TO: EXECUTIVE
21 NOVEMBER 2017

COMMERCIAL PROPERTY INVESTMENT STRATEGY
Borough Treasurer

1 PURPOSE OF REPORT

1.1 Commercial property acquisitions, in line with the investment strategy which was approved by Council in November 2016, have been targeted to deliver on-going additional income of £1m per year, rising to £3m by 2019/20.

1.2 This report sets out progress to date in implementing the Commercial Property Investment Strategy (CPIS) and proposes that additional capital resources of up to £30m are made available for further acquisitions, in order to secure this level of additional income.

2 RECOMMENDATION

2.1 That the Executive recommends to Council that further capital sums of up to £30m are made available to support the Commercial Property Investment Strategy achieving its target level of £3m on-going additional revenue income.

3 REASONS FOR RECOMMENDATION

3.1 A Council-wide Transformation Programme has been established to review all services over time and secure savings that will play a large part in enabling the Council to set a balanced budget for the coming years. Commercial property acquisitions have been targeted to deliver on-going additional income of £1m per year, rising to £3m by 2019/20.

4 ALTERNATIVE OPTIONS CONSIDERED

4.1 The Executive could decide that the level of investment already approved, at £60m, should represent the ceiling for commercial property acquisitions. The consequence of this would be the need for alternative savings to be identified in order to achieve a balanced medium-term financial position.

5 SUPPORTING INFORMATION

5.1 The Council was presented with an opportunity to acquire a commercial investment on the Western Industrial Estate in Bracknell in 2016, being the office park known as Waterside Park. This acquisition was agreed by the Executive as an opportunistic purchase within the Borough of a site adjacent to existing Council holdings.

5.2 The property was purchased for around £4.5M with a headline income of just under £400K per annum, a return excluding costs of around 9%. Since that time two tenants have determined that they will not renew their leases and this is being addressed by the Property team. Indeed, generally the higher the rate of return the more risk associated with the property in terms of tenant covenant, quality of building, rental growth and duration of income stream. In buying Waterside Park the Council was acutely aware of this but the Bracknell location meant that the site offered potential “swing space” to facilitate other options linked to the further regeneration of the town centre or possible location for activities currently within the Commercial Centre allowing that to be developed.

5.3 Having acquired this property the Executive and Directors were keen to establish a formal process and policy to support future acquisitions, which led to the Council adopting a Commercial property Investment Strategy in November 2016.

5.4 A Council-wide Transformation Programme has been established to review all services over time and secure savings and additional income that will play a large part in enabling the Council to set a balanced budget for the coming years. Commercial property acquisitions have been targeted to deliver on-going additional income of £1m per year, rising to £3m by 2019/20. As such, this represents the second largest programme by value to date.

5.5 Full Council agreed funding to support the acquisition programme initially of £20m per year from 2016/17 to 2018/19. Subsequently, approval was granted to make the full sum of £60m available from July 2017.

5.6 Central to the investment strategy is understanding the key elements over each potential deal and establishing minimum parameters below which investment would not be considered. The core principles is to invest in properties where the majority (preferably all) of the income is secure without break for a minimum of 10 years certain, to the best possible tenants and preferably in freehold properties in prime locations and good quality buildings.

5.7 The policy is not geographic, type or use restricted to ensure full access to investment opportunities. Mainland England and Wales opportunities are only to be considered as the property law in Scotland is different.

5.8 In order to assist the Executive Committee (Commercial property) in considering investment opportunities a matrix “tool” has been created. This illustrates the core elements considered by the committee for each opportunity, showing which parameters are acceptable for consideration and those which are not.

5.9 All investments are subject to a full external due diligence process. This includes building condition surveys including all M&E, independent RICS valuations and a legal audit as well as officer site inspection and market consideration. Any items considered less than satisfactory are reported. This has led to one accepted bid being withdrawn following this rigorous due diligence process.

5.10 Under the Council’s strategy two investments totalling £30.3m including costs have been acquired. Offers by the Council have also been accepted for two further properties, with a combined value of £28.3m. It is expected that both will complete in November 2017. Should this happen, total investments will be £58.6m, close to the overall funding available. At their initial rental values, which will increase over time to reflect pre-set increases, the four properties will produce an annual rent of £3.6m and a net return after borrowing costs of £2.1m. Further details are provided in Exempt Annexe A.

