Ashfield
DISTRICT COUNCIL

Report To:	Cabinet	**Date:**	23 March 2017
Heading:	COMMERCIAL PROPERTY INVESTMENT STRATEGY		
Portfolio Holder:	CLLR CHERYL BUTLER – LEADER OF THE COUNCIL		
Ward/s:	N/A		
Key Decision:	Yes		
Subject To Call-In:	Yes		

Purpose Of Report

Cabinet to consider and approve the following approach to investing in commercial property for the purpose of generating a revenue income which will support the Council's Medium Term Financial Strategy.

Recommendation(s)

1) To approve and implement the Commercial Property Investment Strategy as set out in the report,
2) That the Council creates a ring fenced investment fund of £10 million to invest in property investments, that have been evaluated to provide the Council with a suitable rental return on the capital investment.
3) Cabinet recommends to Council to create an investment fund of £10 million in addition to the capital programme.
4) That Cabinet approves the governance arrangements which will be utilised to implement this strategy

Reasons For Recommendation(s)

The purchase of commercial property will enable the Council to invest capital to enable it to receive a revenue income from the rent received, whilst still retaining the freehold interest of the property, which it is anticipated will grow in value over time. The rental income will support the revenue budget in accordance with the Medium Term Financial Strategy and is in line with the Council's aspirations set out in the Commercial Enterprise Strategy. The additional income generated will be used to support the Councils Medium Term Financial Strategy.

Alternative Options Considered (With Reasons Why Not Adopted)

Alternative options would be to not invest in commercial property, but to consider other types of investment which may not provide the same level of return, or provide a similar level of return but at a greater level of risk.

Detailed Information

In November 2015, the Council adopted a Commercial Enterprise Strategy which set out one part of the Council's response to the challenging financial climate. Since 2010, government grant has reduced by nearly 50% and the Council has reduced its operating expenditure from £21m to £15m, whilst minimising the impact on frontline service provision. This achievement has largely been delivered through cost saving initiatives including service reviews, restructures, better procurement and sharing services. The Commercial Enterprise Strategy recognises that further innovation is required to protect frontline services and over the last year the Council has established a commercial team to drive progress.

The recent budget consultation sought views on a range of new commercial opportunities which are actively being explored. One option considered was the establishment of a commercial investment fund and 57% of respondents were supportive of the idea, and only 19% against. In view of this support and the potential returns that may be delivered, the Council is therefore seeking to establish a mechanism to pursue commercial investment opportunities.

The creation of an investment fund to invest in commercial property is an approach already successfully undertaken by other local authorities. Properties purchased around the country have ranged from offices, warehousing and hotels with the objective to benefit from the receipt of the rental income stream.

The council's commercial property team actively manage the current ADC owned commercial property. The commercial property team will lead the process to locate and evaluate potential investments, however external agents and advisers will be used where necessary to assist with this process. This will ensure the Council can fully access the property market and be comprehensively advised, on the property types, locations and the financial returns being considered.

The Commercial Enterprise Board will be kept updated of progress at their scheduled meetings.

Investing in Commercial property is not without risk, as is the case with all types of financial investment. A full risk assessment will be undertaken to minimise this, along with the evaluation process detailed below.

For the Council to consider investing in commercial property the following steps need to be taken :-

Suitable investments need to be identified. It must be recognised that in order for the Council to maximise the opportunity to locate well performing assets, the search will be on a countrywide basis and not restricted to the Ashfield area.

Each opportunity will need to be evaluated on the following basis:-

1) **Income** – This is the annual income the Council will expect to receive following the purchase of the investment. The income received is dependent on the tenant in occupation and the lease agreement in place, and will be assessed looking at the following criteria;-
    - <u>Return on the investment</u> – The financial return on an investment, the initial yield, is the rate of return expected from an investment reflecting the level of income expected to be received and the degree of risk required to receive it.
    - <u>Lease length</u> – This is the length of the contractual agreement currently in place between the landlord (investor in the property) and tenant. Longer agreements are more favourable as they provide the investor with a longer expectation and security of the income to be received.
    - <u>Rent review pattern</u> – This is the frequency and basis that the annual rental received is reviewed over time. Ideally the investor will be looking for regular predictable increases, to allow for future financial planning.
    - <u>Break Option</u> – This is the ability of the tenant to end the lease before the end of the contractual lease term. Leases without an option to break are preferred to provide more certainty to receive the income for the full lease term.
    - <u>Number of tenants in the investment property</u> – Multi let properties require more management and have a risk that part of the building may become vacant. A single tenant who is part of a large national or multinational company would be considered to be less of a risk than several tenants who have a less solid financial track record.
    - <u>Occupancy level</u> – In order to ensure an immediate income stream, it is preferable to invest in a property that is fully let. Vacant or partial vacant properties would be considered less favourable, and the likelihood of them being relet quickly, considered.
    - <u>Property management input</u> - Investment that require the minimum day to day management are considered more favourable. A property let with a single tenant using a lease that requires the tenant to be responsible for all repairs and insurance provision, requires the minimum of management cost by the investor, for the same rate of return. If the investment is located some distance from the Council then minimal management is preferable or a local managing agent will need to be appointed and the cost of this will reduce the net return.

