Cherwell District Council

Executive

1 February 2021

CDC Property Investment Strategy

Report of Assistant Director Property Investment and Contract Management

This report is public

Purpose of report

To establish a new Property Investment Strategy for the Council in line with the current economic climate and seek Members' approval on the proposed strategy before adoption. The Property Investment Strategy forms part of the Council's overarching Capital and Investment Strategy and therefore this document is intended to supplement that 'master document'.

1.0 Recommendations

The Executive are asked:

1.1 To approve the high-level strategic approach which sets out a framework and the criteria against which any expansion or substantial capital investment in CDC's property portfolio will be assessed.

2.0 Introduction

2.1 This strategy document in line with the CDC Property Management Strategy sets out the investments the Council holds and the underlying principles supporting those investments and the decision-making process for investing in property to enhance the Council's financial resilience and safeguard services. It places the Council's investments into the context of its overall financial position, outlines the contributions that the different investments will make to service delivery and gives an indication of the performance of those investments.

2.2 This report sets out Cherwell District Council (CDC) property acquisition investment objectives for the year 2021/22. It also sets out the criteria that will be applied prior to either recommending an investment purchase or recommending substantial investment in an existing asset to the Investment Committee.

2.3 The report draws a distinction between:

- Investment Property where the principal advantage of ownership is the rental return a property generates
- Regeneration Property where the principle objective of investment is to catalyse the regeneration of an area or halt further decline and

- Operational Property where the rationale for ownership / capital investment is CDC's own occupation to facilitate the more effective delivery of council services.

2.4 The report will outline in overview the governance structures that will set the framework for decision making (although each investment is assessed on its merits) and also some high-level background on the current investment climate.

2.5 It is intended that the investment strategy is reviewed annually. For the year 2021/22 there will be a presumption against the acquisition of additional Investment Properties and likewise for Operational Properties save where without the newly acquired asset CDC will be unable to deliver core council services within a three-year timeframe. An example of this would be the acquisition of an alternative depot facility in Bicester to replace Highfield Depot. However, there is no funding allocated neither in the capital budget, nor in the revenue budget for borrowing costs in 2021/22 for such acquisition.

2.6 The embedded strategy within the plan is a Plan-Do-Review approach via annual reviews and analysis of the portfolio performance to generate revised Action Plans, Risk Management Strategies and Performance Targets.

3.0 Report Details

3.1 Overview of Investments

The Council holds a number of different income-generating investments which can be classified into three main categories:

- Investments held for treasury management purposes (e.g. investment in short-term bank deposits and call accounts, money market funds, and deposits with the UK Government and other Local Authorities)
- Loans to subsidiaries such as Graven Hill Village Development Company Ltd
- Alternative investments: tangible assets such as real estate or asset backed loans.

This document is exclusively focusing on the Council's Alternative / Real Estate investments.

3.2 Alternative Investments

All commercial property investments the Council holds and makes are categorised as Alternative Investments.

The Council has a portfolio of investment properties. These are properties which are held principally for the rental income they generate. They are not intended to be used to deliver services although at times they are occupied by Council Departments, such as Environmental Services at Thorpe Place, an investment property located close to

CDC's Banbury Depot or the Customer Services' Link Point in Franklins House in Bicester. The income they generate helps fund the Council's service delivery objectives and its Corporate Priorities. The properties in the portfolio can be split into two groups, those that have been

- owned by the Council for many years e.g. district centres; or
- purchased more recently by the Council as part of its continued investment programme and with regeneration objectives e.g. Tramway Industrial Estate, Castle Quay Shopping Centre and Castle Quay Waterside

3.3 Contribution to Service Delivery Objectives

All investments the Council holds should contribute in some way to the Council's service delivery objectives and help to achieve the Council's corporate objectives and priorities as defined in its Corporate Plan.

The contribution of the Council's investments to these objectives will not always be immediately evident but the income they generate supports services across the Council. Whilst it is not possible to draw a straight line from commercial rental income to the Council's service outcomes it is clear that their contribution each year towards the Council budget (£5.3m in pre-Covid period) is substantial.

Nor is the contribution of commercial property investment always purely financial. Whilst property returns can generally be described in terms of yield and profit this does not always tell the whole story and targeted investment can support the following Council objectives.

- Thriving local economy

Targeted investment can support the Council's economic development ambitions such as supporting the districts town centres, local businesses and jobs. An example of this is CDC's investment in Castle Quay Shopping Centre.

- Economic benefit or business rate growth

The investment has assisted in creating new opportunities for local businesses or has increased the Council's business rates base. These investments will generally be linked to projects or developments promoted by the Local Plan, such as Castle Quay Waterfront, or historically Pioneer Square and Franklin's House in Bicester. However, the benefit of business rates growth would only be retained for a time limited period.

- Respond to local market failure

There may be instances where the Council needs to step in and invest in a development or other entity within the District where, without Council support, the impact on the local economy would be detrimental. Examples of this include our ongoing capital investment in community assets such as Community Halls or more entrepreneurially, the provision of 52 apartments for rent in Crown House, Banbury.

