TITLE	**Investing in our Community**
FOR CONSIDERATION BY	The Executive on Thursday, 29 July 2021
WARD	None Specific;
LEAD OFFICER	Deputy Chief Executive - Graham Ebers
LEAD MEMBER	Executive Member for Finance and Housing - John Kaiser

PURPOSE OF REPORT (INC STRATEGIC OUTCOMES)

To refocus the current Property Investment Strategy approved by Executive in September 2017. This will enable us to continue to invest in our community for service delivery, housing, regeneration and preservation action.

RECOMMENDATION

The Executive is recommended to:

1) note the refocusing of the existing Investment Strategy and criteria as set out in Appendix A;

2) note the delegated authority already given to the Deputy Chief Executive in consultation with the Leader, Executive Member for Finance and Housing and the Executive Member for Business and Economic Development, applies to this refocused policy;

3) agree the changes to the delegated authority with regard to investment criteria as set out in Appendix A.

EXECUTIVE SUMMARY

This report is presented to Executive (as opposed to Audit Committee) because it refers to a refocusing of the Investment Strategy approved by Executive in September 2017. This report considers two types of Community Investment namely:

1. Developments on Council-owned land which will be brought back to Executive unless managed under another delegated authority elsewhere

2. The purchase of and/or development of property assets primarily to deliver policy objectives other than yield in accordance with the delegated authority set out in this report.

The report describes proposals for implementing a Community Investment strategy to improve resources available to the Council by acquiring property assets that will enhance WBC policy delivery in borough.

To fund purchase opportunities the Council will utilise debt including Public Works Loan Board borrowing of up to £100m in addition to the £100m approved in 2017 in accordance with the current MTFP and/or the proceeds of any asset disposals if/when they arise.

BUSINESS CASE

Background

1) In September 2017 the Executive approved a new £100m Property Investment Strategy designed to build up a brand new income stream to replace declining government grant funding. So far, during the three years 2018 – 2021 WBC has invested c. £85m and acquired 10 property assets which produce headline rental income in excess of £4.0m p.a. After deductions for debt and repayment costs this contributes over £1.0m p.a. to Council revenue which supports front line service delivery.

2) Since 2017 the successful delivery of the Investment Strategy has been subjected to rigorous scrutiny and approval by officers, members and external professional advisors. The most recent findings of an independent audit by Ernst and Young are reproduced here:

   Value for Money - What are our findings? (draft report February 2021)

   a) The Authority's key strategic documents are well aligned, with both the Investment and Capital strategies showing planned increases to future investment. The Authority's investment portfolio is well developed, with a portfolio of £79m returning a net yield of 5.25%. The overall aims of the Authority with regards to commercialisation are consistent, with targets clearly outlined.

   b) Property purchases are supported by clearly defined process, utilising desktop appraisals, Property Investment Group (PIG) review, purchase proposals, and cost & yield analysis.

   c) In addition to this, the Authority also has a Treasury Management Strategy. This strategy highlights the potential risks and market fluctuations, delivering insights in relation to any considerations that need to be made around external borrowing. The Authority obtained reputable external advice to generate this strategy, which facilitates more robust and accurate decision making.

   d) Additionally, external legal and property advice is sought throughout the purchase process to supplement the due diligence undertaken.

   e) There is a clear governance structure in place for key decision making.

   f) The 2017 Investment Strategy provides the Deputy Chief Executive and S.151 Officer with the authority to make investment decisions, and he is supported by key individuals within the Authority, who all attend PIG meetings throughout the year. This ensures the involvement of the Leader, Executive Member for Finance & Housing, Executive Member for Business & Economic Development, Lead Specialist Finance & Deputy S.151 Officer, Assistant Director of Commercial Property and the Head of Investment in all decisions in respect of property acquisitions pursuant to the Investment Strategy, irrespective of value.

   g) The acquisition of the Denmark St Car Park investment property was supported by detailed information, including desktop appraisals and purchase proposal documents. Detailed financial analysis was prepared by external

parties providing the PIG with valuable information, allowing for informed decisions.

h) We were also provided with internal workings by the Head of Investment, whose high level calculations to determine the yield were in line with the work done by external parties. The Denmark St property was returning a 4.69% net yield based on the November PIG statement, slightly below the average for the wider portfolio.