5.11 The four properties will provide an average net yield of 3.63%, rising in five years time to 4.35%. This is below the assumed level of 5% which was used to calculate the target for the Transformation Programme. While it would have been possible to achieve the initial target rate of return, this would have involved taking more risk and more active management of the properties, which is against the purpose and nature of the approved strategy. Indeed since the “low risk” strategy was agreed the

Executive Committee has considered seventeen properties. No bid was made on eight of these and fixed bids were made on nine. Of these nine, five have been successful; although the Council subsequently withdrew from one of these as the exit strategy, if the current lease was not renewed, was unsatisfactory.

5.12 It should be noted that there has been heightened public interest in the activities of local authorities buying commercial properties. There have been a number of national press articles in papers such as The Times, The Telegraph and Guardian as well as radio debates and considerable trade press coverage in the leading property journals.

5.13 The focus of the media interest has been around some of the larger investors in the market. These have been principally the following:-

- Surrey County Council acquisition of Worcester Retail Park £74m
- Woking Borough Council acquisition of Dukes Court approximately £70m
- Surrey Heath, The Mall Shopping Centre Camberley £80m
- Spelthorne Borough Council £377.5m on BP's office park in Sunbury-on-Thames

5.14 Apart from the obvious size of these transactions leading questions have been around Councils' ability to manage such assets as well as exit strategies to repay any borrowings. It is expected that steps will be taken by Government at some point in the relatively near future to restrict or place strict rules around property acquisitions by local authorities.

5.15 In this respect, it is felt that this Council's strategy already represents a carefully considered, prudent approach to acquisitions. Within the matrix tool specific consideration is given to the strength of the tenant and the tenancy. Ongoing management of the properties is generally in-house, using staff who have managed commercial properties in the Borough for many years. The exit strategies consider a blend of issues being the existing tenants remaining in occupation, the age and condition of the property at the end of the tenancy in the scenario of the tenant not renewing their lease as well as a market consideration of re-letting the property. If the property is prime location it is generally considered it will re-let in a timely way.

5.16 It is therefore possible that more restrictive regulations or changing market conditions could mean that no further acquisitions are able to be effected. However, based on experience to date, it is recommended that the Council should endeavour to procure further suitable properties in order to provide much needed additional funding to support front line services.

5.17 Assuming that the same average rate of return can be achieved through further acquisitions, it would require a total investment of £83m to achieve the target level of additional income. However, it is impossible to predict the nature and scale of investment opportunities that may arise. For this reason, it is recommended that an additional sum of up to £30m be made available for further purchases to provide a degree of flexibility and avoid the possibility of having to walk away from a good quality investment that could take the overall level slightly above £83m.

6 ADVICE RECEIVED FROM STATUTORY AND OTHER OFFICERS

<u>Borough Solicitor</u>

6.1 The Council has an express statutory power to undertake investment activity pursuant to Section 12 of the Local Government Act 2003 where such investment is for the purposes of the prudent management of its financial affairs. The financial imperative for pursuing further acquisitions has been set out elsewhere in this report.

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6.2 The financial implications are set out in the main body of the report. While the proposed additional expenditure to be funded by debt is a significant sum for Bracknell Forest, the average level of debt for unitary authorities is forecast to be £290m by 31 March 2018. Additionally, very little of this borrowing is supported by a revenue income stream, which would be the case for the proposal in this report.

Equalities Impact Assessment

6.3 There are no implications from this paper.

Strategic Risk Management Issues

6.4 Generating additional income as an alternative to reducing expenditure on front line services is a key part of the Council's financial strategy. The risks of CPIS were considered as part of the strategy's development and should be viewed in that context.

6.5 While it is impossible to remove all the risks associated with commercial investments, the matrix approach ensures that risk is minimised as far as possible by establishing key criteria that need to be fulfilled before any bid is submitted. A detailed due diligence process is also undertaken that includes the use of external specialists to assess the premises and highlight any possible areas of concern. As a result of this process the Council withdrew its accepted offer for one purchase when a number of issues were highlighted.

7 CONSULTATION

7.1 A presentation was made to the Overview and Scrutiny Commission on the Commercial Property Investment Strategy at its meeting on 21 September. Members of the Commission were supportive of the strategy, although there was some nervousness around increasing the level of investment, including in relation to officer capacity to effectively manage additional properties.

Background Papers

Exempt Annexe A – Details of acquisitions made and in progress

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