

# Commercial Investment Strategy

**Cabinet**

**Date: 7<sup>th</sup> December 2016**

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Author:	Deputy Leader and Cabinet Member for Finance and Corporate Services Interim Corporate Director, Resources
Wards:	All
Locality Affected:	All
Parishes Affected:	All

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## **1. Purpose and Reasons**

- 1.1 This report seeks Cabinet's approval to adopt a Commercial Investment Strategy that will allow the Council to innovate and invest wisely on a commercial basis, taking advantage of opportunities as they present themselves. These investments will be key to achieving a balanced budget position and securing a sustainable financial future for the Council.
- 1.2 Following further work to examine the scope for such initiatives this report sets out:
  - 1.2.1 An investment strategy to enhance income to the Council in the longer term (the Commercial Investment Strategy),
  - 1.2.2 The proposed governance framework, including establishment of a Commercial Investment Strategy Board,
  - 1.2.3 A proposal to establish a Commercial Investment Fund (CIF) to provide a mechanism for financing the strategic acquisition and development of high income producing assets.
- 1.3 These recommendations support the Council's Vision Theme 1, Growing Swindon's Economy and Identifying New Forms of Funding, which includes growing the tax base and pursuing commercial investment opportunities that generate new revenue income streams to support the continued delivery of vital services to Swindon residents.

## **2. Recommendations**

Cabinet is recommended to:

- 2.1 **Recommend to Council** that a Commercial Investment Fund (CIF) for the commercial management, disposal of and investment into key assets be established, and that a sum of £50m be allocated within the capital programme to provide pump priming funding for the CIF (including the £15m already allocated to the Housing Development Programme) and, subject to this:
- 2.2 Approve:

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Further information on the subject of this report can be obtained from Paul Smith on Direct Dial No.463976, or Email [psmith2@swindon.gov.uk](mailto:psmith2@swindon.gov.uk).

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- 2.2.1 The Commercial Investment Strategy including the proposed gateway process for assessing investment opportunities, as set out in this report.
  - 2.2.2 The governance arrangements as set out in this report and establish a Commercial Investment Strategy Board comprising the Deputy Leader and Cabinet Member for Finance and Corporate Services, Chief Executive, Corporate Directors for Resources and Economy and Transformation and Director of Law and Democratic Services, supported by appropriate internal and external advisers (including the Council's s151 Officer if that role is not assigned to the Corporate Director for Resources) who will determine detailed investment and appraisal criteria.
  - 2.2.3 An annual budget of up to £60,000 to provide further capacity within the Council's Property Assets team to support an expanded programme of commercial property acquisitions, funded from the investment income generated.
- 2.3 Authorise:
- 2.3.1 The Director of Law and Democratic Services to draw up detailed terms of reference for the Commercial Investment Strategy Board.
  - 2.3.2 The Corporate Director for Resources to (i) determine the detail of funding arrangements for the CIF, in consultation with the Deputy Leader and Cabinet member for Finance and Corporate Resources and (ii) commence a procurement exercise for the appointment of external investment and specialist advisors to the Board.
  - 2.3.3 The Corporate Director for Resources, in consultation with the Deputy Leader and Cabinet member for Finance and Corporate Services, to approve investments involving expenditure of up to £10m where these have cleared the gateway process described in the Commercial Investment Strategy.
  - 2.3.4 The Head of Property Assets, in consultation with the Section 151 Officer, to approve the investment purchases, subject to the Board completing a robust appraisal of each investment proposal against the principles and criteria set out in the Commercial Investment Strategy.
  - 2.3.5 The Director of Law and Democratic Services, in consultation with the Head of Property Assets, to complete the investment purchases and related documentation on such terms as he considers necessary to protect the Council's interests.
  - 2.3.6 The Director of Law and Democratic Services to make appropriate amendments to the Constitution.
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- 2.4 Request that the Leader of the Council reviews the terms of reference for the Leader's Asset Management Advisory Group, with advice from the Corporate Director Resources and the Director of Law and Democratic Services.