i) The Authority has a Treasury Management Strategy that assesses the requirements of the Prudential Code, and provides necessary information to address these requirements, ensuring compliance with the statutory investment guidance and the Code. This allows the Authority to comply with the guidance and make informed decisions on financial investments, which in turn allows for sustainable resource deployment.

j) As above, the Authority obtained reputable external advice and insight in relation to the Treasury Management Strategy, allowing it to make any necessary considerations around external borrowing. Obtaining external advice allows for more robust and accurate decision making. The Authority is prudent and puts aside MRP of 10% of the value of the asset over 15 year to cover any reduction in value if needed.

k) We suggest that the Authority should consider formalising its process for analysing decisions to retain or sell properties, to manage the risk of any loss in market value of the investment. The Authority should also establish a risk register for the new Community Investment Group to review as part of its Terms of Reference and highlight and record any issues that need to be considered at a strategic level in the Corporate Risk Register.

3) Although not highly publicised the original 2017 Commercial Property Investment Strategy has been pursued with the intention of delivering multiple policy wins wherever possible, not just yield. Two notable exceptions were acquired out of borough specifically for the purpose of achieving income security and risk diversification to ensure the Council was not over exposed to locational risk within borough.

4) Apart from these two pure Treasury Investments the other eight assets were acquired in borough in pursuit of dual policy objectives and are held as Operational Property. This focus on dual policy delivery of the 2017 Investment Strategy has been particularly evident under the current membership of the group (since October 2019) that advises the Deputy Chief Executive in delivery of the Strategy. PWLB debt has been drawn down at various times to support the purchase of the 8 in borough dual policy assets.

5) Following the government's recent PWLB Review published 26th Nov 2020 and Circular 162, WBC will no longer be able to invest afresh "primarily for yield" <u>and</u> continue to have access to PWLB debt for any purpose. This is because any new PWLB application must confirm that in the three year period following the PWLB application the borough will not invest primarily for yield.

6) WBC acknowledges that the PWLB reform prevents the continued acquisition of property primarily (i.e. solely) for yield. Accordingly the original Investment Strategy approved by Exec in 2017 needs to be refreshed to reflect the current

regulatory environment, hence this recommendation to Executive to pursue dual policy community investment – for example: the acquisition of a property to be redeveloped in the medium term to provide affordable housing that in the short term provides income from an existing commercial occupier whereby the combined return on total costs meets the Councils minimum investment criteria.

7) However, WBC acknowledges that the 2017 Investment strategy has delivered many properties into the Council's ownership that promote the delivery of valid non-yield policies and it is important that WBC should be able to continue to acquire opportunistically for this purpose. WBC needs to continue to identify in borough opportunities to acquire assets that will deliver socio-economic policy benefits subject to also meeting prudent financial thresholds.

8) Due to the competitive nature of the property market it is essential that any acquisition is able to proceed swiftly and decisively. Otherwise potential sellers will not be willing to engage with a Local Authority if bogged down in red tape and time consuming approval processes. Therefore, just like the 2017 Investment Strategy, it is essential that Executive approves a renewed delegation process to enable swift decisions to acquire assets once a suitable opportunity has been identified.

9) Therefore WBC needs to reaffirm the existing delegated authority to acquire, manage and dispose of property assets for this purpose subject to meeting similar financial thresholds as originally approved in 2017. There is the balance of the original £200 million capital budget agreed at Council in two tranches of £100 million in 2018/19 and 2019/20 respectively. The balance left for the new focus on Investing in our Communities is £115 million.

10) The new delegation must perpetuate the existing delegation to manage and potentially dispose of the 10 assets already acquired under the 2017 Investment Strategy. In the event of any disposals the funds realised shall be re-invested in accordance with this Investing in our Community Strategy.

11) The financial criteria approved in the 2017 Investment Strategy need to be enhanced to suit the nature of the assets to be targeted.

Analysis of Issues

1) It is proposed that there will continue to be two types of investment – development on our own land and/or other development and property-related opportunities via acquisition of assets.

2) The approvals for development on our own land will be in accordance with the current approvals process i.e. through Executive unless suitable powers have been delegated elsewhere.

3) It is proposed that governance for the acquisition or disposal of other opportunities will be in accordance with the additional criteria set out in Appendix A. These criteria are based on the criteria previously approved by Executive in 2017 for Property Investment, plus additional financial criteria previously approved by Executive for the Council's town centre Regeneration projects.

