
Property Investment Additional Funding – Supporting Information

1. Introduction/Background

- 1.1 On 9th May 2017 the Council considered a report which set out a formal policy for the acquisition of commercial investment properties. The Council received a report on 1st March 2018, as part of a formal planned periodic review, an amended Property Investment Strategy. The current strategy is attached in appendix C.
- 1.2 The council has now (as at 22 May 2018) achieved exchange or completion on a total of £39m of commercial property.
- 1.3 It is expected that once fully invested the council can expect to achieve the planned annual income budget of £1m from 19/20 (£500,000 for 18/19).
- 1.4 This report proposes the current £50m, approved as an addendum to the Council's Investment and Borrowing Strategy 2017/18, be extended by an additional £50m to offer a total capital budget of £100m.
- 1.5 The Council's published Medium Term Financial Strategy indicates that further savings and other income proposals will be required for the next 2 years totalling £8.3m whilst assuming a 2% increase in council tax each year.
- 1.6 Meeting these savings targets are becoming increasingly difficult year on year with ever increasing demand for our services particularly in the social care area. This additional commercial investment will assist in meeting these targets whilst managing associated risk as part of a balanced portfolio in accordance with the Property Investment Strategy.

2. Supporting Information

- 2.1 On 9th May 2017 the Council considered a report (C3283) which set out a formal policy for the acquisition of commercial investment properties that would provide a balanced investment portfolio from which the Council could derive a long term, sustainable revenue stream. Council resolved:
 - (1) To approve the Property Investment Strategy as an addendum to the Council's Investment and Borrowing Strategy 2017/2018.
 - (2) To delegate to the Head of Legal Services in consultation with and having received agreement from the Property Investment Board to purchase investment property in accordance with the above Strategy up to a maximum of £10 million per transaction.
 - (3) To delegate to the Head of Legal Services in consultation with and having received agreement from the Property Investment Board to dispose of property in accordance with the above Strategy up to a maximum of £10 million per transaction.

- (4) To delegate to the Head of Finance and Property in consultation with the Portfolio Holder for Property, authority to appoint suitable consultants in accordance with the Contract Rules of Procedure (Part 11 of the Constitution).
- 2.2 The strategy is subject to a planned periodic review. The Property Investment Strategy presented to Council on 9th May 2017 was reviewed and a report was considered at Council on 1st March 2018 (C3401), which resolved to:
 - (1) Adopt the revised Property Investment Strategy (West Berkshire Council – Property Investment Strategy (revised), January 2018);
 - (2) Delegate to the Head of Legal Services in consultation with and having received agreement from the Property Investment Board to purchase investment property in accordance with the above Strategy up to a maximum of £15m per transaction;
 - (3) Delegate to the Head of Legal Services in consultation with and having received agreement from the Property Investment Board to dispose of property in accordance with the above Strategy up to a maximum of £15m per transaction.
- 2.3 A copy of the current Property Investment Strategy is attached in Appendix C.
- 2.4 Following report to Council in May 2017, the council has been conducting acquisitions of commercial property, and we have exchanged or completed on a total of £39m of properties of the £50m capital budget (including costs and fees), which is on-line or ahead of the original estimated period of twelve to eighteen months to achieve full investment.
- 2.5 The original business case conveyed an expectation that once fully invested, the council can expect to achieve a net surplus income of £954,280 and an income budget from 19/20 of £1,000,000 has been set (£500,000 for 18/19). With good progress in acquisitions a check has been carried out, which confirms that this remains a realistic and achievable expectation.
- 2.6 The risks associated with the acquisition of commercial property are managed in the following manner:
 - (1) Through acquisition of property strictly in accordance with the Property Investment Strategy (see appendix C), which reduces risk through the acquisition of a balanced portfolio by:
 - (a) Limiting the size of any single acquisition to £15m;
 - (b) Limiting the acquisition in any single sector to 40% (35% for offices);
 - (c) Limiting the exposure to any single tenant income to £750,000 per annum;
 - (d) Limiting the total invested in any region (the Property Investment Strategy allows for investment in regions throughout England and also includes Scotland & Wales as a region);
 - (e) Acquiring properties with tenants having a Dunn & Bradstreet covenant of 5A1.

