

PROPERTY INVESTMENT STRATEGY UPDATE

Finance Advisory Committee - 30 January 2018

Report of	Chief Finance Officer
Status	For Consideration
Also considered by	Cabinet - 6 February 2018
Key Decision	No

Executive Summary: This report provides an update on the progress of the Property Investment Strategy to date and looks at the future direction of the strategy.

The Property Investment Strategy was approved by Council on 22 July 2014 to support the aim of the council becoming more financially self-sufficient as Government Support continued to reduce.

The acquisitions to date have helped the council achieve this aim and this report provides an update on those acquisitions.

Portfolio Holder	Cllr. Peter Fleming, Cllr. John Scholey
Contact Officers	Adrian Rowbotham, Ext. 7153 Andrew Stirling, Ext. 7099 Alan Mitchell, Ext. 7483

Recommendation to Finance Advisory Committee:

That the report be noted, and any comments forwarded to Cabinet.

Recommendation to Cabinet:

Cabinet considers any comments from Finance Advisory Committee and notes the report.

Introduction and Background

- 1 In recent years Sevenoaks District Council has been faced with ongoing reductions in Government Support culminating in it no longer receiving Revenue Support Grant from 2017/18. 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 On 7 November 2013, Cabinet approved the Corporate Plan which set out key focus areas for the organisation including the need to become more financially self-sufficient. The agreed plan articulated 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.
- 3 On 22 July 2014, Council agreed the Property Investment Strategy with specific criteria. The criteria were updated at Council on 25 April 2017 and the current criteria are included at Appendix A.

Funding Agreed to Date

- 4 A total of £43m of funding for the Property Investment Strategy has been agreed to date as follows:
 - £5m Council 22 July 2014
 - £3m Council 17 February 2015
 - £10m Council 21 July 2015
 - £25m Council 25 April 2017

Activity to Date

- 5 A summary of the expenditure to date is included in the following table:

Date	Activity	Total Cost £000	Average Annual Income Yield %
Activities achieving the required return			
Apr 2015	Suffolk House (including refurb.) (office)	4,721	7.7% (7.1% before refurb.)
May 2015	Swanley Petrol Station and Supermarket	2,566	6.7%
Mar 2017	26-28 Pembroke Road, Sevenoaks (office)	4,673	6.1%

Other Activities			
Feb 2015	Swanley Working Men's Club (including demolition)	1,393	-
2016/17	Quercus 7 set up costs	13	-
Feb 2017	96 High Street, Sevenoaks (retail, office)	4,336	Initially 2% Basic option 7% Other options 7%+
May 2017	Croft Road, Westerham (housing option)	100	
	Total	17,802	

- 6 The above activity has used £17.802m of the £43m approved, therefore £25.198m is unspent.
- 7 **Swanley Working Men's Club** (February 2015) - The premises were demolished in July 2016. This site will be part of the gateway to Swanley. Feasibility studies are being undertaken to establish viable redevelopment options for this site which take into account its location in the Town Centre and requirement to meet the Property Investment Strategy return on investment criteria. This work is linked to the sites at 27-37 High Street and White Oak in Swanley that are referred to later in the report.
- 8 **Suffolk House, Sevenoaks** (April 2015) - This office building is in a town centre location with diminishing levels of office stock in the area. It consists of a total of 16,699 sq ft of office space over four floors with 84 parking spaces. It is managed by a property management company with costs recoverable under a service charge. Several floors have now been refurbished to grade A standard office space and the price per square foot is now significantly higher than when the building was purchased. The remaining vacant space in part of the ground floor is being advertised. Negotiations are currently in hand with interested parties who wish to take a lease on the space.
- 9 **Swanley Petrol Station and Supermarket** (May 2015) - The property comprises a 2,789 sq ft convenience store building with 15 car parking spaces, 8 multi-fuel pump forecourt with jet wash and car wash on a 0.589acre site. The property is let on a lease expiring in August 2030.

