

HAMBLETON DISTRICT COUNCIL

Report To: Cabinet
3 September 2019

Subject: **COMMERCIAL PROPERTY PORTFOLIO**

All Wards

Portfolio Holder for Economic Development and Finance: Councillor P R Wilkinson

1.0 PURPOSE AND BACKGROUND:

1.1 In January 2019 Cabinet approved in principle the creation of a Commercial Property Portfolio subject to the development and approval of an Investment Strategy. The purpose of this report is to seek approval:

- of the Investment Strategy;
- for the purchase of properties in accordance with the Investment Strategy;
- of the governance arrangements set out in the Investment Strategy, which are considered further in section 6 of this report.

1.2 The Council's Commercial Vision as set out in the Commercial Strategy is to be financially self-sufficient by 2020/21 and to not be reliant on Government grants to support the budget. This requires the Council to generate additional income of £400,000 in 2020/21, rising to £600,000 in 2021/22 and then £800,000 in 2022/23 as set out in the 10 year Financial Strategy. Acquiring commercial investment properties will help to achieve those income targets.

1.3 Lambert Smith Hampton have been procured for two stages. Stage 1 entails the development and advising on the Council's Investment Strategy. Appointment of Stage 2 is subject to the approval of Cabinet and Council which will also include approval of the Investment Strategy. Stage 2 will entail acting on behalf of the Council on acquisitions and on-going asset management as well as property managers for a 3 year period. Lambert Smith Hampton have been procured via a Crown Commercial Services framework in line with the Council's procurement rules.

2.0 PROPOSAL:

2.1 It is proposed that a Commercial Property Portfolio is established with a maximum budget of £30m. Purchaser's costs including legal and agent's fees as well as stamp duty land tax are included within this budget. Expenditure is limited to £10m for any one acquisition, so that not any one asset accounts for more than 30% of the portfolio. The limit of £10m includes all purchaser's costs and any capital that may need to be invested.

2.2 The proposal to acquire a commercial investment property portfolio has the potential to make a significant contribution to the Financial Strategy and, therefore, to the delivery of public services and projects to improve the community, economic and environmental well-being of the District. However, the proposal is not without risks. To ensure a careful and managed approach, the Council is proposing to adopt an Investment Strategy which sets out parameters within which the Council would make such purchases. The Investment Strategy is attached at Annex A.

3.0 INVESTMENT STRATEGY

3.1 The Council has employed Lambert Smith Hampton to advise on the Investment Strategy including the parameters and performance measurements that should be considered to ensure a prudent and risk managed approach. Lambert Smith conducted two workshops

with members and members' comments have been incorporated into the investment strategy.

3.2 The strategy sets out the key objectives and focusses on prudence and risk management. The acquisitions would be within the core/core plus sector which means that purchases would be more prudent and returns are not as high as with value-added and/or opportunistic investments. However, the risks associated with core/core plus are also significantly lower. The strategy sets out how every potential asset is assessed with regard to tenant covenant strength, building condition, location, tenure (freehold, long leasehold etc.) and the average unexpired lease terms of the tenancies. This ensures that only investments of good quality are put forward for further consideration.

3.3 With regard to managing the risk, the strategy sets out maximum allocations that should be spent within individual sectors. The number of assets are set at between 4-6 with a minimum of 4 and a maximum of 9 tenancies across the portfolio. The level of return to be achieved is an average gross income yield of at least 4.50% over 10 years, as detailed in the Investment Strategy. Any investment will always be reviewed on its own merits but also with a view of the overall strategy and to meeting the income targets in the Financial Strategy.

4.0 PERFORMANCE INDICATORS

4.1 Property Investment is dependent on how the overall property market is performing. The Investment Strategy therefore proposes to benchmark the Commercial Property Portfolio against the MSCI UK Annual Property Fund Index which tracks over 9,000 direct property investments. The index monitors income and capital returns but also average unexpired lease terms, vacancy rates among others.

4.2 The Investment Strategy also sets out a range of indicators from rent collection to occupier engagement in relation to the operational property management element.

5.0 COMPANY STRUCTURE

5.1 The Council has received advice from Leading Counsel on the operation of the Commercial Property Portfolio Scheme. In line with Counsel's advice the prudent approach is to operate the Scheme through a wholly owned company.

