,000 has been identified for commercial property investments.

## 4. Commercial Property Investment Strategy – Key Extracts

4.1 The proposed Commercial Property Investment Strategy is designed to provide a framework for the Council to compete in the market place on an equal footing enabling the acquisition of properties for investment at a pace whilst ensuring that governance processes are in place, full assessments are made and risks are minimised.

4.2 The principle reason for property investment by the Council is defined as being to secure the economic well being of the City by generating additional income for the provision of services, for the purpose of economic development or regeneration, or a combination of both. This is supported by five key objectives, as follows:

- Deliver sustainable income, to support the continued provision of Council services, by growing the Council's property portfolio in a measured and incremental way.

- Build financial resilience through the creation of a diverse portfolio in order to balance risk and return.

- Acquire land or property for the social and economic wellbeing of the City on a long term investment basis.

- Support the economic development of the City by acquiring assets that encourage local business growth, inward investment and/or new entrepreneurial business start-ups.

- Develop a governance framework that enables the Council to move at a timely pace in line with the market.

4.3 The strategy builds on the criteria for investment as agreed by the Executive in August 2017 and strengthens this criteria through the development of an assessment matrix. All investments would be subject to an initial pass or fail criteria in respect of the initial yield, which is expected to be in the range of 5-8% p.a. Subject to meeting this criteria investment opportunities would then be assessed against the following criteria;

- Tenure
- Covenant
- Occupiers Lease Length
- Building Quality/Obsolescence
- Repairing Obligations
- Location/Sector
- Sector
- Rent Review Mechanism

The assessment criteria does not assess an investment dependent on whether or not it is located within the City boundary. Acquiring property outside of the City will not be discounted but opportunities should be explored in the following location hierarchy;

1. Lincoln
2. Central Lincolnshire
3. Greater Lincolnshire
4. UK

4.4 In terms of governance process wherever possible a report will be submitted to the Executive for approval to acquire the investments. However, given the often fast pace of the property market and the 4 weekly frequency of Executive meetings the situation may arise where an offer for an investment meeting the assessment criteria is needed to be submitted ahead of the next available meeting. In such cases, and with the agreement of the Corporate Management Team, the following approval process, akin to a virtual Asset Management Group, would be undertaken:

- The Strategic Property Manager, in consultation with the City Solicitor, Chief Finance Officer, Leader of the Council, Deputy Leader of the Council and the Portfolio Holder for Economic Growth shall have authority to submit, offer and negotiate on behalf of the Council with a subsequent report to be submitted to the next available Executive meeting.

4.5 The proposed Commercial Property Investment Strategy is attached at Appendix A.

## 5. Strategic Priorities

5.1 The expansion of the Council's portfolio of investments, covering investment in property and assets with a focus on investment within Lincoln, supports the Council's priority of driving economic growth as well as supporting the Council's other priorities by seeking to generate additional income to enhance it's financial resilience and to support the provision of services.

## 6. Organisational Impacts

6.1 <u>Finance</u>

The objective of the Strategy is to invest in commercial property to secure the economic wellbeing of the City by generating additional income to enhance financial resilience and to protect service provision, for the purpose of economic development and regeneration, or a combination of both.

The Council may fund investments through using its reserves, capital receipts and prudential borrowing, where the council has the powers to do so. Any borrowing required would need to be made in accordance with the conditions of the Prudential Code, which includes the council approving any changes required to the prudential indicators. The code requires borrowing to be affordable, sustainable and provide value for money. The return on any investment would therefore need to be in excess of the capital financing costs of the borrowing, which consist of the interest payable and the statutory minimum revenue provision (MRP) that sets aside funds for the repayment of the borrowing.

The strategy requires that all investments are supported by a robust business case considering the financial appraisals, detailed valuations, physical appraisals, and risk assessments. This is to ensure that any investments made are affordable, sustainable and demonstrate value for money.

6.2 Legal Implications including Procurement Rules

The proposal to create an Investment Strategy is made possible by the "general power of competence" introduced by Section 1 of the Localism Act 2011. Local authorities now have a general power that enables them to do anything that a private individual is entitled to do, subject to certain statutory limitations. The power is designed to give local authorities considerable breadth of operation. There are, however, some specific restrictions and it would be important that each individual investment proposal is thoroughly examined before proceeding, particularly if the sole purpose is to achieve a commercial gain.

6.3 Equality, Diversity and Human Rights

The Public Sector Equality Duty means that the Council must consider all individuals when carrying out their day-to-day work, in shaping policy, delivering services and in relation to their own employees.

It requires that public bodies have due regard to the need to:

- Eliminate discrimination
- Advance equality of opportunity
- Foster good relations between different people when carrying out their activities

There are no direct equality, diversity and human rights implications arising as a result of approval of the revised strategy. Each individual acquisition would be assessed to ascertain whether there were any specific implications that the Council would need to consider dependent on the structure and details of the acquisition.

6.4 Land, Property and Accommodation – These are as specifically set out in the report

## 7. Risk Implications

7.1 It is necessary for the Council to take a prudent approach to the management of its financial affairs, it needs to ensure that it strikes the correct balance between risk and reward in a prudent manner so that the cost of funding its commercial property investments do not fall on the public purse.

7.2 It will be essential that the strategy and governance arrangements are legally sound and are deemed to be reasonable and robust by the Council's external auditors.

7.3 Investment in commercial property brings with it a range of financial risks some of which the Council may not previously have been exposed to. The strategy sets out what these key risks are. It will be important that the Council actively monitors and mitigates against these risks.

7.4 As set out in this report it is essential that all proposals for investment opportunities are based upon robust business cases that are developed by the relevant technical officers, and external advice if required, with all due diligence processes having been undertaken, ensuring compliance with the financial stewardship duty that the Council holds to its tax payers.

**8. Recommendation**

8.1 That the Executive;

1) Approve the revised Commercial Property Investment Strategy as set out in Appendix A.

2) Approve the amendment to Strategic Property Manager delegated function as set out in the Constitution in that the postholder can negotiate terms to acquire the freehold of land or premises, in consultation with the City Solicitor, Chief Finance Officer, the Leader of the Council, the Deputy Leader of the Council and the Portfolio Holder for Economic Growth.

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| **Is this a key decision?** | Yes |
| **Do the exempt information categories apply?** | No |
| **Does Rule 15 of the Scrutiny Procedure Rules (call-in and urgency) apply?** | No |
| **How many appendices does the report contain?** | One |
| **List of Background Papers**: | Asset Rationalisation Strategy - Executive 30th August 2017 |
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