## **3. Detail**

### Commercial Investment Strategy

- 3.1 Over the next three years, the Council faces a challenging financial environment as a result of reduced Government funding and increasing demand. The ability to innovate and invest wisely on a commercial basis, taking advantage of opportunities as they present themselves, will be key to achieving a balanced budget position and securing a sustainable financial future for the Council.
- 3.2 The Council's response to its financial position and challenges is focused around 3 key themes, as set out in the 2016/17 Budget Management, 2017//18 Draft Budget and Medium Term Resourcing Plan taken to Cabinet in October 2016 (Cabinet Minute 57, 2016/17 refers).
- 3.3 This report proposes the development of a portfolio of commercial investments to be delivered through:
- 3.3.1 the adoption of a commercial investment strategy,
  - 3.3.2 the establishment of appropriate governance arrangements, including the creation of a Commercial Investment Strategy Board to oversee the implementation of the strategy, and
  - 3.3.3 the creation of a ring fenced account (the Commercial Investment Fund) that will provide an efficient mechanism for funding commercial investments.
- 3.4 These arrangements would also allow for investment in schemes that will support the Council's wider economic and regeneration objectives, provided these are consistent with the over-riding aim of the investment strategy, which is to generate income for the Council to help deliver long-term financial resilience.
- 3.5 The proposed strategic approach to investment is based upon the following key principles:
- 3.5.1 Prioritising the use of capital receipts, the Council's cash reserves and balances to support investments through a Commercial Investment Fund that will deliver savings and enhance income in the longer term.
  - 3.5.2 Investing in a diversified portfolio that provides the optimal balance between risk and return.

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3.5.3 Investing in schemes that have economic development and regeneration potential and meet the over-riding aims of the Commercial Investment Strategy.

3.5.4 Retaining assets where appropriate and if necessary undertaking effective investment in order to enhance income generation.

## Governance

3.6 There are a number of possible options around the governance of the Commercial Investment Strategy which could include:

3.6.1 Delegation to a newly established Member/Officer Commercial Investment Strategy Board.

3.6.2 Delegation to an Officer.

3.6.3 Full Cabinet as now.

3.7 Each of these options is likely to have different advantages and disadvantages, but it is essential that:

3.7.1 Decisions can be made quickly if required to enable the Council to respond in a timely manner to market opportunities.

3.7.2 Business cases are scrutinised with a degree of rigour against a clear set of investment criteria that prioritise the delivery of additional income or savings and give explicit consideration to the management of risk.

3.7.3 There is a clear separation between strategic management of the overall portfolio of investments and the development and delivery of income generating initiatives.

3.8 The governance option that best meets these criteria is the establishment of a Commercial Investment Strategy Board and accordingly Cabinet are recommended to agree to establish such a Board with the following membership:

3.8.1 Deputy Leader of the Council and Cabinet Member for Finance and Corporate Services,

3.8.2 Chief Executive,

3.8.3 The Corporate Director for Resources (the post is currently held on an interim basis until the permanent post holder is appointed),

3.8.4 Corporate Director for Economy and Regeneration, and

3.8.5 The Director of Law and Democratic Services.

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- 3.9 The Board would be supported by appropriate professional advisers including the Council's s151 officer and external property investment advisers, legal, financial and tax specialists. Officers will commence the procurement process to put in place appropriate arrangements. The cost of these advisers will be set against income delivered from investments.
  - 3.10 The remit of the Board would be to consider all proposals that contribute to the delivery of the investment strategy, operating a gateway process to ensure that proposals are supported by a robust business case and meet agreed investment criteria including a consideration of risks, delivery mechanisms and financing. The Board will also be responsible for monitoring all commercial investments against agreed performance benchmarks. This includes existing commercial investments.
  - 3.11 It is suggested that the Corporate Director Resources, in consultation with the Deputy Leader and Cabinet Member for Finance and Corporate Services, be authorised to approve investments involving expenditure of up to £10m where these have completed the gateway assessment process described below. The Board will provide advice to Cabinet on investment decisions involving expenditure in excess of £10m.
  - 3.12 Decisions about asset disposals would continue to be made by Cabinet, as at present.
  - 3.13 Currently, the Leader of the Council operates a Leader's Asset Management Advisory Group, which is a Cabinet Member advisory body as defined by Article 7.07 of the Council's constitution. With the adoption of a Commercial Investment Strategy and Board, it is recommended that the Leader seek advice from the Interim Corporate Director Resources and the Director of Law and Democratic Services on any amendments required to the terms of reference for LAMAG to ensure that any potential areas of overlap with the remit of the Board are clearly delineated.

## Assessment Process and Investment Criteria

- 3.14 The objective of the Commercial Investment Strategy is to help ensure that the Council has a sustainable financial position over the medium to long term. The Board will set detailed investment and appraisal criteria against which all opportunities that require an initial investment will be evaluated, including the acquisition or development of property, assets and commercial delivery models and vehicles. Each investment opportunity will be assessed through a two-stage gateway process.
- 3.15 **Gateway One** comprises evaluation against a number of criteria to determine whether there is a viable commercial proposition. This includes whether the investment or acquisition is within the Council's legal powers and can be undertaken with regard to test of reasonableness, fiduciary duty and value for

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money, the amount of investment required, the period over which the return will be made, the balance of risk and rate of return and whether the opportunity will fit within any limits that may be set in terms of the balance of property and other investments. Any proposals that clear the Gateway One process will proceed to the development of a much more detailed business case to be considered for approval.

