

Cheshire East Council

Cabinet

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| Date of Meeting: | 6 th February 2018 |
| Report of: | Frank Jordan, Executive Director of Place |
| Subject/Title: | Building an Investment Portfolio |
| Portfolio Holder: | Cllr Ainsley Arnold, Housing, Planning and Regeneration |

1. Report Summary

- 1.1. The development of a strategy to enable the Council to invest in commercial property is included in the Council's Medium Term Financial Strategy (MTFS).
- 1.2. This report sets out the practical steps required to implement this.

2. Recommendation

- 2.1. It is recommended that Cabinet:
 - 2.1.1. Authorises the Interim Executive Director of Corporate Services to set (and amend from time to time) the investment criteria in consultation with the Executive Director of Place, the Portfolio Holder for Finance and Communications, and the Portfolio Holder for Housing, Planning and Regeneration.
 - 2.1.2. Authorises the Executive Director of Place to commission commercial agents with the required skills and expertise to actively search for investment properties.
 - 2.1.3. Authorises the Executive Director of Place to commission external commercial advisors with the required skills and expertise to prepare detailed business cases to support any future decision regarding the acquisition of investment properties that are identified.
 - 2.1.4. Authorises the Portfolio Holder for Housing, Planning and Regeneration in consultation with The Director of Legal Services, the Interim Executive Director of Corporate Services and the Executive Director of Place to take any action considered necessary or desirable to establish and/or utilise an alternative service delivery vehicle (or vehicles) to deliver the investment portfolio.

2.1.5. Authorises the Executive Director of Place in consultation with the Portfolio Holder for Housing Planning and Regeneration, the Portfolio Holder for Finance and Communications, the Director of Legal Services and the Interim Executive Director of Corporate Services to acquire the freehold or leasehold interest in commercial property identified in accordance with the investment criteria approved by virtue of paragraph 2.1.1 above and the advice received by virtue of 2.1.3 above.

2.1.6. Authorises the Executive Director of Place in consultation with the Portfolio Holder for Housing Planning and Regeneration and the Portfolio Holder for Finance and Communications to establish management arrangements for any newly acquired assets.

3. Reasons for Recommendation

- 3.1. Developing the council's property investment portfolio is a component of the Council's plan to achieve a balanced budget and has already been accounted for in the Council's budget plan.
- 3.2. This decision would broaden and diversify the Council's investments which would enable the Council to better deal with its budget challenges.
- 3.3. The approach taken is to give preference to assets within the Borough as these have the potential to create additional regenerative opportunities or otherwise assist the Council in delivering its functions.
- 3.4. This paper recommends that the Council should commission an agent to conduct an active search for assets that would enable the council to make a return on its investment. In addition, it is recommended that the Council commissions appropriate external commercial advisors to prepare detailed business cases to support any decision to acquire an investment property in the future. This approach will ensure that the Council is acting upon appropriate external professional advice.
- 3.5. This proposal focuses on investing in existing commercial property in the industrial, office, retail and leisure sectors. It does not consider investing in residential property. However, the Council is looking through other initiatives to consider investment in the residential property this sector.
- 3.6. In delegating the decision to invest in specific assets the Council will be able to act decisively and operate successfully in the property investment market. Investment decisions will be made in accordance with the investment criteria and budget from time to time without further limitation on the powers delegated. It should be noted that that the individual transactions involved are likely to exceed £1m.