4) Any form of investment is not without risk since its value may rise or fall. But this effect tends to soften over time and can be more accentuated in just the short term depending on the precise timing of market entry and exit.

5) The primary purpose of Investing in the Community is to enhance policy delivery rather than to deliver pure financial return. This means that every property acquisition must be justifiable on policy grounds first and foremost. Sound financial performance in accordance with approved criteria will remain a crucial but secondary consideration.

FINANCIAL IMPLICATIONS OF THE RECOMMENDATION
The Council faces severe funding pressures, particularly in the face of the COVID-19 crisis. It is therefore imperative that Council resources are focused on the vulnerable and on its highest priorities.

	How much will it Cost/ (Save)	Is there sufficient funding – if not quantify the Shortfall	Revenue or Capital?
Current Financial Year (Year 1)	£100m budget already allocated in MTFP	Yes	Capital
Next Financial Year (Year 2)	Balance of above	Yes	Capital
Following Financial Year (Year 3)	Balance of above	Yes	Capital

Other Financial Information
Some acquisitions are likely to provide short or long term income in addition to delivering socio-economic policy goals

Stakeholder Considerations and Consultation
Returns generated from the assets will assist in the continued provision of Council services in addition to the policy contribution of each asset

Public Sector Equality Duty
Due regard to the Public Sector Equality Duty is taken when considering each individual property project or acquisition in accordance with this strategy.

Climate Emergency – *This Council has declared a climate emergency and is committed to playing as full a role as possible – leading by example as well as by exhortation – in achieving a carbon neutral Wokingham Borough by 2030*
Properties acquired for potential repurposing may provide additional opportunities to promote the Council's carbon neutral agenda

List of Background Papers
None

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APPENDIX A

INVESTING IN THE COMMUNITY – STRATEGY AND CRITERIA

1 Context

a) The government's PWLB review and Circular 162 of 26th November 2020 confirms that Local Authorities may continue to borrow from PWLB to acquire property but only for specific permitted policy objectives:

   (i) Service delivery

   (ii) Housing

   (iii) Economic regeneration

   (iv) Preventative action

   (v) Treasury management.

b) The schedule at Appendix B identifies the ten property assets acquired by WBC so far and the policies they support. WBC needs to continue to acquire property using debt (including PWLB) to deliver these permitted policy objectives. These objectives align with many of the Council's Priorities set out in the Wokingham Borough Community Vision 2020-2024, for example:

	Priority	Detail
(i)	ENRICHING LIVES	Support growth in our local economy and help to build business
(ii)	SAFE STRONG COMMUNITIES	Nurture communities and help them to thrive
(iii)	CHANGING THE WAY WE WORK FOR YOU	Work with our partners to provide efficient effective joined up services which are focused around you
(iv)	A CLEAN GREEN BOROUGH	Protect our borough, keep it clean and enhance our green areas
(v)	RIGHT HOMES, RIGHT PLACE	Build our fair share of housing with the right infrastructure to support and enable our borough to grow
(vi)	KEEPING THE BOROUGH MOVING	Enable safe and sustainable travel around the borough with good transport and infrastructure

d) Many of these priorities depend upon the Council being able to acquire and control suitable land and buildings. This can be achieved either by direct development or by indirect development via swapping or relocating uses to enable onward provision of suitable infrastructure, facilities, services and accommodation.

e) The new Investing in our Community strategy will continue to target all property types just like the 2017 Strategy. But the current emphasis is towards delivery of properties that will eventually provide or support additional housing and regeneration of our town centres via the second £100m funding tranche approved in the MTFP.

f) WBC will acquire in borough only. It will not acquire out of borough unless via a joint arrangement where cross border intervention is desirable to achieve WBC policy objectives or where a specific in borough property straddles a boundary encroaching into a neighbouring borough.

g) The “Property Investment Group” will cease to operate once the new delegation has been approved and the Deputy Chief Executive will appoint a new advisory group of officers and members to support the delivery of the new Strategy. The new advisory group is likely to operate under the title “Community Investment Group” (CIG).

h) The investment strategy approved in 2017 includes many features and criteria that remain valid under the new policy focus. However new criteria need to be set to complement the original criteria to enable a wider scope of property acquisition for redevelopment and resale as opposed to holding for income return.

i) This is especially relevant to acquiring properties where the current use is to be replaced by an alternative use in the future and where that future use is likely to result in an onward sale of the property in a different form or parts. Relevant criteria have already been approved by Executive in respect of the Council’s regeneration projects.

j) Properties may be bought as income producing assets in the short or medium term. Income will enhance feasibility while alternative asset plans are prepared and delivered. This means that the criteria need to provide benchmarks for assets that start as income producing assets but transform into different assets to be sold for a one off capital gain.