2) **Location** - This is an important criteria to ensure the investment is purchased in an area that is expected to remain vibrant and desirable. This will increase the probability that the capital value of the investment will increase over time, should the Council choose to dispose of the asset in the future, and will remain an attractive location to the existing tenant or to a future tenant should the existing tenant vacate. As noted above, in order to allow the Council to maximise the opportunity to locate well performing assets, the search needs to also look beyond the Ashfield area.

3) **Building** - This needs to be in good condition with a fit for purpose design that is anticipated to remain fully functionally for a significant period into the future. It also needs to have good energy efficiency and performance.

4) **Tenant** – The tenant in occupation needs to be of good financial and ethical standing to ensure the lease agreement that is providing the income is as certain as possible to be provide the required income for the remaining lease term.

5) **Financial viability** – Each potential investment will be evaluated to ensure the income received is sufficient to provide an acceptable net level of return following the payment of borrowing costs, management fees and any running costs.

Methods of purchase –

Private treaty - The Council expects to purchase investment property by private treaty, either investments that are openly being marketed or off market where an opportunity may be offered to the Council without it being first formally marketed for sale.
Auction – An investment may be offer for sale at auction, which requires the Council to purchase on the day of the auction under usual auction conditions.

Governance Process for Purchases

Where time constraints allow, a collective Cabinet decision will be sought, however, it is highly likely that to ensure an opportunity is not missed, a quicker decision-making process will be required. Frequently, where the Council is negotiating a deal by Private Treaty, the seller is likely to want to proceed with the transaction swiftly for financial reasons. Where the Council is looking to purchase at an auction, clearly the contract is signed at the end of the auction and therefore, authorisations must be in place in advance. As such, the Council will seek to use existing provisions within the Scheme of Delegation and Access to Information Procedure Rules to ensure a decision can be taken expediently. In all cases, a full written report and decision record will be maintained and required notices will be published in accordance with the legal requirements.

Specifically:

- Where timeframes do not allow a collective Cabinet decision, the Leader of the Council will take a delegated Executive Decision.

- Where a potential purchase is a key decision and/or will contain exempt information but the full 28 days' notice cannot be given due to the urgency of the matter it is anticipated that a General Exception will be applied (Rule 15). This will give five clear days' notice of the decision which is about to be made. The Monitoring Officer will inform the Chairman of the Overview and Scrutiny Committee and publish the required notices.

- Where there is a greater urgency and 5 clear days' notice cannot be given, the Special Urgency provisions will be used (Rule 16). In this case, the permission of the Chairman of the Overview and Scrutiny Committee (or if they are unable to act, the Chairman of the Council or, in their absence, the Vice Chairman of the Council) will be obtained before making the decision. The Rule 16 notice will be published.

- In such cases it is expected that the decision will need to be implemented without delay and therefore it is anticipated that the decision may not be subject to call in. The report will explain the reasons in each case as to why a decision is not to be called in.

- The Leader must report to the next available Council meeting any decisions which are made pursuant to Rule 16.

Funding Provision

It is proposed to make provision for an initial investment fund of £10million, to purchase investment property based on the evaluation process detailed above. This budget will be set aside purely for commercial investments and will only be accessed by schemes which have been fully evaluated through the Council's commercial investment matrix.

Implications

Corporate Plan: To provide financial sustainability to continue to deliver services

Legal:

Section 120 Local Government Act 1972 – empowers a District Council to acquire land for the purpose of any of the Council's functions or for the benefit, improvement or development of their area by agreement inside or outside its area. No ministerial consent is required.

Section 1 Localism Act 2011 – allows Councils to do anything that an individual generally may do. This includes the power to do it anywhere in the UK or elsewhere, for a commercial purpose, and for the benefit of the authority, its area, or persons resident or present in the area.

Section 1 and 2 Local Government Act 2003 – gives the Council the power to borrow and invest money for any purpose relevant to its functions.

Finance:

This report requires Council approval. If approved, this report is effective from 27th April 2017 and has the following financial implications:

Budget Area	Implication
General Fund – Revenue Budget	Upon approval of purchase, the budget shall be amended to reflect additional borrowing costs and lease income. The net effect should represent a net reduction overall in the Council's budget. The process minimises risks as far as possible however there may be situations where revenue costs are unavoidable (e.g. aborted costs where a specific project does not come to fruition, costs associated with management of property where the property is empty). Whilst the Council would look to contain these costs in the first instance, additional budget may be requested thereafter.
General Fund – Capital Programme	A capital fund of £10m for this project will be established once approval is given. As and when properties are approved for purchase, these shall be added to the Capital Programme. Purchases shall only be for Commercial Premises and the Council will adopt Option 4 in respect to the determination of the Minimum Revenue Provision (MRP). The amendment in MRP policy is outlined in the Treasury Management Strategy (also part of this agenda). Upon sale, receipts

	will only be used to repay debt.
Housing Revenue Account – Revenue Budget	None
Housing Revenue Account – Capital Programme	None

Human Resources / Equality and Diversity:

There are no direct Human Resources implications arising from the report.

Other Implications:

NA

Reason(s) for Urgency (if applicable):

Background Papers

Report Author and Contact Officer

Matthew Kirk - Commercial Property Manager
01623 457277
m.kirk@ashfield.gov.uk

Edd de Coverly
Service Director – Place and Communities