- 3.16 Property investments will additionally be assessed by a **Gateway Two** process. This will identify whether the investment is appropriate to achieve the recommended balance between types of property, geographic mix and risk profile. Proposals will be assessed against specific criteria set out in a Property Investment Strategy. These criteria, which will be developed by the Board with specialist external advice for Cabinet approval, will ensure that there is a balanced portfolio with an acceptable risk profile. Additionally, a specialist adviser would review any proposed property investments with the Head of Property Assets alongside the investment strategy. If an acquisition is considered to meet the criteria, the reasons supporting a recommended acquisition would be set out to the Board.
- 3.17 Where further work is required to develop a full business case the Board may sanction any additional spending required to complete due diligence and the development of a full business case.
- 3.18 The existing commercial property acquisition process requires funding to be approved on a site-by-site basis. This can be a lengthy process and in an active, fast moving and increasingly competitive property investment market there is a significant risk that attractive investment opportunities will be missed if the Council is not able to respond quickly enough to exploit any commercial property acquisition opportunities that may arise.
- 3.19 Accordingly, it is recommended that Cabinet give delegated authority to the Head of Property Assets, in consultation with the S151 officer, to approve investment purchases upon the completion of a robust financial appraisal in accordance with the principles and criteria set out in the investment strategy. This will require appropriate amendments to the Scheme of Delegations and Designations of Proper Officers.
- 3.20 It is further recommended that an additional post be created in the specialist team within Property Assets who manage the current non-operational property portfolio to ensure the on-going active management of both the existing commercial property portfolio and its expansion at a cost of up to £60,000 per annum, funded from the investment income generated.

## Risk Management

- 3.21 The implementation of the investment strategy means the Council will be managing different financial risks. Investments will be subject to inherent



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economic and market risks and therefore it is essential that a diversified and balanced investment portfolio is maintained. This will take some time to create and will be dependent on suitable opportunities coming to market.

- 3.22 The governance process recommended is designed to mitigate these risks. All investments will be based upon a robust business case, informed by specialist external advice, and which give due and proper consideration to the balance of risk and reward and the underlying security of the investment to ensure compliance with the Council's fiduciary duty.
- 3.23 Specific mitigation measures with regard to commercial property investment additionally include:
- 3.23.1 Annual reporting plus valuation by an investment advisor to achieve the acquisition and disposal strategy to achieve a balanced portfolio at any given time
  - 3.23.2 A target rate of return which ensures that the financing costs of delivering the investment strategy are covered and that an annual surplus is delivered which is consistent with assumptions made in the Medium Term Resourcing Plan
  - 3.23.3 Each investment acquisition will be subject to detailed business case that clearly sets out the risks and associated mitigation measures.
  - 3.23.4 Property assets will be of good quality with income derived from good covenanted tenants in good or growth locations on full repairing leases or where all costs are recoverable via occupiers by way of a service charge.
  - 3.23.5 An overall investment scheme provision that there will be an agreed cap on the percentage of income that is derived from a single organisation or tenant and a cap on the single asset value as a percentage of gross asset value.
  - 3.23.6 Professional advice on asset management will be sought as part of the appointment of investment advisors given the significance of asset management to the generation of returns.

## The Commercial Investment Fund

- 3.24 The Commercial Investment Fund is a ring-fenced account designed to support implementation of the investment strategy. An important underlying principle is that funding is recycled over time to develop a sustainable long-term revenue stream. This means that after consideration has been given to the delivery of financial targets within the Medium Term Resourcing Plan, any surplus income from investments, together with receipts from asset disposals, will be recycled back into the Fund.

