

## **INVESTMENT STRATEGY**

**Council – 22 July 2014**

Report of Chief Finance Officer

Status: For recommendation

Also to be considered by: Finance and Resource Advisory Committee – 26 March 2014  
Cabinet – 10 April 2014

Key Decision: Yes

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### **Executive Summary:**

This report builds on the direction as set out in the Corporate Plan for the Council to move towards a more financially self-sufficient position.

The report details a proposed investment strategy building on an approach of property based investment in order to deliver increased revenue income. The proposal is set against a background of reducing Government Support and continued low rates of return through existing treasury management arrangements.

Proposed investment criteria and governance arrangements are set out in the body of the report.

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**This report supports the Key Aim of providing value for money.**

**Portfolio Holder** Cllr. Ramsay

**Contact Officer(s)** Adrian Rowbotham Ext. 7153  
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### **Recommendation to Finance & Resource Advisory Committee:**

- (a) That the Committee endorse and recommend to Cabinet the proposed approach to the principle of an investment strategy based on property assets.
  - (b) Subject to recommendation (a) the Committee recommend to Cabinet that the proposed investment strategy be adopted subject to the criteria set out in paragraph 22
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**Recommendation to Cabinet:**

- (a) That Cabinet approve the proposed approach to the principle of an investment strategy based on property assets.
- (b) Subject to recommendation (a) that Cabinet approve the proposed investment strategy be adopted subject to the criteria set out in paragraph 22
- (c) Cabinet recommends to Council to agree to set aside up to £5m from a review of reserves for the purposes of the proposals outlined in the Investment Strategy.

**Recommendation to Council:**

That Council agrees to set aside up to £5m from a review of reserves for the purposes of the proposals outlined in the Investment Strategy.

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**Introduction and Background**

1. In recent years Sevenoaks District Council has been faced with ongoing reductions in Government Support. This has led to a number of decisions that have been taken through the 10 year budget process to try and ensure that the Council remains in a financially sustainable position going forwards.
2. This position has been increasingly difficult to achieve due to the ongoing nature of budget reductions, compounded by continued low interest rates resulting in returns on treasury investments generally not higher than 0.8%.
3. The Council has sought to address this position by regularly reviewing assumptions within the 10 year budget and by proposing appropriate reductions in service expenditure where achievable.
4. At its November meeting Cabinet approved the Corporate Plan which sets out key focus areas for the organisation including the need to become more financially self-sufficient. The agreed plan articulates an approach of investing in assets that will generate revenue income to allow less reliance on diminishing Government Support. It goes on to state that this could be done either through the review of use of reserves or through borrowing at low interest rates.
5. In December 2013 the Council was subject to a Peer Challenge process. As part of this process, the Peer Challenge team were specifically tasked with reviewing not only the 10 year budget framework but also the ambitions set out in the Corporate Plan to better utilise either reserves or available borrowing to generate investment income higher than that of our current treasury management approach.
6. The findings from the Peer Challenge as reported to Cabinet in February 2014 endorsed the Corporate Plan and the approach the Council is looking to take. They further recommended in their feedback that the opportunity to generate greater income from investing in appropriate property assets would significantly contribute towards the aim of financial self-sufficiency.

7. Subsequent to the above but included in the final budget report agreed at Council on 18 February, the actual level of Government Support included in the settlement was significantly worse than we had previously assumed. The Revenue Support Grant element has reduced by £710,000 (24%) in 2014/15 and £722,000 (31%) in 2015/16 giving a cumulative reduction of £1.432m (47%).
8. In this same report, Members agreed that alternative ways of increasing revenue be investigated and further agreed to put £200,000 in to a Corporate Project Support Reserve to fund investigations into a number of potential options, including property investments.
9. Other Authorities, including Surrey County Council, Ashford Borough Council and Luton Borough Council have adopted similar approaches to investing in property and infrastructure assets.
10. It should also be considered that this approach could deliver wider benefits to the Council in terms of Economic Development & Business Support opportunities, such as a 'Start Up' Business Centre. If an appropriate building could be found and a business case established that showed an appropriate level of financial return, then a Business Centre catering for start up or small companies could be established.
11. If Members are minded to develop this approach further, the remainder of this report suggests a framework for how this can be delivered.

### **Proposed Investment Strategy**

12. It is recommended that a diversified and balanced portfolio of investment assets be assembled with regard to the following considerations.
13. Established property investment practice has evolved based on long standing markets for assets in main stream sectors such as Offices, Retail, Industrial and Residential. Investing in these traditional asset categories in a balanced fashion, allows for a lower risk investment when compared to emerging markets such as Student Accommodation, Nursing Homes and Medical Centres.
14. When considering the tenure of an asset, freehold would be preferable to leasehold. Freehold provides for greater levels of security against a leasehold asset that would effectively decrease in value over time. However assets on long leasehold basis may still be suitable for consideration.
15. Whilst properties let to only one tenant may offer an acceptable level of risk, multi-tenanted properties would be favourable as they offer the opportunity to minimise the impact of any one part of the asset being vacant due to tenant default or lease expiry. If assets are occupied by a single tenant, then detailed financial due diligence would be undertaken to ascertain their financial stability.
16. Given the greater market knowledge of the local area, it is suggested that initial investment opportunities are restricted to those within Sevenoaks District.
17. Based on the above considerations and taking into account local market conditions, a suggested lot size of between £1m and £5m is recommended. This

is to avoid the lower part of the local market where private high net worth individuals would be seeking to invest and also the high end, where Pension Funds and Life Assurance Funds tend to dominate.