- (2) Scrutiny of each property is conducted at several stages of the acquisition process. The flowchart in appendix D indicates the stages, each of which offers opportunity to either progress, seek additional information or reject the property. This also offers an indication of the number of properties scrutinised to date through this process.
 - (3) Governance of acquisitions is through a Property Investment Board (PIB), consisting of five members (three officers and two Executive Members), which acts to scrutinise proposed acquisitions and recommend progression, subject to due diligence prior to delegated sign off by the Head of Legal Services. Decisions are based on unanimous decision by the members of PIB.
 - (4) All acquisitions are managed by the WBC Property Services team, which makes use of both in-house resource, specialist property agents (Montagu Evans), and the WBC Legal Services team for all legal due diligence.
 - (5) To minimise the period for voids, properties acquired are on the basis that there is a reasonable length of unexpired lease with the existing tenant, to offer infrequent need for negotiations to renew leases or marketing for new tenants.
 - (6) To further minimise the risk of voids, Montagu Evans are appointed to both strategically manage the invested portfolio, and conduct property management (rent collection, building condition, etc.) which create early discussion on the medium to long term goals for properties and the leases within the portfolio.
 - (7) The income expected to be derived from the invested commercial property portfolio, has been modelled on the basis of a number of costs and allowances. This includes the allocation of a risk fund at 5% (circa £140,000 pa) of the annual gross income, for periods of void properties.
- 2.7 Although, WBC is acting to mitigate risk to protect the income from commercial property, it is acknowledged that there are external risk factors which have the potential to impact this income.

Offering comment on matters related to the wider economy and predictions is notoriously difficult (even for the economists) but the following is both data and views expressed:

- (1) Economic growth and employment
 - (a) Economic growth slowed in 2017, with growth of 1.8% down from 1.9% in 2016 and the slowest annual growth since 2012. This has continued into 2018, with the economy growing by just 0.1% down from 0.4% in the previous quarter.

However in its February Inflation Report the Bank of England forecast UK GDP to expand by 1.7% in 2018, compared to a previous forecast of 1.5% in November. Growth in 2019 is expected to be 1.8% compared to a previous forecast of 1.7%.
 - (b) Economic slowdown can be attributed to a sluggish manufacturing sector and sharp fall in construction with the ONS showing a fall of 2.7% in March 2018, the biggest fall since 2012.

- (c) Continued uncertainty over Brexit, with unsettled business environment may have corresponding impact on UK real estate, albeit the fundamentals in terms of occupational markets are sufficiently robust to limit any impact.
 - (d) Average earnings including bonuses rose by 2.8% in the three months to February 2018 with real earnings growth back in positive territory for the first time in over a year (see graph in appendix E).
 - (e) Unemployment fell by 16,000 to 1.42 million in the three months to February 2018, representing the lowest unemployment rate since 1975 (source: ONS).
 - (f) The biggest growth in employment is anticipated in Professional scientific & Technology, Administrative & Support but good growth is also estimated in Construction and the Wholesale & Retail trades (see graph in appendix E).
- (2) Inflation & consumer spending
- (a) UK inflation (CPI) fell to 2.5% in March, down from 2.7% in February and the lowest rate in a year.
 - (b) Predicting interest rates seems to have the biggest failure rate on the part of economists, but current prediction of some is for the base rate to rise at least once in 2018 (likely to be in August) based on the information in early May 2018. This note was drafted soon after the date of the Monetary Policy Committee vote to retain the base rate at 0.5% which then was almost immediately countered by comment from Governor, Mark Carney hinting that in the event of a 'disorderly' Brexit, the rate may be cut!
 - (c) The increase in wages, coupled with the level of inflation offers assistance with consumer confidence, but is still confused by uncertainty on Brexit (although the deadlines between 2019 and 2021 may be sufficiently distant to minimise concerns), house prices and interest rates makes for a confused consumer.
- (3) On balance it is anticipated that consumer confidence will increase, coupled with continued low unemployment, and growth in employment in some sectors will continue to contribute to an occupational market to maintain demand for commercial property leases and investors.
- 2.8 The investment model created to support the Property Investment Strategy, enabling a net surplus income of £1m pa from 19/20 is based on loans from the Public Works Loans Board (PWLB) at 2.53%. Future increases in PWLB rates will impact the net return.
- 2.9 The proposed increase of the capital allocated for the acquisition of commercial property from £50m to £100m will increase the borrowing commitment of council.
- 2.10 The Council's new limits for external debt to include this additional £50m investment for 2018/19 and the following two financial years are shown below in comparison with the agreed level for 2017/18:

