

**OVERVIEW AND
SCRUTINY**

**EXECUTIVE HEAD OF REGENERATION AND
PROPERTY**

30 MAY 2019

REPORT NO XXX

KEY DECISION NO

REVIEW OF COMMERCIAL PROPERTY INVESTMENTS

1. INTRODUCTION

- 1.1 Following an initial report to the Overview and Scrutiny Committee meeting of 1 November 2018 the Executive Head of Regeneration & Property undertook to review the performance of the investment assets acquired so far and highlight the key stages in the acquisition of property assets.
- 1.2 This would be considered in the context of the Council emerging Asset Management Plan and set out what further work would be undertaken to provide further rigour to the process of commercial property acquisition.

2. BACKGROUND

- 2.1 The Council owns assets across the borough and others outside its boundary. Initially the guidance for the acquisition of commercial property investment assets from CIPFA envisaged the purchase of assets that could be considered as generating additional income for local authorities outside its administrative area and did not specify any restrictions. In 2018 this guidance changed to expect such purchases to be in the area of economic influence of each authority. Although there is no definition of “the area of economic influence” this has been interpreted by local authorities as being neighbouring areas that have an influence on the economy of their administrative area such as providing employment.
- 2.2 As the budgetary pressures have grown for Rushmoor the programme of property acquisition has continued within these guidelines. Inevitably, as market conditions change, specific investment performance changes, the portfolio matures and the costs of finance change there is a need to review performance of assets acquired and whether there needs to be rebalancing of the portfolio to reflect these changes. This includes refinancing, sales, addition purchases and the development of opportunities within the portfolio.
- 2.3 A detailed review of processes connected with asset management will be undertaken following the approval of the Asset Management Plan (AMP) that has been considered by the Policy and Projects Advisory Board (PPAB) at its

meeting on 3rd April 2019. This is attached as Appendix 1. The AMP work programme will include a formal policy for the acquisition of assets overall and be consistent with the approach to the purchase of investment assets set out in this report..

3. CURRENT POSITION

Acquisition Process and Considerations

- 3.1 The Council does not currently retain agents to act on its behalf. Approaches are made to Rushmoor by various companies with regard to available assets within the Borough or in adjoining areas as most are aware of the new guidance.
- 3.2 Of particular interest are assets where the Council already owns an adjoining interest or an existing interest in the land, such as the freehold and a long leaseholder is selling its interest. The Council has bought a number of assets on this basis as there is significant potential to immediately enhance the asset value by combining the interests.

Income and Borrowing

- 3.3 The key performance requirement is that property investment assets create a net surplus for the Council after borrowing costs and the Minimum Revenue Provision (MRP) have been considered. The MRP is the repayment element of the loan that is currently assessed as being paid back over 50 years. On the basis of current long-term interest rates this generally means that the Council needs to achieve, approximately, a net initial yield of approximately 5.25%, with the prospect of this increasing, to make an asset purchase financially viable. Clearly a higher priced asset with a lower yield (reflecting a lower risk profile) could return the same as a lower priced asset with a higher yield (indicating more risk). Prior to the requirement to borrow some of the assets in the investment portfolio were acquired at lower rates of return on the basis of anticipated long-term capital growth.

Risk

- 3.4 Another element that is fundamental to considering the suitability of assets is the risk profile of the investment. This generally focuses on the average lease lengths and the financial stability of the tenant. In an ideal situation all tenants would be a very strong financial basis. These tenants with long leases tend to be propositions that are priced either less than or close to Rushmoor's breakeven point. Therefore, the investments have to be either large in size or quantity to bring the necessary returns above borrowings to support the continuation of services at the Council. Buying investments above this lower level of return, that reflects relatively secure income, results in a greater level of risk as this often means a larger number of tenants with a variation of financial strengths. The external agents and the Council's financial team review the financial quality of the tenants

Location

- 3.5 Underlying all the purchase considerations is the quality of the location of investments. Even what have been considered quality tenants in the past have experienced financial collapse allowing the administrator to disclaim leases leaving landlords to renegotiate terms or find a new tenant. The quality of location is therefore an important factor in considering investment opportunities for long-term options and exit strategies.

Balancing the Portfolio

- 3.6 Care is being taken not expose the Council to extensive risk in any one sector, location or to a particular tenant. There are sectors that are not currently represented in the portfolio, such as leisure and energy. There are limited opportunities to obtain such assets with the Borough or its economic area of influence and any opportunities will be scrutinised in the same way as other sectors for a suitable fit for Rushmoor's requirements.

Recommendation to bid

- 3.7 If the property meets the expectations set out above the introducing agent is asked to prepare a summary of the case to buy that is used to supplement an internal review and forms a recommendation to bid that is considered by the relevant Cabinet Members.

Member Review

- 3.8 The recommendation to bid is scrutinised by the relevant Cabinet Members and clarifications provided to allow a decision, or a qualified decision, to be made. If approval is given a provisional offer is made, subject to conditions such as Cabinet approval and Council approval, where appropriate.

Due Diligence and Negotiations

- 3.9 If a bid is made a solicitor is normally appointed. The introductory agent works with the solicitor to assess the detail of the information in relation to the asset. On the basis of this any negotiations on terms are carried out both before Cabinet (and Council, if appropriate) and afterwards where appropriate delegations are approved. An independent valuation of the asset it is proposed to purchase is also sought as part of the purchase process so that the vested interest of the introducing agent in achieving a completed purchase is not perceived to influence advice to the Council.

Summary of the Process of Acquisition

- 3.10 The attached summary of process (Appendix 2) highlights the outline process for acquisitions. Creating further detail on the process of acquisition forms a stream of work for the AMP.

Performance

- 3.11 Set out in Appendix 3 is a summary of the investment performance of the property asset investment portfolio with some explanatory notes.
- 3.12 As can be seen some assets have performed better than anticipated and others have underperformed compared to predictions.
- 3.13 There also opportunities to redevelop parts of the assets that are underutilised. The nature of the property asset class means that there are often asset management issues to resolve to maintain the value of the asset and ensure income is maximised. This can mean costs or voids are part of the income profile.
- 3.14 Overall, the net benefit (after costs) to the Council is approximately £2.93m per annum. As referred to in the notes the is based upon the current interest rates that are lower short-term rates rather than higher long term rates.
- 3.15 An initial external review of the performance of the property investment assets has been commissioned to examine the performance of the investment assets purchased, their potential and provide future recommendations with regards their asset management.

4. RECOMMENDATIONS

- 4.1 The processes related to the acquisition of property assets, including the acquisition of property investments, is reviewed as a workstream from the AMP. If members of Overview & Scrutiny have comments on the AMP these should be raised directly at PPAB or through the Chair or Vice Chairs of PPAB.
- 4.2 In order to ensure that the Council fully understands the risks in acquiring property investments external advice continues to be sought as part of the purchase process.

APPENDICES

- 1. Asset Management Plan
- 2. Outline Purchase Process
- 3. Investment Asset Performance **(Part II Confidential)**
 - a. Performance Table
 - b. Explanatory Notes

BACKGROUND DOCUMENTS:

None

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