- Regeneration

The investment will help (or has helped) to drive regeneration. There will generally be a link to the Local Plan when this type of investment occurs. E.g.: Tramway Industrial Estate, Castle Quay Waterfront, or indirect investments such as Crown House or Graven Hill (loans to subsidiaries).

- Better Use of Assets

The Council own land and buildings with embedded (re)development potential and these which include car parks, retained land and council occupied assets have historically been under-appreciated. Value can be realised either through a sale of these assets or it can be maximised by direct development and we have this expertise and can build upon it (Castle Quay Waterfront, Crown House, Build!, Bicester Eco Centre).

It is possible for individual investments to meet more than one objective.

However, whilst the Council would like to invest in all of these categories to drive better outcomes for the residents of Cherwell, in practice suitable opportunities are few and far between. With the probable exception of using Council assets for principally residential development investment in regeneration projects or addressing market failure is risky and carries with it an inherent risk of capital loss.

3.4 Investment philosophy

The Property Team have established a set of criteria which are designed to allow the Council to systematically assess risk and consider the likely future performance of the Council's investments. These are summarised in Appendix 1.

Security of capital is the underlying objective of all financial investments made by the Council. This means that the safety of the Council's money is the main criteria considered when deciding whether to make an investment.

The yield (or return on investment) is only considered once the appropriate level of security of capital has been determined and satisfactorily met by the proposed investment. However, it is possible for the relative balance between these principles to differ depending on the nature and objectives of the individual investment being made, particularly where regeneration or social factors are prominent drivers of a particular project. It is imperative that the downside financial risks of any such project are appreciated and balanced against the targeted regeneration or social upsides. This balancing of financial risk and non-financial reward is not an exercise that the Property team can undertake in isolation. Quantifying the value of environmental and social good outcomes, possibly at the prejudice of income security / risk and returns, is an exercise that the Property Team can only undertake by working closely with other service teams.

3.5 Market Outlook

The impact the Covid crisis is having on the UK economy is significant and there is little to be gained from rehearsing its evolving consequences in this report. We are however clearly living through a period of tremendous social and economic turbulence and whilst attempts to quantify Covid-19's long term effects remain uncertain; few would argue that national prosperity and confidence have been severely damaged.

With the exception of one or two important sub-sectors (distribution, for example) this has translated in property terms into declining capital values, a drop in transaction volumes and a fall in both occupier and investor confidence.

3.6 Public Works Loan Board (PWLB) limitations

PWLB is the principle source of borrowing for local authorities but there have been increasing calls from CIPFA and other industry leaders for central government to address what has been seen by many as local authorities taking on disproportionate levels of debt in order to buy investment properties.

Following extensive consultation with local government HM Treasury has issued a summary document titled ‘Public Works Loan Board: Future lending terms’, whose recommendations became effective 26 November 2020. In the context of this report to CEDR its two key impacts are:

1. Interest rates

   Interest rates on PWLB lending will be decreased by 100 basis points (bps) (1%). This is essentially a reversal of the 100 bps increase in rates announced in October 2019 and, for example, 40-year annuity rates are at the time of writing this report set at 1.92%. CDC is a qualifying authority which means that this rate can be reduced by 20 basis points (0.2%) if certain reporting requirements are met.

2. Ban on cash-flow acquisition

   On all new lending the PWLB will ask a local authority’s finance director to confirm that there is no intention to buy investment assets primarily for yield at any point in the next three years. This in effect prevents local authorities accessing PWLB funds for any purpose if it is their intention to acquire properties purely to generate income, either with or without debt.

   As short extract from the guidance is pasted below:

1.10 The main features of the new lending terms are:

a) As a condition of accessing the PWLB, LAs will be asked to submit a high-level description of their capital spending and financing plans for the following three years, including their expected use of the PWLB. In order to minimise the administrative burden for LAs, this process is closely modelled on the existing application process that most large LAs follow to access the Certainty Rate (a discounted rate offered by the PWLB).

b) As part of this, the PWLB will ask the finance director of the LA to confirm that there is no intention to buy investment assets primarily for yield at any point in the next three years. This assessment is based on the finance director's professional interpretation of guidance issued alongside these lending terms.

c) It isn't possible to reliably link particular loans to specific spending, so this restriction applies on a 'whole plan' basis – meaning that the PWLB will not lend to an LA that plans to buy investment assets primarily for yield anywhere in their capital plans, regardless of whether the transaction would notionally be financed from a source other than the PWLB.

In simple terms the application of these provisions in a CDC context is to make borrowing costs to finance the purchase of operational property (and probably to fund regeneration projects) more competitive, whilst simultaneously making the use of PWLB funds to acquire conventional commercial property investments virtually impossible.

As a public body CDC's finances are a matter of public record and it is clear that if CDC in the future wish to access PWLB funds as part of its day to day operation, the purchase of income producing assets is effectively no longer currently possible.

However, subject to the principles of prudential borrowing and Minimum Revenue Provision applying, borrowing to acquire property for operational or regeneration reasons remains an option.