18. Given the likely risk profile of an asset meeting the above considerations, it is suggested that an income yield of in excess of ***an amount as detailed within the gold pages of the main agenda*** is appropriate. Opportunities should be sought that lend themselves to a potential to increase rental income than is currently being realised.
19. A limited number of opportunities that include the potential for development should also be considered. This approach may have the potential to deliver an additional ***amount as detailed within the gold pages of the main agenda*** return on investment could be realised.
20. Where sites that are already in the ownership of the Council could be redeveloped in partnership with neighbouring sites, added value can be derived from 'marriage' of the sites. Consideration should be given to Joint Venture (JV) projects that maximise value, with priority given to those which would result in the delivery of assets meeting the investment criteria.
21. It is proposed that external specialist property investment advisors be retained on each transaction, advising on suitability having undertaken detailed pre purchase due diligence, including valuation, risk analysis and lease / title reviews.
22. Taking all of the above considerations into account, the following specific criteria are proposed:  
  
(i) to (viii) ***as detailed within the gold pages of the main agenda.***

**Should Members wish to discuss the exempt information contained within this paragraph of the gold pages (or the amounts detailed in paragraphs 18 and 19 above) then a resolution to exclude the press and public should be made.**

23. It is proposed that initially, the Strategic Asset Management and operational Property Management of the portfolio be delivered from existing resource within the Council's Property & FM Team. There will however be times when specialist external advice is needed and this work will be commissioned on an 'as required' basis, funded from the income from the assets. This approach is to be reviewed regularly, including ongoing resource requirements, as the portfolio grows.

## **Funding**

24. Funding for the acquisition of assets should be reviewed on a case by case basis but could be derived from a number of sources:
- Receipts from property disposals in 2013/2014 currently held on deposit £2.65m
  - Receipts from proposed land / property disposals in future years (Estimated in the financial year 2014/2015 at £3.5m)
  - Reallocation of some of the funds currently held in reserves
  - Borrowing from the Public Works Loan Board (if appropriate)
  - Municipal Bonds
25. It is proposed that an initial total investment threshold for 2014/15 is set at £5m.

## **Governance Arrangements**

26. To operate property investment on a commercial basis, the Council would need to establish a property investment company. Section 1 of the Localism Act 2011 (“the power of general competence”) enables local authorities to do anything that a private individual is empowered to do, subject to certain statutory limitations. The power includes the ability to do such things for a commercial purpose but any such commercial activity must be undertaken through a company within the meaning of section 1 of the Companies Act 2006. Local authorities also have powers to trade under section 95 of the Local Government Act 2003.
27. The Council is presently in the process of establishing a trading company and Members are referred to the report entitled “Establishment of Local Authority Trading Company Structure” (the Trading Report) which is on the same Agenda as this report and which recommends the purchase of a generic off the shelf company limited by share.
28. The Trading Report identifies that a major Governance issue is the relationship with Sevenoaks District Council (the Shareholder) and the Company’s internal processes. It is important that the Company is able to act quickly in order to generate and sustain business but on the other hand the Council needs to manage risks and to be able to determine whether it is appropriate for the Company to enter into a particular contract(s). Therefore, it is proposed that a provision be included in the Articles of Association of the Company whereby the Council’s consent via its Shareholders be granted before a particular property acquisition or business contract is entered into by the Company. The Council being the Shareholders would be represented by Cabinet especially as property acquisition or disposal is a Cabinet function. Cabinet will be able to approve any proposed acquisition or disposal by the Company up to a value of 5 million pounds and an Emergency meeting of Cabinet may be called if there is a need for an urgent decision.

## Key Implications

### Financial:

29. As previously stated in this report, the proposals outlined are suggested in order to contribute to the aim of the Council becoming more financially self-sufficient as articulated in the approved Corporate Plan.
30. This proposal will require an element of financial management, which will include billing rents, service charge and insurance. It is proposed that this work will initially be undertaken by the Council's Finance Team. This will be subject to regular review and should a service charge administration role be required, it may necessitate external agents delivering the role, to enable compliance with the RICS Service Charge code of Practice.

### Legal Implications and Risk Assessment Statement.

31. Resource would be required from the Legal Section (or possible external legal advisors) to undertake legal pre purchase due diligence. There is also likely to be an increase in the level of Landlord and Tenant related legal work.
32. A full risk analysis for this approach is included at Appendix A to this report.

### Equality Impacts

Consideration of impacts under the Public Sector Equality Duty:		
Question	Answer	Explanation / Evidence
a. Does the decision being made or recommended through this paper have potential to disadvantage or discriminate against different groups in the community?	No	
b. Does the decision being made or recommended through this paper have the potential to promote equality of opportunity?	No	
c. What steps can be taken to mitigate, reduce, avoid or minimise the impacts identified above?		

## Value for Money and Asset Maintenance

33. It is suggested that value for money derived from available finances when looked at in conjunction with the current treasury management strategy has the ability to be increased if the proposals outlined in this report are adopted.

## **Conclusions**

34. In acknowledgement of the ongoing reductions in Government Support and the continued low returns on investment of reserves, this report sets out an alternative approach as indicated by the approved Corporate Plan.
35. If Members are minded to adopt this approach it further sets out suggested criteria by which the investment strategy could be applied. It also details the monitoring and governance structure within which such a strategy could operate.

## **Appendices -**

Appendix A – Risk Analysis

## **Background Papers:**

LGA Peer Challenge Feedback Letter – [Report to Cabinet 6<sup>th</sup> February 2014, Appendix A – LGA Peer Challenge Letter](#)

[Sevenoaks District Council Corporate Plan](#)

[Revenue Budget and Council Tax Report to Council 18<sup>th</sup> February](#)

**Adrian Rowbotham**  
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