- 10 **Quercus 7 set up costs** - expenditure was approved by Council on 31 March 2015 to be funded from the Property Investment Strategy Reserve.
- 11 **96 High Street, Sevenoaks (February 2017)** - This premises consists of ground floor retail space, 1st and 2nd floor office space with residential potential and development opportunity to rear. The most basic option of refurbishing the office space and selling the land to the rear will give a 7% annual return. The land at the rear is next to a council car park which in turn is next to the bus station and therefore has the potential to be a catalyst for wider development. Initial feasibility work is underway on the options for the site which will take into account its location in the Town Centre and requirement to meet the Investment Strategy return on investment criteria. Options are also being considered for a 'meanwhile use' of the first and second floors to generate additional income prior to any redevelopment options being implemented.
- 12 **26-18 Pembroke Road, Sevenoaks (March 2017)** - This is a modern freehold office investment in Sevenoaks town centre. The 10,499 sq ft building over three floors has 56 car parking spaces is currently fully let on a ten year lease.
- 13 **Croft Road, Westerham** - This land has been sold to a developer to build 18 residential units. The council has taken up an option to acquire two houses at a discount (based on external valuation). It is proposed to sell the properties and the first property will be completed and ready for sale in June 2018.
- 14 All acquisitions have been supported by a thorough business case and approved by the Policy & Performance Portfolio Holder in consultation with the Finance Portfolio Holder as required by Council.

Property Investment Strategy Income

- 15 The 10-year budget approved by Council on 21 February 2017 included net Property Investment Strategy income of £500,000 in 2017/18 and £735,000 in 2018/19.
- 16 Net income of £545,000 is forecast in 2017/18, therefore £45,000 above the budget. The increased budget for 2018/19 is expected to be achieved due to rent free periods in Suffolk House expiring and the occupation of vacant space.

Funding Sources

- 17 The £17.8m spent to date has been funded by (or is expected to be as part of the 2017/18 annual accounts process):
 - Property Reserve and Financial Plan Reserve £4.6m. Funds put aside for the Property Investment Strategy agreed as part of the annual budget setting process including New Homes Bonus.

- Capital receipts £8.9m. Proceeds from the sale of council assets.
 - Internal borrowing £4.3m. From council balances. No interest is paid but Minimum Revenue Provision (MRP) is charged. MRP is the minimum amount which must be charged to the revenue account each year and set aside as provision for repaying loans and meeting other credit liabilities. This is a requirement for any form of borrowing so that an amount is set aside to repay the loan. An MRP charge of £145,000 is forecast in 2017/18.
 - External borrowing £nil. This funding method incurs interest and MRP costs each year.
- 18 Funding options will be considered on a case by case basis and may be funded by reserves, capital receipts, internal borrowing or external borrowing. Due to current commitments it is likely that a significant proportion will come from external borrowing (PWLB 30 year annuity loan interest rate at 16/01/18 is 2.74%).
- 19 Each scheme will also be analysed to decide whether it is preferable to proceed as the council or via Quercus 7. £5m of the approved Property Investment Strategy funding has been earmarked for Quercus 7.
- 20 As investment in the Property Investment Strategy continues to increase and the requirement to obtain external borrowing becomes more prominent, the Finance Portfolio Holder is keen that the 'gearing' of funding of the council's investment properties remains below 30%.
- 21 Gearing refers to the level of an organisations debt related to capital and expressed in percentage terms. For this council's purposes it is taken as the amount of external borrowing used to fund investment properties (including those outside of the Property Investment Strategy) as a percentage of the value of investment properties.
- 22 As no external borrowing has been used to fund the current investment properties, the gearing ratio is 0%. If the remaining £25m approved for the Property Investment Strategy was spent, up to £15m could be funded from external borrowing to keep the gearing ratio below 30%.

Future Opportunities

- 23 The following projects are expected to progress as part of the Property Investment Strategy.
- 24 **Swanley** - a separate report will be presented to Members at an appropriate stage, therefore the funding requested in this report is not required to fund these schemes. The sites are:
- Bevan Place / 27-37 High Street, Swanley - potential for residential units and business start-up space.