2 Current Criteria

These are the criteria already approved by Executive that will continue to apply to the Investing in our Community strategy:

a) Objectives

(i) Invest up to £200m as set in the capital programmes agreed in the 2018/19 and 2019/20 budget setting.

(ii) Purchase freehold interests although in special circumstances long leasehold will be considered too.

(iii) Finance purchases through debt (including Public Works Loan Board) or asset disposals

b) Acquisition

(i) The purpose of the investment will be identified and agreed by way of an asset strategy related to permitted policy goals per DMO circular 162 – service delivery, housing, regeneration, preservation action.

(ii) Where property is income producing leases and tenant covenants will be suitable for the asset strategy (for example, if acquiring for imminent redevelopment purposes, it should not be encumbered with a long lease).

(iii) Properties will not be considered if associated with adverse public relations, reputational risk, ethics, excessive financial or practical risk.

(iv) Lot sizes will vary to balance risk.

(v) Property condition shall be considered carefully having regard to the asset strategy and any need for further investment to deliver alternative policy objectives.

(vi) The risk/reward ratio will depend upon the timeframe and certainty of policy objective but will seek am income margin of at least 2% net above the borrowing rate across the portfolio. This will be measured at the point of appraisal.

c) Process

(i) External acquisition advisers will be appointed for commercial purchases with core expertise retained in-house.

(ii) External managing agents will be appointed for commercial property while retaining in-house expertise.

(iii) In order to complete the purchase of commercial acquisitions in an efficient and speedy manner, Shared Legal Services may be used if they have capacity, otherwise external solicitors will be appointed.

(iv) The Council will hold the property assets directly, although if converted to housing for rent they may be transferred to relevant Council owned and controlled companies for management and compliance purposes.

(v) If relevant a dedicated contingency, refurbishment or redevelopment budget will be established for each property to provide for delivery of the relevant policy objective at the relevant time and this shall be reflected in the initial appraisal.

(vi) The Council's Commercial Property Department supplemented by specialist external advisors will provide ongoing fund management advice including exit strategy advice as required.

Disposal

(i) Generally speaking, the purpose of Investing in our Community is to acquire and hold assets in accordance with the specific asset strategy approved for each property at the time of acquisition.

(ii) Disposal is unlikely to be a deliberate feature of an individual asset strategy other than by way of rack rented short leases of individual lettable units, or the long leasehold (or freehold) disposal of component parts of the whole in the event of a residential conversion of a larger building previously in a different use.

(iii) Nevertheless, the possibility of a strategic disposal of any income producing asset is kept under constant review in light of evolving economic and market circumstances and events at the property itself. A specific review is undertaken at each year end when all assets are independently valued by external specialist valuers.

(iv) The annual review considers the value and likely future performance profile of each asset. It also considers the likelihood of being able to reinvest the same funds in keeping with the investment strategy.

(v) If a disposal is identified as a prudent course of action, the asset will be prepared for sale following a mirror image of the acquisition process. Independent advice will be taken from a suitable expert to agree a disposal plan and target price. Then the asset will be prepared for sale and transacted in line with normal market practice.

(vi) Following any disposal, a key challenge will be to identify an alternative opportunity to reinvest the proceeds of sale to maintain a similar level of investment income to support the Council's expenditure needs. Subject to market conditions, this may

require investing a lesser sum at a higher riskier yield or investing a higher sum at a lower safer yield.

e) Governance

i) The overall budget for the programme is set by Council and contained within the capital programme.

ii) In order to make necessary quick decisions on the acquisition or disposal of commercial assets, delegated powers to approve them within this framework will be granted to the Deputy Chief Executive, in consultation with the Leader, the Lead Member for Finance and the Lead Member for Business, Economic Development and Regeneration.

iii) Members of the Executive will be advised of purchases and disposals.

iv) The Executive will approve decisions relating to the development of our own land in the normal manner unless formally delegated via another route.

