

## PROPERTY INVESTMENT STRATEGY UPDATE

### Cabinet - 14 February 2019

Report of	Chief Finance Officer's
Status	For Decision
Also considered by	Finance Advisory Committee - 29 January 2019 Council - 26 February 2019
Key Decision	No

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**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 are currently overachieving the income budgets previously agreed by Members. This report provides an update on those acquisitions.

In a changing property market it is important to review the criteria of the strategy on a regular basis.

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

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### **Recommendation to Finance Advisory Committee:**

- a) That the report be noted.
- b) Forward comments to Cabinet including recommended changes to the Property Investment Strategy criteria.

### **Recommendation to Cabinet:**

- a) Cabinet considers any comments from Finance Advisory Committee and notes the report.
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- b) Any changes to the Property Investment Strategy criteria be recommended to Council

**Recommendation to Council:**

Council agrees the updated Property Investment Strategy criteria recommended by Cabinet.

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**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 £50.3m of funding for the Property Investment Strategy (including the Sennocke Hotel) has been agreed to date as follows:
  - £5m Council 22 July 2014
  - £3m Council 17 February 2015
  - £10m Council 21 July 2015
  - £7.3m (total spend) Sennocke Hotel Council 3 November 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 %
<b>Activities achieving the required return</b>			
Apr 2015	Suffolk House, Sevenoaks (including refurb.) (office)	4,837	9.1% (7.1% before refurb.)
May 2015	Swanley Petrol Station and Supermarket	2,566	7.2%
Mar 2017	26-28 Pembroke Road, Sevenoaks (office)	4,673	6.0%
Aug 2018	Sennocke Hotel, Sevenoaks	7,332	6.3%
<b>Other Activities</b>			
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	Currently 2.7% Basic option 7% Other options 7%+
May 2017	Croft Road, Westerham (housing option)	100	
	<b>Total</b>	<b>25,250</b>	

6 £25m of the £50.3m approved is therefore 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. All 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. All space is currently let and a return of over 9% is being achieved.
- 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, 1<sup>st</sup> and 2<sup>nd</sup> 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. A 'meanwhile use' has been found for the remainder of the property. The first and second floors have been let to the Second Floor Studios CIC, which has converted the space into 19 artists studios and this agreement lasts until 2021.
- 12 **26-28 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 an agreed price formula). It is proposed to sell the properties and the first property was completed in August 2018. In the light of current market conditions consideration is being given to holding the property in Quercus 7 Ltd and letting it until market conditions improve
- 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.
- 15 **Sennocke Hotel (August 2018)** - The 83 bed Premier Inn was completed in July 2018 and opened for trading on 4<sup>th</sup> August 2018. The hotel scheme and the funding method were separately approved by Council but it is recognised as a Property Investment Strategy asset with the income being included in

the figures below. Following an initial rent free period, income is due to be received from May 2019 and is reflected in the increased budget from 2019/20.

### Property Investment Strategy Income

- 16 The 10-year budget approved by Council on 20 February 2018 included net Property Investment Strategy income of £735,000 in 2018/19 and £1.185m in 2019/20.
- 17 Net income of £755,000 is forecast in 2018/19, therefore £20,000 above the budget. £30,000 is also proposed to be transferred to the Property Investment Strategy Maintenance Reserve to help cover future liabilities.
- 18 It is proposed that the budget for 2019/20 be increased from £1.185m to £1.258m to reflect the income expected from the current portfolio. This is after transferring £100,000 into the Property Investment Strategy Maintenance Reserve.
- 19 It is proposed that the budget for 2020/21 - 2022/23 be increased from £1.185m to £1.311m per annum again with £100,000 per annum being transferred into the Property Investment Strategy Maintenance Reserve.

### Funding Sources

- 20 The £25.3m spent to date has been funded by:
  - Property Reserve and Financial Plan Reserve £11.5m. Funds put aside for the Property Investment Strategy agreed as part of the annual budget setting process including New Homes Bonus.
  - Capital receipts £9.5m. 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 £150,000 is forecast in 2018/19.
  - External borrowing £nil. This funding method incurs interest and MRP costs each year.
- 21 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 02/01/19 is 2.63%).