New Recommended Limits for External Debt		
	Authorised Limit £m	Operational Boundary £m
2017/18 Approved	226	216
2018/19 Proposed	283	273
2019/20 Proposed	289	279
2019/20 Proposed	293	283

- 2.11 Clearly, this further significant loan commitment of £50m and interest payable of circa £1.25m pa will need servicing from the rental receipts from the acquired properties before any expected surplus income can be returned to the Council.
- 2.12 In the event of rental streams from these acquisitions not covering these loan debt charges then alternative funding sources would have to be found along with covering any reduction in value of assets due to unforeseen factors. However, it is considered that risks associated with this further investment can be appropriately managed for a Council of this size and scale, and will be kept under regular review.

3. Options for Consideration

- 3.1 The preferred option is to increase the current capital budget of £50m by an additional £50m, offering a total budget of £100m, to be expended in accordance with the agreed Property Investment Strategy.
- 3.2 To retain the current budget of £50m, without any increase. This is expected to be fully invested by the end of the calendar year 2018.

4. Legal Implications

- 4.1 Specific powers relating to setup of the Property Investment Strategy:
- (1) Sections 1 and 12 of the Local Government Act 2003 affords the Council broad powers allowing it to invest and to borrow, in each case either for purposes relevant to the performance of any of their functions or generally for the prudent management of their financial affairs.
 - (2) Under Section 120 of the Local Government Act 1972 the Council may also acquire property by agreement located either inside or outside of their district for the purposes of any of their functions, including their investment functions, or otherwise for the benefit, improvement or development of their area.
 - (3) Under section 111 of the Local Government Act 1972 the Council may also take any action (whether or not involving the expenditure, borrowing or lending of money or the acquisition or disposal of any property or rights) which is calculated to facilitate, or is conducive or incidental to, the discharge of any of their functions, which would again include their investment functions.

- (4) Under section 1 of the Localism Act 2011, the General Power of Competence (GPC) the Council is allowed to invest in property or to hold property assets for a return and if this is essentially an activity for a commercial purpose then it cannot be undertaken directly by the Council under section 4 of the Localism Act 2011 but would need to be carried out through a company.
- (5) In exercising its powers under Section 1 and 12 of the Local Government Act 2003 the Council should have regard to DCLG Guidance on Local Government Investments (Guidance). The Guidance advocates the preparation of a prudent investment policy which the Council will be expected to follow in its decision making process unless a sensible and cogent reason is articulated for departing from it. The Guidance defines a prudent investment policy as having two objectives: achieving first of all **security** (protecting the capital sum from loss) and then **liquidity** (keeping the money readily available for expenditure when needed) followed by **yield**.

- 4.2 In relation to investment and borrowing functions (see 2.22(1) above) the Council needs to ensure that any actions in connection with the property investment are reasonable and proportionate and for proper purposes consistent with the Council's prudential regime and its investment strategy. Investment decisions also need to be taken mindful at all times the Council's fiduciary duties to ensure the sound management of public finances.
- 4.3 Legal due diligence will be required on all property acquisitions to include a review of title and ownership and searches and enquiries of the vendor in order to ascertain relevant liabilities and restrictions connected with the subject property. The results of the legal enquiries and any associated risks should be considered prior to any decision to enter into contract.
- 4.4 On any sale of an investment property the Council will be required to obtain best consideration in accordance with s123 of the Local Government Act 1972. Usually this will be achieved by placing the property onto the open market or otherwise in respect of a sale agreed off market, demonstrating by way of professional valuation that it is achieving no less than market value for the property.

