

## **COUNCIL**

**12 OCTOBER 2017**

### **DIRECT PROPERTY INVESTMENT – ADDITION TO THE CAPITAL PROGRAMME**

Portfolio Holder: Councillor Alan Jarrett, Leader  
Councillor Adrian Gulvin, Resources

Report from: Perry Holmes, Chief Legal Officer  
Phil Watts, Chief Finance Officer

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#### **Summary**

The purpose of this report is to seek Council approval to add a further £20 million to the capital programme to allow direct investment in commercial and other non-operational property to generate rental income and longer term capital growth.

#### **1. Budget and policy framework**

1.1 The management and maintenance of the Council's corporate property portfolio is a Cabinet responsibility and additions to the capital programme are a matter for Full Council. Cabinet Property transactions over £500,000 are to be reported to Full Council for information. The Treasury Management Strategy is agreed at Full Council after consideration by Audit Committee.

#### **2. Background**

2.1 Full Council agreed in October 2015 to add £2 million to the capital programme in order for investment to take place in non-operational property.

2.2 This followed an amendment to the Council's Treasury Management Strategy which included the addition of investment in property funds and also direct property investment. As a result of this £20 million is being invested in property funds.

2.3 The investment of £2 million in non-operational property has now been successfully completed.

2.4 An amendment was made to the Constitution after agreement by Full Council on 12 January 2016 to delegate authority to the Chief Legal Officer in

consultation with the Leader, Portfolio Holder for Resources and Chief Finance Officer to acquire, manage, let and dispose of suitable investment properties where funded from provision made for this purpose in the Council's Capital Programme, and that the requirement to seek a Cabinet decision on any transactions exceeding £100,000 is waived only in respect of non-operational investment property transactions covered by this delegation.

2.5 Corporate Investment criteria were subsequently developed and agreed.

### **3. Direct Property Investment**

3.1 In order to generate improved investment returns from cash balances, the Chief Finance Officer proposed a widening of the Treasury Management Strategy to encompass investment in property which was approved at Full Council in October 2015. Investment in externally managed local authority property funds has now taken place with further funds to be invested. Investment directly in property in Medway via the capital programme has also taken place.

3.2 The Council through its Valuation and Asset Management Team has a good track record of achieving reasonable rental returns on its current portfolio of assets, including not just those sites acquired as 'pure' investments, but also those which the Council holds as part of its regeneration agenda. Rental returns range from peppercorn to almost 20% of market value and circa £20.1 million of property is delivering rental returns in excess of 5%. In total, this rental income amounts to around £1.09M. The vacancy in the Britten Farm site is affecting that performance detrimentally but the rest of the portfolio continues to achieve positive returns.

3.3 After the approval for investment was agreed by Full Council, the £2 million was invested in buying out the requirement to pay a rent to Peel Ports and by purchasing five two and three bedroom houses and one larger block of four units in Medway. All were let quickly through liaison with the Council's Strategic Housing team. The process involved identifying properties, applying the agreed corporate investment criteria and then acquiring the properties. Local agents were used to seek properties, recovering their fees from vendors. First offers on the residential premises were made in August 2016 and completions took place between October and early February 2017. The process was time consuming and involved the Capital Projects Team, Valuation and Asset Management Team, Planning Team and Legal Services Team. The costs for each of these teams were recovered from the capital sum. Overall the investment is returning 5%+ and the capital assets acquired are increasing in value with the local market.

3.4 The Chief Finance Officer has advised that the Council could invest up to a further £20 million in investment property funded by taking out additional loans. Borrowing from the Public Loans Works Board (PWLb) over, say, a 50 year period would currently be at a cost of 2.7% in interest and 2% in minimum revenue provision (MRP) to repay the principal, total 4.7% per annum. There are some suggestions of an interest rate rise in the autumn so this figure could be higher at, say, 5.25%.

3.5 The Chief Finance Officer has also advised that neighbouring Councils have successfully adopted similar investment strategies to the one proposed and received national recognition in one case. Their approach has been to look for

investments in the region of £5 to £15 million to avoid either competing with smaller investors at one end of the scale or large institutional investors at the other. Hence, the suggested addition of £20 million at this stage to allow some flexibility in seeking appropriate investments. Further advice on the types of commercial and other property to consider can be taken from specialist agents who could be retained to take a more active role in this proposal.

#### **4. Options**

- 4.1 A key component of the Council's financial plans must be to maximise the contribution made by its property assets and this can be achieved through a portfolio approach looking to invest both in non-operational commercial premises and residential units.
- 4.2 Investment will be undertaken both in Medway and wider afield. Local investment in Medway has a number of benefits such as officers' local knowledge, ease of geographical access for surveys and management, plus the additional benefits possible such as easing pressure on temporary accommodation numbers or advancing regeneration or economic growth. Investment wider afield also has benefits such as access to a wider and more diverse portfolio of commercial premises.
- 4.3 A strategy of investing in property to generate annual rental income and longer term capital growth has the potential to deliver greater returns than leaving surplus cash balances on deposit or taking the decision not to make such investment.

#### **5. Advice and analysis**

- 5.1 Cabinet considered the Capital Budget Monitoring report 2017/18 Quarter 1 on 8 August 2017, where it was reported that a revenue pressure of £1.9 million will need to be dealt with this year to balance the budget. Cabinet is also aware of the Medium Term Financial Strategy reporting £4 million of pressure for 2018/19 with further pressures in subsequent years.
- 5.2 The Council has taken a number of steps to alleviate revenue pressures and to take a longer term strategic approach to implement a commercial strategy to secure external income in subsequent years through the activity of Medway Norse and the Medway Commercial Group. Cabinet in September approved the setting up of the Medway Development Company Limited to develop housing sites on Council land for profit.
- 5.3 Generating income by investing in non-operational properties is an additional option for the Council as it seeks to respond to budgetary pressure.
- 5.4 The Council has a framework for property agents which in the first instance may provide sufficient access to investment opportunities. If that is not the case the Council can either run a procurement process to engage other agents or seek to use other frameworks in existence.

#### **6. Financial and legal implications**

- 6.1 The financial and legal implications are set out in the body of the report.

## 7. Risk management

7.1 The following potential risks have been identified:

<b>Risk</b>	<b>Description</b>	<b>Action to avoid or mitigate risk</b>	<b>Risk rating</b>
Financial	Inability to locate appropriate investment properties delays the generation of investment income.	Use of agents through the Council's consultancy framework to identify suitable investments.	Low
Financial	Vacancies of let properties, tenant default and bad debt reduce rental returns and capital values.	Careful consideration of investment properties and tenants before acquisition/letting.	Medium
Financial	Reduction in capital and/or rental values.	Careful consideration of investment properties before acquisition/letting against an agreed criteria.	Medium
Financial	Increase in interest rates reduces investment income.	Long term borrowing through the PWLB or similar.	Medium

## 8. Recommendations

8.1 Council is asked to approve a £20 million addition to the capital programme to allow for further investment in property so that the delegated authority set out in paragraph 2.4 above can be exercised.

8.2 Council is requested to delegate authority to the Chief Legal officer in consultation with the Leader, Portfolio Holder for Resources and Chief Finance Officer to agree a strategy and a robust set of criteria for investing the £20M in property which compliments the Council's current investment priorities of security, liquidity and yield.

### Lead officer contact

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### Appendices

None

### Background papers

None