4. Other Options Considered

- 4.1. During the development of this proposal, a number of alternative options have been considered and discounted. The principal point considered when assessing these alternatives was the Council's desire to develop an additional income stream as part of its prudent investment strategy spreading and diversifying the risk to the Council. However, investment activity within the Borough is considered likely to realise other objectives such as regeneration or facilitating the delivery of other council functions. Investments will be fully evaluated on a case by case basis, but the opportunity to realise other such benefits would enhance the rationale for making a particular investment. Therefore there is a preference to acquire assets within the Borough but that is not to exclude investment in assets outside the Borough where there is a compelling case to do so.
- 4.2. Option 1 - Do nothing. It is entirely possible that the Council could choose not to invest in incoming producing assets. However the Council would lose the opportunity to develop an additional revenue stream.
- 4.3. Option 2- Investment in assets with income as a secondary objective. The primary scope of the agreed business case is clear - to develop an income stream generated by acquiring investment property. Should the investment opportunity also present other opportunities to achieve the Council's objectives this would be a positive consideration factored in to the evaluation of a business case. However, the primary objective is to realise a return on investments to increase the resilience of the Council's funding base. It is also clear that the Council would not want to invest in assets that were not aligned to its corporate and social values and objectives.
- 4.4. Option 3 - Development of property to be held for investment income purposes. The Council could look to maximise investment returns by focusing on the acquisition of properties with development potential, and then undertaking the development of the same. However, that entails a degree of increased risk and as such, at this stage, it is proposed to concentrate on "market ready" developed assets. Once a degree of investment maturity has been established through what is currently proposed, the Council can consider adding a development portfolio. Cabinet authority will be sought prior to expanding the strategy to embrace a development portfolio.
- 4.5. Option 4 The Council could look to different delivery models such as investment in property funds. This has been discounted at this time, preferring a straight forward approach of utilising the existing Assets Team supported, when necessary, by specialist advisors.
- 4.6. Option 5 The Council could look to other sources of revenue, such as increasing its holdings of other investments. This would reduce the opportunity to diversify the Council's investments and would also lose the opportunity created by the Council investing in borough in physical assets,

which in the long term can generate strategic opportunities for the Council and contribute to the delivery of other council functions.

5. Background

- 5.1. The Council is currently faced with financial challenges over the next three years. This proposal would reduce current and future financial pressure by increasing the revenue income stream to the Council by increasing rental income from property assets and, to a lesser extent, through capital appreciation.
- 5.2. There are two broad routes that the Council could use to increase its income in this area:
 - Route 1 - Acquire property and receive a revenue stream from the asset. This is the simplest way for the Council to start to invest in property. This is the approach that has been submitted in the Business Case and is presented in this Cabinet Paper;
 - Route 2- Acquire then enhance an asset and release value by onward sale or receiving a revenue stream from the asset. This is a more complex type of investment strategy reliant on revenue income and capital appreciation, and is more sensitive to the economic cycle. This requires a more mature investment skill set which may be an opportunity for the Council in the future. This approach does not always generate an immediate stable income and is better suited to an investor with a greater degree of investment maturity.
- 5.3. The principal focus of this paper is on the acquisition of property assets and receiving a revenue stream (rent) from such assets. This requires capital funding to purchase property investment assets on the open market. The business case, which has been agreed as part of the Council's budget setting process, proposed to set up a property investment fund to deliver an investment return for the Council.
- 5.4. The Council has engaged an experienced commercial consultant team to develop a recommended approach to investment. Through workshop activity it was very clear that the Council's requirements are primarily:
 - Security of income
 - Obtaining best value in transactions
 - Stable long term investment balancing risk and yield
 - Where possible to acquire within the borough
- 5.5. This overall approach was supported by the consultant's advice. Given that the Council's primary objective is to generate an income from investment in property assets, they confirmed that the approach set out above was appropriate and that the best opportunities would be obtained through investment in the Borough where the Council would have a better

understanding of the local property market. However to maximise potential investment returns, it may also be necessary to acquire assets outside of the Borough. In the case of every individual proposed acquisition, due diligence will be undertaken to ensure the strategy is implemented prudentially and in accordance with relevant statutory requirements.

