



## **Building the Councils' Investment Portfolios: An update and future direction for Strategic Investment Fund**

### **Report by the Director for the Economy**

#### **1.0 Summary**

- 1.1 The purpose of this report is to provide Members with a progress report on the use of the Strategic Property Investment Fund and the associated financial, economic and social benefits.
- 1.2 Consideration is given to the opportunities presented by further judicious investment in commercial property and the rationale for extending the borrowing ceiling by a further £15m per authority from 2017/18.

#### **2.0 Background**

- 2.1 At its meeting on 7th July 2015, the Joint Strategic Committee approved the establishment of a Strategic Property Fund, with the aim of identifying opportunities to acquire or develop commercial property to help generate a future income stream for the Councils and support delivery of services. The Fund, which has formed part of the Councils' Capital Investment Programme since 2016/17 initially comprised a £2m contribution from each Council, with a commitment to increase to £5m per authority per annum from 2017/18.
- 2.2 Since that time approval has been sought to increase contributions to £5m per Council in 2016/17 and £10m per authority per annum from 2017/18. In 2016/17, a further one-off contribution of £1.5m was approved by Worthing Borough Council to enable the purchase of a strategic site.
- 2.3 Following the decision to establish a Strategic Property Fund, a report was taken to the February 2016 meeting of the Joint Strategic Committee, where approval was given to a number of guiding principles and key criteria to inform the development of a Joint Investment Strategy and the use of the Strategic Property Fund.

- 2.4 The criteria set out reflect the aims of the Strategy, ie to generate additional revenue streams through the acquisition of additional (primarily commercial) property assets, develop a balanced property portfolio, and take a proactive approach to management of the portfolio, in order to optimise returns and manage risk.
- 2.5 One of the key criteria approved at the February meeting was the requirement for acquisitions to generate a yield of between 7.5% and 8.5%. This was based on an expectation that the costs of borrowing would be in the region of 5.5% and therefore generate an actual return to the Councils of between 2-3%.
- 2.6 Following changes to interest rates and the policy for repayment of debt, approval was subsequently given by the Joint Strategic Committee at its meeting on 13th September 2016 to revise the wording associated with the yield criterion, so as to require investments to
- “...give sufficient rental income to provide a return of investment of at least 2% over the cost of any associated borrowing”<sup>1</sup>. Furthermore, if an investment is of particular strategic merit and/or of high quality and offering a long term secure tenancy; it was agreed that a lower yield would be accepted, with the proviso that the return should always exceed the cost of borrowing by at least 1%.

### **3.0 Strategic Property Fund - Current Position**

- 3.1 Since the introduction of the Strategic Property Fund, four commercial property purchases have been completed on behalf of Worthing Borough Council, amounting to an investment of approximately £13.1m. A purchase on behalf of Adur District Council has also been completed, with a total investment cost of £11.93m.
- 3.2 It is important to note that whilst strategic investments generate income to help fund delivery of Council services, they can also act as a catalyst for regeneration, helping to bring forward key development sites and lever in additional public and private sector investment. This is reflected in the purchases to date.
- 3.3 After borrowing costs, the 2017/18 expected net initial return (after borrowing costs) from investments made to date is £543,000. This is set against a current revenue target of £420,000, indicating the potential for above target growth of 29% in the current financial year.
- 3.4 There is clearly potential to further increase the returns available to the Councils through continued judicious investment in commercial property acquisitions. Therefore, given the opportunity this provides to help deliver a balanced budget in 2018/19 and beyond, it is recommended that the Councils each contribute a further £15m to the Strategic Property Fund from 2017/18.

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<sup>1</sup> JSC 13th September 2016, Item 6, para 6.2

## 4.0 Legal

- 4.1 Part 1 of the Local Government Act 2003 sets out the framework for capital finance and expenditure and the Local Government (Capital Finance and Accounting) (England) Regulations 2003 include more detailed requirements.
- 4.2 Section 111 of the Local Government Act 1972 allows the Councils to do anything which is intended to facilitate or is conducive to or ancillary to any of its functions.
- 4.3 Section 1 Localism Act 2011 provides for the general power of competence and empowers Local Authorities to do anything which generally individuals may do, in the UK or otherwise, for a commercial purpose or otherwise and for, or otherwise than for, the benefit of the authority, its area or persons resident or present in its area.
- 4.4 Paragraph 3.14.3 of the Councils' Scheme of Officer Delegations give authority to the Head of Place and Investment to acquire land in connection with the Council's functions, in consultation with the Leader and Executive Member for Resources and the Chief Financial Officer.

## 5.0 Financial implications

- 5.1 The budget strategy approved last year recommended the investment in good quality commercial property to produce additional income for the Councils for the future. This was part of a combined strategy to ensure that the Council would meet the financial challenges ahead with a mix of:

- Investment in commercial property;
- Generation of additional income from commercial activities each year;
- Investment in a new digital strategy to generate business efficiencies;

With this in mind, the Councils released £10m capital funding per year per Council as part of 2017/20 Capital Strategy. The 2018/21 Capital Strategy elsewhere on the agenda recommends that this be increased to £25m per year.

