

Report to: Audit, Best Value and Community Services Scrutiny Committee

Date of meeting: 22 March 2018

By: Chief Operating Officer

Title: Property Asset Disposal and Investment Strategy

Purpose: To provide the Audit Best Value and Community Services Scrutiny Committee with a draft Investment Strategy that supports the Council's four priority outcomes. The strategy will be presented to the Cabinet meeting on 24 April 2018.

RECOMMENDATIONS: The Committee is recommended to:

- 1) Receive and provide feedback on the draft Property Asset Disposal & Investment Strategy contained in Appendix 1 of the report;**
 - 2) note the governance and resource arrangements required to deliver the Strategy;**
 - 3) note that any initial revenue costs of funding initiatives that will deliver enhanced income and capital receipts in the longer term will be considered as investment proposals against the Council's Transformation reserve which is delegated to the Chief Executive to approve; and**
 - 4) note that any capital investment into assets will be subject to Cabinet approval of business cases developed to support the investment consideration.**
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1. Background

- 1.1 Given reductions in grant funding, many local authorities have adopted income generation strategies as a means of securing alternative sustainable funding sources. East Sussex County Council (ESCC) has a well-established Income Generation Group and the intention is, during 2018/19, to broaden its focus into wider 'commercialisation', to support the County Council to operate successfully in a largely self-financing local government finance environment. This will also be informed by the combined Peer Review undertaken through the Local Government Association (LGA) to consider commercialisation across the whole County.
- 1.2 Previous discussions through Cabinet and the Audit, Best Value and Community Services Scrutiny Committee regarding property investment indicated that members were generally supportive of investing in development and building up a portfolio of new income producing assets within East Sussex where it could meet the objectives of providing an investment return and support delivery of the Councils four priority outcomes.
- 1.3 Cabinet and the Audit, Best Value and Community Services Scrutiny Committee gave a strong direction to officers that, at this stage, borrowing to invest in specific property assets in the property market purely for financial return was not a priority for the Council. The Council's Treasury Management strategy has been developed to incorporate investment into pooled property and mixed asset funds utilising the cash the Council has available for investment in the context of the Treasury Management Strategy priorities around balancing security, liquidity and return.

- 1.4 In response to such comments and feedback, the accompanying strategy outlines a framework that intends to support the delivery of the Council's priority outcomes, noting the likely risks and returns to be achieved from such a strategy. It is acknowledged that there is an inherent risk in property development and ownership and that property values (and the income derived from such properties) will fluctuate over time.
- 1.5 In December 2017, the Chartered Institute of Public Finance and Accountancy (CIPFA) published revised Prudential Code for Capital Finance and Treasury Management Codes of Practice. Following this, in February 2018, the Ministry of Housing, Communities and Local Government (MHCLG) updated its statutory guidance on local government investments and minimum revenue provision. The updates reflect the changing nature of the public sector and seek to improve the understanding and transparency of the risks and rewards associated with a wider range of investments, commercialism and financial support to other bodies and the impact on long term financial sustainability. Any investments under the new Property Investment Strategy will need to adhere to these codes and guidance.

2. Investment Strategy

- 2.1 To position an investment strategy that meets ESCC priorities, the recommendation is to adopt an approach that looks at a combination of direct property investment and development opportunities, with the Council making these investments alone or in partnership, predominantly within the local administrative area. There may also be opportunities for the Council to provide development loans to partner or third party organisations where this contributes to the achievement of improved economic outcomes in the County, in line with its corporate objectives.

3. Legal Framework

- 3.1 The report considers the framework under which Councils can acquire property assets and the General Power of Competence introduced in the Localism Act in 2011, which other Councils have in particular relied upon to support their investment strategies.

4. Financial Framework

- 4.1 The Council may fund its investments through using its reserves, capital receipts and prudential borrowing. The report considers the latter two sources in particular, noting that the Council's reserves are managed under a separate Treasury Management Policy and supporting strategy
- 4.2 The strategy considers the level of risk and associated return for the various strands of property investment and development and seeks to ensure an appropriate balance between direct/indirect investment/development is maintained to mitigate such risks, whilst maintaining a meaningful positive net return to the Council. It should be noted that a strategy that focusses more heavily on direct development to enhance economic growth will involve greater risk, and more up-front expenditure but potentially higher returns.
- 4.3 As local authorities are increasingly investing in non-financial yield bearing investments, the MHCLG recognises that a one size fits all approach is not suitable given the increasing variation in the objectives and nature of local authority investment activity. At the same time, the Government recognises that local authorities have a key role in local economic regeneration, and this may mean that councils choose to take on projects that the private sector would not consider.

5. Existing Assets & Improving Service outcomes

- 5.1 The County Council's Corporate Property Asset Management Plan (CPAMP) sets out objectives and targets applied in managing the property portfolio and is part of the suite of documents that align to the Corporate Plan priority outcomes. The CPAMP seeks to ensure that assets are managed efficiently and sustainably noting the emphasis over recent years has been on factors relating to cost minimisation of the "operational" estate.
- 5.2 Through service planning activity work, surplus or potentially surplus assets are identified enabling the property team to review opportunities for the future. There is an established protocol that circulates potentially surplus asset information to all services ahead of investigating potential alternative options.
- 5.3 Alternative options will always seek to consider best value outcomes which may include a range of options along the spectrum from "dispose to hold" (i.e. immediate sale, to added value activities ahead of sale work, to retention for alternate use, collaborative or community uses etc.). Options around collaborative projects may involve our SPACES or East Sussex Better Together (ESBT) partners and co-investment opportunities can form part of wider regeneration, place making and/or whole system led service improvements.
- 5.4 The Asset Disposal element of the Investment Strategy seeks to optimise the capital (as a result of a disposal) or revenue (as a result of the asset being held as an investment) return to the Council through a robust Options Analysis exercise of each surplus asset. This is to ensure the most appropriate option is pursued taking into account the size of the asset, scale of the receipt/revenue, resource required to deliver it and the risks associated.