- 5.6. The Consultants also confirmed that when undertaking property investment acquisitions it is vital to be able to act quickly and decisively.
- 5.7. Therefore the proposed structure of the decision making process delegates the specific investment decision. This would enable the council to act decisively in a competitive and fluid market whilst providing appropriate Member oversight on acquisitions.
- 5.8. It should also be noted that Central Government has recently produced updated guidance on local government investments which is proposed to take effect from 1 April 2018.
- 5.9. The approach outlined in this paper takes account of this guidance as follows.
 - It is proposed to commission an agent (or agents) and commercial advisors to work on behalf of the Council, with the relevant professional knowledge and understanding of the Council's investment requirements, that can search the market, prepare detailed business cases and then advise the Council on potential investment opportunities.
 - Following acquisition, there will be a requirement to manage the asset and comply with statutory requirements. It is proposed to do this utilising, in the short term, the existing commercial arrangements in place for the asset in question. The Council would subsequently put appropriate management arrangements in place.
 - The Council will always obtain appropriate professional advice, from external sources if need be, to identify and evaluate potential acquisitions and to support the acquisition process.
 - In order to support the decision, an investment decision matrix will be developed to ensure that any proposed investment would be aligned to the objectives of the Council and that risks can be identified and evaluated during the decision making process.
 - The funding for the proposal is contained within the Addendum to the Capital Programme and to gain access to this funding a full and robust business plan will be developed and considered by the Central Finance Group (CFG).
- 5.10. The governance arrangements for the acquisition process are set out in the recommendations. Acquisition decisions will be made on the basis of professional advice. In order to make the decision on a specific acquisition

this will be initially recommended by property professionals. Although preference would be given to assets within the Borough as this could create additional benefits to the Council investments outside the borough will also be considered.

6. Wards Affected and Local Ward Members

6.1. All Wards.

7. Implications of Recommendation

7.1. Policy Implications

7.1.1. This implementation of this proposal underpins elements of the Council's budget. Not achieving the level of investment income identified through this proposal would result in an additional challenge being placed on the Council in achieving a balanced budget.

7.2. Legal Implications

7.2.1 There are powers to borrow, invest, incur expenditure, acquire and dispose of property in the Local Government Act 1972, the Local Government Act 2003 and the Localism act 2011.

7.2.2 Where the Council proposed to acquire an asset solely for commercial purposes, that is to say that acquisition and operation of the property will not serve or assist in the discharge of any of its statutory functions, then it must operate through one of its companies (or establish another one for that purpose).

7.2.3 There are other specific duties to be mindful of, such as the rules around achieving best consideration for the disposal of property assets, and the rules on "state aid". In addition, the Council is under a duty to ensure that public funds are not exposed to unnecessary risk.

7.2.4 All of these issues must be managed appropriately on a case by case basis through appropriate due diligence in the process of identifying, acquiring and managing individual assets in accordance with the strategy proposed.

7.3. Financial Implications

7.3.1. The MTFS provides for a fund of £5m in the first instance, however this will be reviewed depending on the type of opportunities that are presented to the Council in any detailed business case that would follow. This funding is in the capital addendum and therefore to draw on this funding approval from the Central Finance Group is required. It is noted that the guide yield at this stage would be 5% net. However, this is dependent on a number of factors including investment type, location, general performance of the market and the Council's appetite for risk. As assets for investment are brought forward

these risks and the likely performance of the asset will be considered and tested based on due diligence information known at the time.

7.4. Equality Implications

7.4.1. None identified at this stage. It should be noted that any investment would be in line with the Council's corporate objectives.

7.5. Rural Community Implications

7.5.1. None identified at this stage, however investment opportunities in rural areas may present.

7.6. Human Resources Implications

7.6.1. It is expected that any property investment acquired would be managed in the longer term by commercial agents minimising the potential burden on existing resources.

7.6.2. Resources will also be required from the Council's Assets and Legal teams. Impacts on those teams will have to be carefully monitored and any adverse effects addressed to ensure that baseline deliver of statutory functions is not impacted.

7.7. Health and Wellbeing Implications

7.7.1. None identified at this stage.

7.8. Implications for Children and Young People

7.8.1. None identified at this stage.

8. Risk Management

8.1. The risks have been identified and evaluated alongside mitigation measures in the main body of the report.

9. Access to Information

No Background papers

10. Contact Information

Contact details for this report are as follows:

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