3.7 Governance

The Investment Advisory Board, a non-decision-making Working Group, was created in part to facilitate the further growth of the investment portfolio. The Board and its role are noted in the constitution of the council and its powers and constitution is outlined in Appendix 2.

3.8 Strategic approach

The Property Investment Strategy aims to provide a clear set of objectives and a framework, compliant with HM Treasury and CIPFA guidance and legislation, by which new projects are evaluated. In doing so it will deliver the Council Objectives/Corporate Priorities with a focus on commercialism – projects that generate a revenue surplus – but which also deliver wider economic or service objectives e.g. regeneration / job growth.

3.9 Real Estate Investment and Disinvestment

3.9.1 Investment

In a commercial property investment market currently characterised by falling capital values and Covid uncertainty local authorities will have a general presumption against making new investments. This decision is reinforced by what is in effect a moratorium on investing in lower risk assets which is a consequence of the new PWLB lending regime.

Therefore, the focus will instead be on maximising the embedded development potential of the Council's existing portfolio and for the 2021/22 financial year this will principally be on its retained land assets where residential value can be released. This approach is explored in the Strategic Property and Asset Management Plan where the land portfolio is examined on a site by site basis.

3.9.2 Disinvestment

The ongoing suitability of CDC's operational properties for continued occupation is under constant review and this too has been discussed in the Strategic Property and Asset Management Plan. Given the current market uncertainty it is not envisaged that the Council would divest in any of its current property assets.

4.0 Conclusion and Reasons for Recommendations

Subject to the above the following principles will underpin the CDC Property Investment Strategy:

- There should be a general presumption against investing purely for yield in the year 2021/22 as the property market and the economy is too volatile to confidently predict the direction of capital values. Furthermore, these types of investments would limit the Council's ability to borrow from the PWLB.

- Wherever possible investment for regeneration or social good should be directed to land and buildings currently owned by the Council. This will optimise profits and reduce capital risk.

- Investments that relate to regeneration should be pursued only when through vigorous stress testing the risk of capital loss is judged to be extremely low, and the social benefits are tangible.

- All acquisitions that have planning risk will only be acquired on a subject to planning basis.

- Whilst there should be a general presumption against the disposal of income producing assets in line with the Strategic Property and Asset Management Plan this presumption will be reviewed on an asset by asset basis at the start of each quarter. This reflects the uncertainty of the occupational property market due to Covid and at present the retail and leisure focused investments are thought to be particularly vulnerable to further movement which may precipitate a review of this presumption.

Next Steps

- Members' comments to be incorporated into final strategy

- Strategy to be presented to Full Council on 22 February 2021.

5.0 Consultation

Marketing agencies and Investment Consultants:

The Property Team are in regular contact with commercial investment and letting agents in order to have the most up-to-date market intel. Retaining agents, planning consultants and on occasion architects is however recognised as essential to refining and implementing the recommendations made herein and securing their input will follow usual procurement rules.

6.0 Alternative Options and Reasons for Rejection

The sale of the investment portfolio as a whole has been considered but rejected because the portfolio currently produces income which supports the provision of statutory council services and any money raised through a programme of disposals could not be reinvested to generate a higher return.

7.0 Implications

7.1 Financial and Resource Implications

CDC must have regard to its legal duty under the Local Government Act 1999 and guidance thereunder to secure best value when reviewing service provision, requiring the council to make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness. Officers must also follow both internal procurement policies and external procurement law and practice in pursuit of the recommendations set out in this report.

Comments checked by:
Steve Jorden, Corporate Director of Property Investments, steve.jorden@oxfordshire.gov.uk

The service has confirmed that there is no extra budget required for the preparation of this strategic review. It should also be considered that low yielding assets could be sold and capital receipts to be used to reduce the Council's overall levels of debt, thus reducing MRP and interest costs and generate a financial benefit to the Council.

It is important to note paragraph 3.6 and the PWLB's expectation that any borrowing taken out will not be used for investment in assets primarily for yield.

Comments checked by:
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7.2 Legal Implications

In addition to endorsing the Financial and Resource Implications, officers will also need to be mindful of the council's duty, when purchasing or disposing of any property assets, to secure the best value reasonably obtainable pursuant to s122 and s123 of the Local Government Act 1972 and government guidance issued in relation thereto.

Comments checked by:
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7.3 Risk Implications

The risks identified throughout the implementation of the proposed strategy will be managed as part of the Place Programme Board risk register and escalated to the Leadership risk register as and when necessary.

Comments checked by:
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8.0 Decision Information

Key Decision	No
Financial Threshold Met:	N/A
Community Impact Threshold Met:	N/A

Wards Affected

Cherwell District

Links to Corporate Plan and Policy Framework

Efficiencies

Lead Councillor

Cllr Lynn Pratt, Portfolio Holder for Property

Document Information

Appendix number and title

- Appendix 1 – Investment Decision Factors
- Appendix 2 – The Investment advisory Board and Governance

Background papers
None

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