6. Governance

- 6.1 Appropriate Governance arrangements are detailed in the strategy report, with differentiation recognising the existing delegated powers held by the Chief Operating Officer and Chief Property Officer, and the proposal to establish an Investment Board to provide appropriate due diligence evaluation to any proposals for investment or disposal.
- 6.2 Officers in Property and Finance will provide advice on each proposal coming forward to the relevant decision making party. This advice will include how each investment proposal could be taken forward, including a consideration of the risks, how the opportunity is structured and financed. All investments will require a robust business case to ensure that the investment is affordable, sustainable and provides value for money. The governance process will be subject to periodic review to ensure that it is fit for purpose and supports the achievement of the desired outcomes for the strategy.
- 6.3 All decisions (by Chief Operating Officer, Chief Property Officer or by the Investment Board), and the performance of investments will be subject to the scrutiny of the Audit, Best Value and Community Services Scrutiny Committee.

7. Resource Implications

- 7.1 The Property Asset Disposal and Investment Strategy would be delivered and supported by key officers in Property, Finance and Legal Services. It should be recognised though that a key constraint is the availability of specialist resource and therefore it will be important to assess required capacity for both Operational and Investment activities, whether held directly by the Council or through a subsidiary company.
- 7.2 Resource modelling options have been considered and a model that allows for a control over decisions to be maintained by the Council, whilst having an ability to bolster existing internal resource with the services of a trusted advisor providing scalable resource dependant on the skills and capacity required, is the favoured option.

8. Risks & Risk Mitigation

- 8.1 There are inherent risks in property ownership and property values will increase and decrease in line with the market. Investment is subject to inherent economic and market risks which will require a balanced portfolio of investments to be built up over time. Vacant property attracts additional risks and liabilities, in the form of council tax, security, utility costs and management which will continue to be borne by the Council until a property is let/sold or demolished.
- 8.2 Carrying out direct development activities (design, build and management), or providing debt or equity finance involves risks that are not necessarily present in the current policy of selective disposals within the operational estate. Whilst it is anticipated that each business case would be subject to clear evidence, advice and programme management to support targeted outcomes, these proposed activities carry specific and non-specific risks that are not always easy to predict or model which can reflect on the overall financial outcome.
- 8.3 Retaining a property for the revenue return and granting a lease interest to a third party, thereby creating an investment product, exposes the Council to the additional risks of retaining property ownership and ensuring the resource and mechanisms are in place to manage the property effectively. This will include rent collection, facilities management, service help desk and ongoing estate/ asset management and valuation processes.
- 8.4 To aid in the mitigation of such risks, the internal team will require the appointment and the assistance of external advisors to help support the team in implementing the strategy and scaling the resource necessary as the strategy develops.
- 8.5 The Investment Board will consider robust business cases which will consider appropriate mechanisms (Scoring Matrix and Option Appraisals) for evaluating and approving projects, supported by senior officers in Property, Finance and Legal services, before being recommended to Cabinet. The decisions of the Investment Board will be subject to scrutiny by the Audit, Best Value and Community Services Scrutiny Committee, and the performance of the Property Asset Disposal and Investment Strategy will be reported to Cabinet on an annual basis.
- 8.6 From 2018/19, a new accounting standard, International Financial Reporting Standard (IFRS) 9 – Financial Instruments will be adopted. The aim is to ensure that the fair value of gains and losses of financial assets are reported transparently, fairly and consistently. The rule changes mean that for some types of investment, the statement of accounts would have to show the impact of unrealised losses on

general balances. The MHCLG are currently considering whether to allow a statutory override to remove this impact. In addition, the standard requires that the impairment of financial assets must be recognised at inception rather than wait until an actual loss occurs. For example, loans to other entities will need to be assessed for the likelihood of default at the start of the loan and throughout the life of the loan. Loss allowances will then be charged to revenue and updated annually. Any investments under the new Property Investment Strategy will need to take account of the potential impact of IFRS9 on council tax and balances.

9. Conclusion and reasons for recommendations

- 9.1 The development of a Property Asset Disposal and Investment Strategy, covering investment in assets already producing an income and investment in development opportunities that support the Council's ability to enhance its financial resilience in the longer term, will act as a catalyst for improved economic outcomes for the County. The financial returns delivered from the strategy will support the Council in continuing to deliver its essential services to residents. The proposed approach is based upon the following key principles;
- Invest in schemes that align with and support the Councils four priority outcomes.
 - Invest in income producing assets within the County, creating a diversified portfolio to manage risks and secure an annual return.
 - Retaining assets where appropriate and undertaking effective property and asset management initiatives and investment to enhance income or capital receipts.
- 9.2 The Council will manage these investments by establishing an officer Investment Board. The Board will oversee property asset disposal and investment decisions that are delegated to officers to manage and recommend business cases to Cabinet for Cabinet approval where capital investment is sought.

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LOCAL MEMBERS

All

BACKGROUND DOCUMENTS