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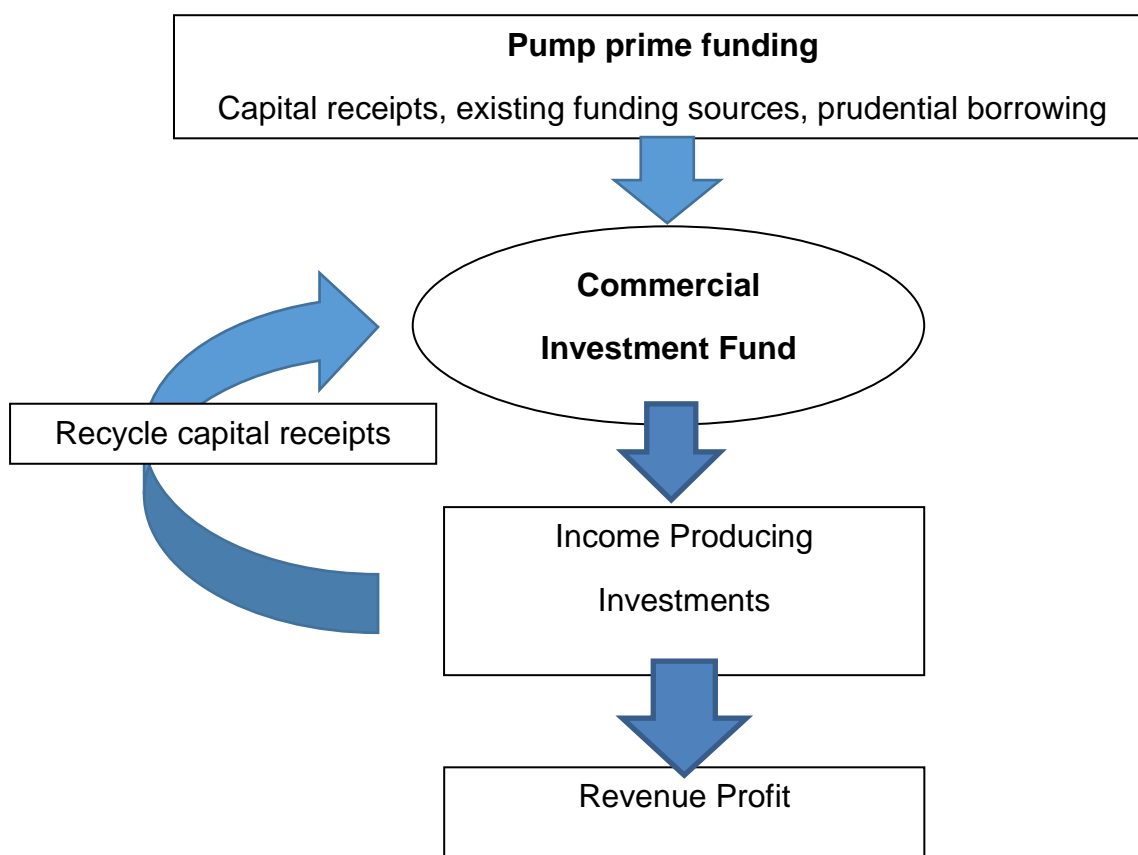
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- 3.25 The establishment of a Commercial Investment Fund will enable investment decisions to be made in the context of a commercially driven programme aligned to the Council's strategic priorities and the Medium Term Resourcing Plan. The pooling of funding and ability to recycle capital receipts and a proportion of returns, together with the use of existing reserves and cash balances to "cash flow" funding requirements in a more efficient way based on anticipated investment needs and capital receipts plans, would enable the Council to minimise long-term borrowing and the associated revenue costs (interest and Minimum Revenue Provision).
- 3.26 Examples of investments that could be financed from the CIF include:
- Additions to the Council's commercial property portfolio
  - Development of housing for sale on Council owned land
  - Development of private rented sector housing solutions
  - Redevelopment of the civic campus
  - Investment in solar projects
  - Strategic commercial investments or acquisitions
  - Strategic land acquisitions.
- 3.27 The CIF could also be used to provide funding for asset acquisition or development to companies in which the Council has an interest (for example, a newly established housing company) by way of a loan or line of credit on commercial terms.
- 3.28 The diagram on the next page shows in outline how the CIF would work.



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- 3.29 It is important to note that the ring-fenced account remains part of the overall Council capital programme and treasury management activities. Ultimately the Council is not formally bound by the ring fence itself as it is an internal mechanism.
- 3.30 It is recommended that the initial value of the CIF be set at £50m. This will be kept under review as the shape of the investment programme becomes clearer and specific opportunities are brought forward for approval.
- 3.31 The Interim Corporate Director for Resources will determine the detail of funding arrangements for the CIF, in consultation with the Deputy Leader and Cabinet Member for Finance and Corporate Resources. Initial pump priming funding for the ring-fenced account could include unallocated capital receipts, transfers from existing reserves and prudential borrowing together with an element of revenue funding. As the model develops, other funding sources can be added such as New Homes Bonus and retained business rates.
- 3.32 Any borrowing requirements would be considered with regard to the principles of the Prudential Code and as such will explicitly consider affordability, prudence

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and sustainability. Any such proposals will also need to operate within the agreed treasury management borrowing levels set each year by Council.