- White Oak Leisure Centre
- 25 **Timberden Farm** - The majority of land has been sold. The agricultural buildings have currently been retained and feasibility design work undertaken on the conversion of two of them. The intention is to obtain planning permission for their conversion in Spring 2018 and then dispose of the buildings.
- 26 **Small sites development** (including Stangrove Estate and Spitals Cross, Edenbridge). A consultation event is being held at the end of January for the community to comment on improvements to parking, management of open space and trees together with a new local shop and some new homes on the Stangrove Estate. Feasibility schemes have been prepared for Kemsing and two sites in Swanley.
- 27 Due to the number of developments planned for the next few years it is recommended that the emphasis for any further acquisitions are for sites where no further work is required rather than those with development potential.

Risks

- 28 The risks of the Property Investment Strategy are included in Appendix B. The risks were previously analysed by the Audit Committee on 9 September 2014.
- 29 The Council's Strategic Risk Register was also agreed by the Audit Committee on 26 September 2017 and the relevant category for the Property Investment Strategy is also included in Appendix B.
- 30 Property Investment is inherently more risky than leaving reserves in the bank but this has been taken to account when approving the Property Investment Strategy and setting the investment criteria.
- 31 The risks of each potential investment are considered by carrying out due diligence to include the following:
- Valuation.
 - Market conditions.
 - Covenant strength of tenants.
 - Terms of leases.
 - Structural surveys.
 - Funding options.
 - Future costs.

- 32 It should be recognised that there is likely to be a time when there are business reasons to dispose of assets currently owned and invest elsewhere instead.
- 33 The Scrutiny Committee set up a Property Investment Strategy Member Working Group at their meeting on 5 July 2016 and reported their findings at the Scrutiny Committee on 30 March 2017.
- 34 The Member Working Group concluded that the benefits of the Property Investment Strategy do outweigh the risks, provided that the council remains constantly aware of changes in the market and financial risks.
- 35 Internal Audit have recently completed an audit report on the Property Investment Strategy. The audit opinion given in the report was of full assurance.
- 36 The audit report conclusion was as follows: “Audit fieldwork confirmed effective governance and financial arrangements are in place for the delivery of the Property Investment Strategy. The attainment of set objectives is being achieved. Existing arrangements are fit for purpose for the delivery of the Strategy and comply with Council procedures.”
- 37 The Government has recently completed a consultation on the proposed changes to the Prudential Framework of Capital Finance. It is unclear what changes will result from this consultation but there may be new restrictions as to what type of investments external borrowing can be used for.

Key Implications

Financial

As previously stated in this report, the Property Investment Strategy is a major contributor to deliver the aim of the council remaining financially self-sufficient.

It is expected that a significant proportion of future Property Investment Strategy funding will be provided by external borrowing. Each acquisition will be looked at on a case by case basis to ensure that the most appropriate funding method is used.

Legal Implications and Risk Assessment Statement.

Legal resources would be required to undertake legal pre-purchase due diligence for any future acquisitions. This would be undertaken either internally by the Council’s Legal Team or externally and a decision would be made on a case by case basis.

A full risk analysis is included at Appendix B to this report.

Equality Assessment

The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act. There is no perceived impact on end users.

Value for Money and Asset Maintenance

Value for money derived from available finances when looked at in conjunction with the Treasury Management Strategy has the ability to be increased via the Property Investment Strategy.

Conclusions

In acknowledgement of the position with Government Support and the continued low returns on investment of reserves, further investment in the Property Investment Strategy will continue to support the alternative approach as indicated by the approved Corporate Plan.

Appendices

Appendix A - Property Investment Strategy

Appendix B - Property Investment Strategy - Risk Analysis

Background Papers

[Report to Council 22 July 2014 - Investment Strategy](#)

[Report to Audit Committee 9 September 2014 - Investment Strategy Risk Register](#)

[Report to Council 17 February 2015 - Budget and Council Tax Setting 2015/16](#)

[Report to Council - 21 July 2015 - Property Investment Strategy](#)

[Report to Council - 25 April 2017 - Property Investment Strategy Update](#)

Adrian Rowbotham

Chief Finance Officer

Lesley Bowles

Chief Officer Communities and Business