5. Proposals

- 5.1 The council is progressing well with the acquisition of commercial property, in accordance with its Property investment Strategy and is reaching full investment slightly ahead of programme. Assessment of the acquired properties demonstrates we expect to achieve the income stated in the original business case and agreed income budgets for 18/19 and 19/20.
- 5.2 With the strategy in place and operating well, formal processes and governance in operation and the support of both the in-house teams (principally Property Services and Legal Services) and procured property agents (Montagu Evans), the Property Investment Board has discussed the opportunity to increase the capital budget to enable the acquisition of a larger property portfolio.
- 5.3 It is proposed that the current budget of £50m be increased by £50m to offer a total budget of £100m.

5.4 The increase by £50m offers an amount that is both manageable in the context of the volume of properties, an amount which remains suited to the structure of the Property Investment Strategy, will bring forward property types and values which PIB has knowledge and experience of dealing with.

5.5 The Council's published Medium Term Financial Strategy indicates that further savings and other income proposals will be required for the next 2 years totalling £8.3m whilst assuming a 2% increase in council tax each year. This additional commercial investment will assist in meeting these targets whilst managing associated risk as part of a balanced portfolio in accordance with the Property Investment Strategy.

5.6 A growing number of local authorities are adopting a strategy for the acquisition of commercial property. Below are some examples of LAs and their capital budgets:

(1)	Adur & Worthing	£125m
(2)	Bracknell Forest	£90m
(3)	Brentwood	£100m
(4)	Canterbury	£83m
(5)	Cherwell	£200m
(6)	East Hampshire	£200m
(7)	Eastleigh	£200m
(8)	London Borough of Bexley	£120m
(9)	London Borough of Bromley	£250m
(10)	Northumberland	£318m
(11)	Portsmouth	£110m
(12)	Shropshire	£100m
(13)	Spelthorn	£500m
(14)	Surrey County	£298m
(15)	Surrey Heath	£150m

5.7 This proposal is formed on the basis of the original business case, the strict criteria and risk management contained within the strategy and the strong progress with acquisition of the portfolio.

5.8 Additionally, based on the strategy of offering a balanced portfolio it is anticipated that in terms of managing risk across the portfolio, the proposal offers a further spread of risk across a larger portfolio.

5.9 The budget will be managed in accordance with the Property Investment Strategy in the same way it is currently managed and there is no proposed amendment to the strategy, its processes or the governance for the acquisition (and disposal) of commercial property.

5.10 This would offer a revised income proposal as follows:

18/19	Year 1	£500,000
19/20	Year 2	£1,000,000
20/21	Year 3	£1,700,000
21/22	Year 4	£2,000,000

6. Conclusion

- 6.1 Following the approval of the Property Investment Strategy in May 2017 (and its revision in March 2018), the acquisition process is advancing slightly ahead of programme with almost 80% of the capital budget invested within the first year and income expected to be on-line with agreed budgets.
- 6.2 It is proposed to take the opportunity to increase the capital budget for property investment from the current approved £50m to a total of £100m.

7. Consultation and Engagement

- 7.1 Montagu Evans – the council's appointed property agents for acquisitions, strategic management and property management.
- 7.2 Savills – economic statistical data and graphs for appendix E.

Background Papers: West Berkshire Council – Property Investment Strategy (revised)

Subject to Call-In:

Yes: ☐ No: ☒

As the item is due to be referred to council for final approval

Strategic Aims and Priorities Supported:

The proposals will help achieve the following Council Strategy aim:

☒ **MEC – Become an even more effective Council**

The proposals contained in this report will help to achieve the following Council Strategy priority:

☒ **MEC1 – Become an even more effective Council**

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