- 5.2 The proposed budget strategy elsewhere on the agenda demonstrates the value of the continued investment in commercial property. It is expected that overall the income generated via the developing portfolio will contribute a significant percentage of the savings required over the next 5 years:

	2018/19	2019/20	2020/21	2021/22	2022/23
Overall budget shortfall	£'000	£'000	£'000	£'000	£'000
Adur	1,486	1,848	3,120	3,357	3,824
Worthing	1,485	2,301	3,957	4,463	5,303
Total cumulative savings	2,971	4,149	7,077	7,820	9,126

required

	2018/19	2019/20	2020/21	2021/22	2022/23
	£'000	£'000	£'000	£'000	£'000
Expected income from the investment in commercial property	963	1,372	1,886	2,245	2,655
Investment income as a percentage of savings targets	32.41%	33.07%	26.65%	28.71%	29.09%

5.3 Whilst the income from the commercial property investment makes a valuable contribution to the budget shortfall, the risks associated with holding property need to be managed. Consequently it is recommended that an element of income is held back from the anticipated gains to create a 'voids provision' so that any loss of income associated with temporarily empty properties can be managed. This is detailed within the budget strategy report but it is suggested that voids provision be built up over the next few year as follows:

	2019/20	2020/21	2021/22	2022/23
	£'000	£'000	£'000	£'000
Adur	100	150	200	250
Worthing	100	150	200	250

5.4 Of the budgets released to date, only a proportion remains unspent as follows:

	Adur District Council		Worthing Borough Council	
	2016/17	2017/18	2016/17	2017/18
	£	£	£	£
Grafton site purchase*			1,500,000	
Agreed as part of the capital budget	2,000,000	10,000,000	2,000,000	10,000,000
Approved amendment in year**	3,000,000		3,000,000	
Carried forward from previous year		5,000,000		3,027,918
	5,000,000	15,000,000	6,500,000	13,027,918
Purchase made in year		-11,630,000	-3,472,082	-9,639,699
Budget remaining	5,000,000	3,370,000	3,027,918	3,388,219

\* Agreed by Joint Strategic Committee on 3rd December 2015

\*\* Agreed by Joint Strategic Committee on 13th July 2016

- 5.5 Releasing additional funding in 2017/18 will provide the Councils with the opportunity to purchase additional properties as they come on the market, generating an in-year saving and ensuring that the Council deliver on the commitments for the 2018/19 budget.
- 5.6 Members are reminded that the purchases will be funded from prudential borrowing and that each £1m borrowed will cost the Council £36,170 each year based on a 2% interest rate and a 40 year asset life.

## **6.0 Recommendations**

- 6.1 It is recommended that:
- (a) the Joint Strategic Committee note the success of the Strategic Property Fund to date, and the above target income stream secured for 2017/18;
  - (b) the Joint Strategic Committee recommends to each Council to approve an additional allocation of £15m to the Strategic Property Investment Fund from 2017/18.

## **Local Government Act 1972**

### **Background Papers:**

JSC Report, Capital Strategy 2015-18, 7.7.15

JSC Report, Strategic Property Investment Fund - Investment Strategy, 2.2.16

JSC Report, 1st Capital Monitoring Report and Outline Forecast & Budget Strategy, 3.9.16

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## **Schedule of Other Matters**

### **1.0 Council Priority**

- 1.1 Contributes to Platforms for our Places, in particular Financial Economies and Services & Solutions

### **2.0 Specific Action Plans**

- 2.1 Commitment 1.4 - Use the Councils' Strategy Property Investment Fund to deliver new revenue streams and support investment Projects  
Commitment 1.6 - Investment in and delivery of Major Projects and key infrastructure  
Commitment 4.3 - Continue to develop financial strategy to ensure that the Councils are self-funding by 2020, through investment, income generation and efficiency initiatives

### **3.0 Sustainability Issues**

- 3.1 Matter considered and no issues identified

### **4.0 Equality Issues**

- 4.1 Matter considered and no issues identified

### **5.0 Community Safety Issues (Section 17)**

- 5.1 Matter considered and no issues identified

### **6.0 Human Rights Issues**

- 6.1 Matter considered and no issues identified.

### **7.0 Reputation**

- 7.1 Potential to enhance the Councils' reputation by demonstrating proactive approach to managing financial risk and minimising potential negative impact on public services.

### **8.0 Consultations**

- 8.1 Consultation has taken place with senior Members and Officers

### **9.0 Risk Assessment**

- 9.1 Each acquisition is subject to rigorous financial appraisal and due diligence processes in line with the agreed principles and criteria for the Investment Strategy.
- 9.2 To help manage and spread risk across all commercial property assets, an Asset Portfolio Manager is being appointed. This post will support the development of a

diversified portfolio and ensure a robust approach is taken to the acquisition, management and disposal of commercial assets; including the optimisation of returns and management of risk.

- 9.2 Wise investment in commercial property provides an additional revenue stream for the Councils to help mitigate the potential negative impacts arising from changes to Government funding for local authorities.

## **10.0 Health & Safety Issues**

- 10.1 Matter considered and no issues identified

## **11.0 Procurement Strategy**

- 11.1 Matter considered and no issues identified

## **12.0 Partnership Working**

- 12.1 Matter considered and no issues identified