- 22 A Member Working Group is currently investigating Income Strip Funding as an additional funding source (as requested by Council) and depending on their findings, this may be a more beneficial way of funding some schemes.
- 23 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.
- 24 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%.
- 25 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.
- 26 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**

- 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.
- 28 Current developments being investigated include industrial units as the portfolio does not currently include any assets in this category.
- 29 Work on current property holdings in Swanley and Sevenoaks High Street are continuing.
- 30 **Small sites development** (including Stangrove Estate and Spitals Cross, Edenbridge). Following a consultation with the local community on improvements to parking, management of open space and trees together with a new local shop and some new homes on the Stangrove Estate, further work has been carried out on the proposals. It is likely that they will be progressed in 2019.

Feasibility schemes have been prepared for a site in Church Road, Kemsing and two sites in Swanley. A planning application for three accessible bungalows on land owned by the Council at Church Road, Kemsing will be submitted in the summer of 2019. Scheme designs are being finalised prior to a public information event for two sites Russett Way and Alder Way, Swanley.

- 31 **Otford Road Park and Ride site** - This site has been included within the draft Local Plan as an employment site. There is a considerable shortage of modern light industrial units in the District and it is proposed to undertake a feasibility study for the development of employment units on this site to generate further income for the Council.

## Risks

- 32 The risks of the Property Investment Strategy are included in Appendix B. The risks are reviewed each year and were initially analysed by the Audit Committee on 9 September 2014.
- 33 The Council's Strategic Risk Register was also agreed by the Audit Committee on 16 October 2018 and the relevant category for the Property Investment Strategy is also included in Appendix B.
- 34 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.
- 35 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.
- 36 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.
- 37 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.
- 38 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.
- 39 Internal Audit completed an audit report on the Property Investment Strategy in 2017/18. The audit opinion given in the report was of full assurance.

- 40 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.”
- 41 CIPFA are currently looking to amend the Prudential Framework of Capital Finance. This may affect the ability to borrow for investments outside of the district and also to borrow in advance of need. Officers will continue to monitor this situation and report to Members if any changes are likely to affect the ability for future investments to meet the Property Investment Strategy criteria.

### Property Investment Strategy Criteria

- 42 The annual update report gives Members the opportunity to review the Property Investment Strategy criteria previously agreed. The current criteria are included in Appendix A.
- 43 Areas Members may wish to consider include:

- i. Income Yield of 5%+ when not borrowing or in excess of 3% for schemes that include some external borrowing, based on an average over 10 years. (Flexibility may be applied to those opportunities that show an acceptable social return on investment).

It may be more appropriate to set the two elements at a consistent % above different bases such as ‘Income Yield of 3%+ above the Council’s current average treasury management return (currently 0.7%) when not borrowing or internally borrowing, and 3%+ above the borrowing rate (currently 2.6% for 30 years) when externally borrowing, based on an average over 10 years. (Flexibility may be applied to those opportunities that show an acceptable social return on investment).’

- ii. Lot size of £1m - £5m

The lot size has remained unchanged since the strategy started in 2014. It was originally set at this level because at the time it was viewed that this range was above that of small investors but below that of institutional investors.

The view of Allsop (independent property consultancy) is that it has been a rising market in recent years and therefore smaller investors are now interested in the £1-5m range making it a more competitive market. The current view is that there is a natural cut off at £5m and a further one at £10m. Therefore it may be beneficial to amend the lot size to £1m - £10m.

- iii. Individual Properties or Portfolios / Lot size of £1m - £5m

If buying a portfolio of properties or a number of flats/units in a building, the current criteria limits the total size of each scheme to £5m. It may be more appropriate to apply the limit to individual properties within a portfolio or individual flats/units in a building.

- iv. Investment opportunities are restricted to those within a 50 mile radius of the Council's Argyle Road offices.

This may need to be changed in future as CIPFA are reviewing whether council's should be able to borrow for investments outside of their area.

- 44 The Property Investment Strategy criteria also applies to Quercus 7 for private sector residential acquisitions.

## **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 ensure that the Council remains financially self-sufficient.

**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**