DECISION-MAKER:		CABINET COUNCIL		
SUBJECT:		PROPERTY INVESTMENT FUND		
DATE OF DECISION:		15 OCTOBER 2019 20 NOVEMBER 2019		
REPORT OF:		CABINET MEMBER FOR RESOURCES		
CONTACT DETAILS				
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STATEMENT OF CONFIDENTIALITY		
None		
BRIEF SUMMARY		
The report sets out proposals to renew the previously agreed policy for investment in commercial property via a Property Investment Fund. An allocation of up to £200m is proposed for inclusion in the capital programme. Allocations will be made provided the investment and other criteria are met and in accordance with the governance processes outlined and as previously adopted by the authority when a property investment fund was agreed in 2016 and subsequently investments of £29.7M made.		
CABINET		
RECOMMENDATIONS		
	(i)	Re-affirms the commitment to a property investment fund as a part of the strategy for addressing future budget shortfall.
	(ii)	Agrees the approach as outlined in this report and the investment criteria attached to this report.
	(iii)	Agrees to delegate to the Service Director – Strategic Finance and Commercialisation, in consultation with the Cabinet Member for Resources, the ability to amend the property investment strategy prior to making the first additional purchase into the Fund.
	(iv)	Notes the addition and spend of £200M. It is proposed to include this sum in the 2019/20 capital programme. Whilst it will be included in full, in practice it is likely there will be a need to spread such an investment beyond the current year. This will be funded by Council resources.
COUNCIL		

RECOMMENDATIONS		
	(i)	The Council renews its commitment to its commercial property investment fund by earmarking up to £200M for new acquisitions within the capital programme.
	(ii)	Approves the addition and spend of £200M. It is proposed to include this sum in the 2019/20 capital programme. Whilst it will be included in full, in practice it is likely there will be a need to spread such an investment beyond the current year. This will be funded by Council resources.
	(iii)	Approves the investment criteria, detailed in appendix 1.

REASONS FOR REPORT RECOMMENDATIONS	
1.	To allow the council to expand its property investment portfolio acquisitions to date. This in turn will make the council more financially resilient at a time of significant demand pressures faced by many front line services and when core funding from Government has been reduced significantly.
ALTERNATIVE OPTIONS CONSIDERED AND REJECTED	
2	Not to invest in commercial property for a return above cost would mean additional revenue to help with the budget shortfall the authority faces would not be available. The budget gap for 2020/21 as outlined in the Medium Term Financial Strategy report to Council in February 2019 was £9.5M. The absence of increasing the yield from additional commercial property investment would mean other savings being required which could include budget cuts.
DETAIL (Including consultation carried out)	
3.	The authority agreed a property investment fund in 2016, and subsequent to that a drawdown of £29.7M was made for investment purposes. The return from this investment is formally reported to council each year as a part of the update on the year-end financial performance. The report this year, made to the July Council meeting, highlighted that to date the authority has purchased three properties. The rate of return on these investment in 2018/19 was 5.95% gross and 2.05% net (after borrowing costs of £1.16M were incurred), which therefore represents a contribution to the revenue account of around £0.61M.
4.	The investment made by Southampton City Council in commercial property highlights that local authorities are increasingly reliant on income generating activities as a means to address their funding challenges. According to the Medium Term Financial Strategy agreed by Council in February 2019, the authority faces a budget gap of around £9.5M in 2020/21.
5.	Direct Property Investment is now commonly undertaken by local authorities, acquiring assets both within and without their boundaries. The right commercial properties can be capable of generating income to cover the costs of capital financing and provide a net positive return to the authority. This helps cover budget shortfalls, mitigating budget reductions needed to achieve a balanced budget.
6.	This paper proposes using the ability to borrow from the Public Works Loan Board (PWLB) on long term and fixed interest rates, with borrowing continuing to be available at low rates. Borrowing is subject to regulation and guidance, and a full assessment will take place before borrowing is entered into to ensure

	compliance with appropriate standards and the criteria for investment set out in this policy.
7.	By adding additional resource into commercial property, the main purpose will be to generate additional income, over and above the costs concerned, and which will be expected to provide a strong income stream over the longer term.
8.	In some cases, there may be a case to consider opportunities within or possibly close to the city boundaries which contribute to wider economic and regeneration objectives.
9	Within the strategy, the potential will be recognised for investment opportunities that arise which, whilst they may not offer the optimum financial return, provide for a number of wider aims to be achieved around investing locally in the economy to assist with regeneration and also the generation of returns from local business rates in Southampton. Local authorities benefit from a share of the growth in their local business rates as a part of the funding system for local authorities. Hence, a flexible approach will be considered but as part of an overarching aim to achieve sound and long term returns for the authority for sustainable funding streams with less reliance on Government funding.
	Criteria
10.	The criteria to be applied for new property acquisitions is provided at **Appendix 1**. The criteria on the yield to be achieved outlines that a target level of 2% over and above the financing and other costs will apply, unless there are other significant considerations for acquiring the asset being considered (other criteria are set out at the end of the appendix).
11.	As applied to previous direct property investments, due diligence will be applied to each investment decision, which will include the type of asset, location, ownership, tenure and lease terms, covenant quality, yield and growth in future yield, risks and 'fit' within an overall and balanced property portfolio.
	Property Investment Governance
12.	Transparency with governance and due diligence on property acquisitions forms an essential part of the strategy. Given the demands of the commercial property market, it is also important that officers are able to respond promptly, within the authority granted, to avoid missing any opportunity through delays.
13.	Authority was given under the Property Investment Fund report made to Cabinet in April 2016 for the Head of Capital Assets, following consultation with the Leader of the Council and the Council's Capital Board to agree the detail of the business plan for the property fund and future variations to investment criteria.
14.	In addition, delegated authority was also given to the Head of Capital Assets, again following consultation with the Leader of the Council and the Service Director – Strategic Finance and Commercialisation to approve the acquisition or sale of property or other investments in accordance with the business plan, investment criteria and delivery options. Furthermore, that delegated authority for the Head of Capital Assets extended to take decisions on real property acquisitions and disposals irrespective of value. To add to this process, the Cabinet Member for Resources will also be fully consulted regarding the business plan, investment criteria and all acquisitions and disposals.
15.	The arrangements for taking decisions on disposal and acquisition of assets as set out in the previous report on Property Investment and as summarised above