## Financial Implications

- 3.33 The objective of the Commercial Investment Strategy is to use the Council's resources to invest in income generating assets and commercial opportunities to partially offset the loss of government grants over the longer term and to protect service provision while minimising the burden on local Council tax payers.
- 3.34 The Council may fund investment using reserves, capital receipts, prudential borrowing and revenue contributions where the Council has powers to do so. Any borrowing required would need to be made in accordance with the Prudential Code. The Code requires borrowing to be affordable, sustainable and provide value for money. The return on any investment would therefore need to be in excess of the capital financing costs of the borrowing, which consist of the interest payable and the statutory Minimum Revenue Provision (MRP) that sets aside funds for the repayment of borrowing.
- 3.35 All investments will require a robust business case to ensure that the investment is affordable, sustainable and provides value for money. Some investments will generate a return in the medium to long term but incur losses in the early years. The Commercial Investment Fund will provide £50m that will be used to fund the initial capital financing costs in the short term until investments generate a net return. Returns made on investments will need to be sufficient to repay the Fund so that further investments can be made as well as generate a surplus to meet revenue funding requirements set out in the Council's Medium Term Resourcing Plan.
- 3.36 Assets created through these investments and the associated liabilities will be consolidated in the Council's Balance Sheet and treated in accordance with the Code of Practice for Local Authority Accounting in the UK, which is supported by International Financial Reporting Standards.
- 3.37 Investment property is that which is held solely to earn rentals or for capital appreciation or both, rather than for use in the delivery of service or as part of wider regeneration or community development schemes. The proposal to buy property purely for their rental income streams, would mean such assets expect to be classified as investment assets.
- 3.38 Where an investment property is purchased, the initial cost comprises the purchase price, and any directly attributable expenditure. This includes professional fees for retaining the services of a specialist acquisition agent who will act for the Council in identifying and negotiating the legal purchase of suitable properties, legal services, property transfer taxes (such as stamp duty) and other transaction costs. This would be the initial balance sheet valuation of the assets. As an investment asset it would require annual valuation to ensure

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that at year end the carrying value was materially accurate to its fair value. Such assets are not depreciated but are, instead, automatically reflected in the property's fair value. This re-measurement gain or loss is taken through the accounts within the financing and investment income section, but reversed back out so as not to impact on Council tax requirements.

- 3.39 As with any financial accounting standards there is the risk that regulations may change in future that might affect this reversal, which could then impact on the general fund, but officers are not aware of any impending or proposed changes to this classification of asset.
- 3.40 Any proceeds from future disposal of such assets will, like other items of property, plant and equipment, be classed as capital receipts and recycled through the CIF.
- 3.41 Whilst the Investment Strategy has the potential to generate substantial income for the Council in the future it entails significant risks. In implementing the strategy the Board will need to ensure that decisions made recognise the unique fiduciary duty owed to local residents.
- 3.42 The governance arrangements outlined, including the requirement for each investment to have a robust business case approved by the Commercial Investment Strategy Board, provide the necessary control of these risks. In approving each business case, the Board will satisfy itself that the investment is within the Council's legal powers, it has properly considered the advice of its external advisors (both internal and external) and that full due and proper consideration has been given to the balance of risk and reward and the underlying security of the investments proposed to ensure compliance with the fiduciary duty to ensure that the financial standing of the Council is protected.

## **4. Alternative Options**

- 4.1 Funding could continue to be allocated for commercial investments and property acquisitions on a case-by-case basis as it is currently. This would entail the risk of investment opportunities being missed due to the Council's inability to take speedy decisions as well as the potential for higher financing costs arising from the absence of a strategic and planned approach to the funding and assessment of commercial opportunities.

## **5. Implications, Diversity Impact Assessment and Risk Management**

### Financial and Procurement Implications

- 5.1 These are contained within the body of the report.

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## Legal and Human Rights Implications

- 5.2 All legal and human rights considerations have been taken fully into account in compiling this report. It is considered that the recommendations of this report are compatible with Convention rights.

## All Other Implications (including Staff, Sustainability, Health, Rural, Crime and Disorder)

- 5.3 There are no such direct implications.

## Diversity Impact Assessment

- 5.4 There is no impact on DIA associated with management of the Councils cash balances.

## Risk Management

- 5.5 All risks are included in the body of the report

## **6. Consultees**

- 6.1 The Interim Corporate Director, Resources (Section 151 Officer) and Director of Law and Democratic Services (Monitoring Officer) are consulted in respect of all reports.

## **7. Background Papers**

- 7.1 None.

## **8. Appendices**

- 8.1 None.

## **9. Key Decision/Decision in Cabinet Work Programme and Forward Plan**

- 1.1 This is not a key decision and is included in the Cabinet Work Programme / Forward Plan for September 2016.