6.0 GOVERNANCE AND DELEGATION

6.1 The governance and delegation levels are set out in the Investment Strategy on pages 3 to 6 and take into account that the properties will be acquired and managed through a company. Legal advice has been taken with regard to the governance structure and delegation authorities.

7.0 LINK TO COUNCIL PRIORITIES:

7.1 This project is instrumental in meeting the Council's commercial vision of becoming self-sufficient in 2020/21 and not rely on Government grant to support the budget. Securing this commercial income will underpin the delivery of the Council's priorities across all departments.

8.0 **RISK ASSESSMENT:**

8.1 Risks in approving the recommendations

Risk	Implication	Gross Prob	Gross Imp	Gross Total	Preventative action	Net Prob	Net Imp	Net Total
Management costs increasing or higher than expected	Depending on the scale of cost increase, additional income streams may need to be identified to maintain funding of Council Services at the same level	4	4	16	Careful choice of property, tenants as well as monitoring through the governance arrangements as set out in the Investment Strategy and property investment advisor input	4	3	12
Rental income reducing due to business failures or delay in reletting units	Depending on the scale of income reduction, additional income streams may need to be identified to maintain funding of Council Services at the same level	4	4	16	Careful monitoring through the governance arrangements as set out in the Investment Strategy and property investment advisor, also advice from property investment advisor regarding market intelligence	4	3	12
There is insufficient knowledge within the Council to support this commercial investment	Opportunities are missed and risk unidentified	4	4	16	Regular monitoring reports from Property Investment advisor should minimise this risk	4	3	12

8.2 The key risk in not approving the recommendations is as shown below:-

Risk	Implication	Gross Prob	Gross Imp	Gross Total	Preventative action	Net Prob	Net Imp	Net Total
The Council struggles to find alternative income streams	Reduction of services and projects	4	5	20	Explore further savings and efficiencies	4	4	16
The Council embarks on higher risk projects to secure additional income	The income is potentially volatile and at risk	4	5	20	Fully appraise each project and consider all risks	4	4	16

Prob = Probability, Imp = Impact, Score range is Low = 1, High = 5

Overall the risk of agreeing with the recommendations outweighs the risks of not agreeing them and is considered acceptable.

9.0 **FINANCIAL IMPLICATIONS:**

9.1 The funding of £30m for the Commercial Property Portfolio will be included in the Capital Programme which will be used to support the wholly owned company set up to deliver the

Investment Strategy. The funding will be made up of external borrowing, taken at the most opportune time in accordance with the Treasury Management Strategy where both short and long term borrowing will be considered, as well as the Council's surplus funds. Authority is proposed to be delegated to the s151 Officer as to when the borrowing is required.

- 9.2 All costs of setting up a company for the Commercial Property Portfolio, the associated legal and financial advice will be funded from the Income Generating Fund.
- 9.3 The finance costs and any ongoing running costs of the company will be funded from the income generated from the Commercial Property Portfolio.
- 9.4 The net income anticipated to be received by the Council from the commercial property portfolio is £400,000 in 2020/21, £600,000 in 2021/22 and £800,000 in 2022/23 as is detailed in the Investment Strategy.

10.0 LEGAL IMPLICATIONS:

- 10.1 The Council is seeking to use S.4 of the 2011 Localism Act to set up a company for the purposes of acquiring and managing Commercial Properties. Legal advice has been sought on appropriate governance structures and these are reflected in the Investment Strategy on pages 3 to 6. If approved, legal support will also be required to set up the company structure.

11.0 EQUALITY/DIVERSITY ISSUES:

- 11.1 Equality and Diversity Issues have been considered. However there are no issues associated with this report.

12.0 RECOMMENDATIONS:

- 12.1 That Cabinet approves and recommends to Council that:
 - (a) the Investment Strategy is approved;
 - (b) authority is delegated to the Chief Executive:
 - (i) to set up a wholly owned company for the purposes of acquiring and managing investment properties;
 - (ii) to appoint legal and financial advisors in line with Council's procurement rules;
 - (iii) to appoint Lambert Smith Hampton as property advisors and property managers;
 - (iv) in consultation with the Portfolio Holder for Economic Development and Finance to make minor amendments to the Investment Strategy that may become necessary
 - (c) authority is delegated to the s151 Officer for the financing of the commercial property portfolio.

DR JUSTIN IVES
CHIEF EXECUTIVE

Background papers: None

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