	will continue to apply to the additional investment allocation proposed by this report.
RESOURCE IMPLICATIONS	
Capital/Revenue	
16.	Under this proposal, £200M would be added to the capital programme for further investment in a commercial property portfolio.
17.	The council's 2020/21 revenue budget is expected to include a target of £2.8M for income, over and above the costs of financing the investment, as a contribution towards balancing the budget.
18.	Examples are given below on the type of investment the authority is looking for, the costs and expected return. The examples are based on a sample of properties taken from the market in September 2019. The net yield is after allowing for capital financing and other potential costs.
19.	(table below)

	Value	Rent	Gross Yield	Net Yield	Net Yield
	£M	£M	%	£M	%
Car Park	**11.40**	**0.52**	**4.54%**	**0.30**	**2.61%**
Industrial 1	**10.40**	**0.63**	**6.06%**	**0.31**	**2.97%**
Industrial 2	**22.37**	**1.24**	**5.55%**	**0.61**	**2.74%**
Total	**44.17**	**2.39**	**5.41%**	**1.22**	**2.76%**

Based on these examples, an investment of £100M would provide a net return of approx. £2.8M, assuming these properties met all criteria for being considered as appropriate investments. Approval is therefore sought to add £200M in 2019/20 to the capital programme earmarked for investment in commercial property investments. A detailed business plan will be drafted and reviewed by the Council's Capital Board, with the governance on the application of this funding as set out in the report from 2016 and highlighted again in this report.

20	Adding to the capital programme in the current year will allow the best opportunity for early investments to be made and realising the income they bring to assist the council's budget position as soon as opportunities arise and are secured.
Property/Other	
21.	Property – as above. Additionally resource will be required within the Capital and Asset Management team to undertake appropriate research into the market for investment opportunities. Furthermore, resource will be needed to undertake conveyancing work, either via the in-house legal team or possibly from external solicitors depending on the timescales required and available in-house resource at that point in time.

22.	The council may either approach the vendor directly or through a third party. If the Council receives an initial introduction from an agent and proceeds with a transaction, it would need to pay a one-off finder's fee which is typically in the region of 0.5% to1% of the purchase value.
LEGAL IMPLICATIONS	
Statutory power to undertake proposals in the report:	
23.	S.1 Localism Act 2011 permits a Council to do anything an individual may do (the General Power of Competence) subject to there being no other statutory bars or conditions on the use of the power. The Property Investment Strategy will be applied in accordance with conditions imposed on s.1 relating to commercial trading and statutory and non-statutory guidance to local authorities in relation to the acquisition and disposal of property investments. Acquisition of property is generally made under s.120 Local Government Act 1972 but a range of other powers, including s.1 as set out above, also provide additional rights to acquire properties.
Other Legal Implications:	
24.	All relevant property law requirements will be met in relation to the acquisition of land processes on a transparent and fairly negotiated commercial basis together with the requirements of the Financial Services and Markets Act 2000 and the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 and the Equalities Act 2010.
RISK MANAGEMENT IMPLICATIONS	
25.	The risks will be managed by a process of due diligence for any acquisition considered. Criteria will be applied as set out in the appendix to this report.
26.	Commercial property investment involves a degree of risk, but whilst this is an inherent part of making investments in can be managed and mitigated. Prices can fluctuate and there are risks around tenant failure. These were recognised as part of the approach with the investment properties held to date and will continue to be recognised by applying checks as part of the due diligence required ahead of each investment (including detailed property and company financial checks etc).
27.	Criteria will be applied such as looking at spreading the risk around different sectors of the market; strength and longevity of tenant covenant and location quality. Possessing a mix of properties will help diversify the property portfolio to reduce exposure to risk. It is intended to re-enter the market as a long term investor, applying a balanced portfolio to manage risks.
POLICY FRAMEWORK IMPLICATIONS	
27.	The proposal of adding to the current commercial property investment portfolio is consistent with that previously agreed by the Council.

KEY DECISION?	**Yes**
WARDS/COMMUNITIES AFFECTED:	All
SUPPORTING DOCUMENTATION	
Appendices	

1.	Investment Acquisition Criteria

Documents In Members' Rooms

1.	Property Investment Strategy

Equality Impact Assessment	
Do the implications/subject of the report require an Equality and Safety Impact Assessment (ESIA) to be carried out.	**No**
Data Protection Impact Assessment	
Do the implications/subject of the report require a Data Protection Impact Assessment (DPIA) to be carried out.	**Yes**
Other Background Documents **Other Background documents available for inspection at:**	

Title of Background Paper(s)		**Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)**
1.		
2.		