3 Additional Criteria:

The refocusing of the policy increases the likelihood of needing to acquire property that either has no immediate rental income or an inadequate level of income to cover all holding costs in the short term until the property has been repurposed for policy objectives. In this situation the viability of the acquisition and repurposing will be measured not on initial yield but on overall profit or life cycle return.

To accommodate this broader approach the Strategy will need to embrace a broader range of financial models. Therefore, in addition to the existing investment criteria (as re-stated above) the Strategy will need to work to additional criteria required to meet national criteria and local requirements to make financial return as follows:

a) The objective of Investing in our Communities is to acquire property to support delivery of permitted policy objectives, service delivery, housing, regeneration and preservation action. This may involve direct policy delivery at the property to be acquired. It may also involve swapping uses to another property, assembling a larger site or providing essential infrastructure or access to enable another property holding to deliver policy objectives.

b) Investments will be located wholly or partly in Wokingham Borough (including in association with its existing land and buildings and properties that may straddle the borough boundary).

c) Where a property is purchased for redevelopment it may be vacant and non - income producing (or income producing for only a short period). In this situation the vacant holding costs prior to redevelopment will be included in the overall appraisal to determine the total project return on cost.

d) Where a property is purchased with a view to long term redevelopment where the end result is uncertain or speculative it will be desirable to manage an income from the property until it is ready for redevelopment. In this situation the income will be required to provide the minimum rate of return (see current criteria section above).

e) Property purchased specifically for defined redevelopment either as an individual site or as part of a larger composite site or project must show (either individually or in the aggregate context as appropriate) a minimum return on cost including finance costs equal to the rate adopted for the Borough's regeneration projects. This rate is effectively a minimum break even target plus a prudent risk margin.

f) The original Investment Policy criteria included an individual lot size cap based on 20% of the initial £100m fund. The purpose of this cap was to ensure risk diversification across multiple assets. This has already been achieved having purchased 10 lots in the first £100m phase. Now that the total target fund has been increased to £200m the lot cap should be increased as well. The need to diversify remains but the risk is already much reduced due to the existing portfolio spread. Therefore in the context of the increased overall fund budget the max individual lot size shall be capped at £30m which actually reduces the individual lot size relationship from 20% to 15% of total the fund.

g) Properties purchased for short to medium term redevelopment may be less likely to provide sufficient income to cover holding costs. In this situation (just like the Wokingham Town Centre Regeneration project) any income will be ring-fenced to the asset to support viability and not released to the general fund. But once the redevelopment is finished and either sold or fully let at an enhanced level of rental income then the ring-fence will be withdrawn once income or receipts have cancelled all or a substantial element of the debt.

h) Property purchased for longer term redevelopment that cannot be adequately defined at point of purchase should aim to comply with the current minimum income return on cost for at least the period leading up to the proposed redevelopment.

4 Conclusion

a) Government guidance confirms that it is acceptable for local authorities to act knowingly and advisedly to take managed risks with public funds to make property acquisitions to deliver policy objectives. This is clearly reinforced by DMO Circular 162. Risk must be managed carefully by competent staff and members applying suitable techniques and resources.

b) Local authorities have been making property investments in the name of economic regeneration for many years. Many have done so deliberately in full knowledge that the project will not make a conventional commercial return. Instead they have focused on primarily delivering socio economic policy objectives at a defined cost.

c) This strategy intends to achieve first and foremost socio-economic policy delivery, supported by sound commercial judgement and financial performance in accordance with the criteria set out.

APPENDIX B

WBC INVESTMENT PROPERTIES 2017-2021

	Property	Policy
1)	Barclays, 31 Market Place Wokingham	Regeneration
2)	Cox Plastics, Fishpond Rd Wokingham	Protection
3)	Mulberry Business Park Wokingham	Protection
4)	Alexandra Court, Wokingham	Regeneration
5)	Waitrose London Rd Twyford	Regeneration
6)	Twyford House London Rd Twyford	Regeneration
7)	Denmark St Car Park Wokingham	Protection
8)	Waitrose Crockhamwell Rd Woodley	Regeneration
9)	Wickes Churchill Way Basingstoke	Treasury
10)	Stapletons Club Way Peterborough	Treasury