APPENDIX 1

# PROPERTY ASSET AND INVESTMENT STRATEGY 2018/19

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## 1. INTRODUCTION

1.1 This strategy explores and positions the role that Property can play in shaping and influencing the Council's wider corporate priorities as well as being a means to generate capital receipts or revenue or a combination of both through an Asset & Investment Strategy.

1.2 It provides a framework by which East Sussex County Council (ESCC) can consider the means by which the existing asset base can deliver capital receipts and/or revenue returns and the ability to facilitate current and future service and locality needs. As a second phase, the strategy could seek to invest in property solely for the purposes of achieving an investment return which provides additional income to contribute to the funding of Council priorities.

1.3 The strategy recommends robust governance arrangements that would be appropriate for such a strategy, ensuring an open and transparent approach to property decisions recognising and taking into account alternative options that may be available to the Council.

## 2. THE ROLE OF PROPERTY

2.1 The Property service, and in particular the Asset Strategy and the Investment & Disposal teams, acts as an internal partner to ESCC services, assisting frontline services in the provision of suitably specified and sustainable buildings within a location that can deliver an optimal service to the identified user groups.

2.2 By identifying opportunities that can deliver effective property solutions, the Property service can ensure services are securing value for money in the constrained financial environment within which the public sector now operates, whilst at the same time exploring, where possible commercial opportunities that may also exist providing the Council with the opportunity to generate capital and/or revenue following investment or redevelopment of the asset.

2.3 The County Council's Corporate Property Asset Management Plan (CPAMP) sets out objectives and targets applied in managing the property portfolio and are part of the suite of documents that align to the Corporate Plan priorities. 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.

2.4 Service planning is fundamental to the development of asset strategies at both a portfolio and asset level, and by working with services to identify, and support, their current and evolving models of delivery, assets can be better matched with need, giving the potential to both improve service outcomes and reduce cost (both capital and revenue).

2.5 Through a wider engagement with other public sector bodies such as the NHS, Police and Fire Service and in particular as a result of the SPACES (Strategic Property Asset Collaboration in East Sussex) group, the Property Service can identify the supply and demand for service use of the wider public estate. Property Services can facilitate the transition of particular service groups to sites and locations that are suited to the needs of the community, permitting potential economies of scale to be realised and a co-location approach to be fostered between services, focused on delivering a locally based need.

## 3. ASSET & INVESTMENT STRATEGY

3.1 This strategy seeks to position an Asset & Investment Strategy that addresses the joint priorities of:

- providing support and to be an enabler to services in the delivery of their property strategy,
- exploring income generation from property,
- optimising capital receipts, and
- promoting economic growth across the county.

3.2 Further, the strategy looks at a combination of investment and development opportunities across the county, with the Council making such investments alone or in partnership with other authorities in the local administrative area or with a third party. There will be an emphasis on the optimisation of ESCC's existing asset base and a cautious approach to direct property investment for commercial return, as a distinct and separate second phase.

3.3 This is outlined in the Four Quadrant approach that has been developed, as shown in the table below, noting that some property activities are common or available to each quadrant:

| | Activity | Activity |
|---|---|---|
| Operational Assets | Optimise Receipt / Revenue from Disposal<br>Section 5 | Development for Corporate Priorities / Service Need<br>Section 6 |
| | | |
| Investment Assets | Phase 2<br>Direct acquisitions of up and let investments<br>Section 7 | Direct development or provision of Equity or Debt finance<br>Section 8 |

3.4 Changes in the way in which services are delivered across the County may release surplus assets for disposal. In the past there has been a piecemeal approach, with the sale process adopted for an individual site being in accordance with the market circumstances prevailing at the time. This has led primarily to sales conditional on planning, where the purchaser secures planning consent and then completes on the asset purchase (or not if planning is unforthcoming), or sales on an unconditional basis but possibly with top up arrangements in the event planning is secured for alternative use.

3.5 An alternative approach is to link activities to the Council's corporate strategy and consider various options, in particular promoting economic growth within the county, of which the availability and supply of housing is a key factor. This strategy may still seek to optimise capital receipts from surplus property assets, where it is appropriate to do so.

3.6 Previous discussions through Cabinet and Audit Best Value and Community Services Scrutiny Committee regarding property investment indicated that members were generally supportive of building up a portfolio of new income producing assets, but with a preference that such development and investment be focussed within East Sussex where it could meet such joint objectives of income generation and supporting the Councils 4 priority outcomes, utilising, in the main, the existing council owned asset base.

3.7 In response to such comments and feedback, the strategy intends to meet both of these objectives, noting the higher level of risk and returns that may be prevalent in this approach and acknowledging that there is an inherent risk in property ownership and that property values (and the income and capital receipts derived from such properties) will fluctuate over time.

3.8 The proposed governance structure will consider the business case proposals for such development and as a distinct and separate second phase would also consider and support direct acquisitions of existing let investments (purely for commercial return).

## 4. OPERATIONAL ASSETS

4.1 The core focus of the strategy will be on the optimisation of the Council's existing asset base to deliver capital receipts and/or revenue from the sale of surplus properties or the development of those assets for service use and/or to meet the council's corporate priorities, including housing as a means of delivering economic growth.

4.2 Through service planning activity work linked to SPACES, surplus or potentially surplus, assets are identified enabling the property team to review opportunities for the future. There is an established protocol whereby Property circulates potentially surplus asset information to all services ahead of investigating potential alternative options.

4.3 Alternative options will always seek to consider best value outcomes which may include a range of options along the spectrum from immediate sale, to added value activities ahead of sale (securing planning consent for an alternative use), to retention for alternate use, collaborative or community uses etc. Options around co-location and 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.

4.4 At the point an asset becomes surplus, an Options Analysis report on a site (or basket of sites) will be undertaken which will include a recommendation as to whether to:

- Appraise the site for an identified service need (on a whole/part of the site)
- Sell a site on an unconditional/conditional on planning basis
- Sell the site upon grant of planning, for which a revenue budget will be required for the cost of planning.
- Secure planning (as above), develop and sell completed units
- Secure planning (as above), develop and sell/retain part or the whole for revenue return purposes.

## 5. OPTIMISE RECEIPT / REVENUE FROM DISPOSALS

5.1 In some instances an immediate sale (say by auction) may be recommended, particularly where the asset is of low value or where there is limited prospect of development, alternative use development.

5.2 Where however added value activities can be secured ahead of marketing, such as securing a higher value planning consent for the land, then this can be pursued either by the County (in effect to minimise risk for the purchaser and thereby enhance the land receipt) or by the County selling the site but conditional upon the purchaser pursuing planning for a new consent. Any such transfer may still be subject to certain claw back or overage restrictions that seek to secure further payments in the event of excess profits being secured, but the ability to secure such overage provisions will be dependent upon the quality of the site and prevailing market conditions at the time of sale.

5.3 With regard to freehold disposal of assets, particularly where future redevelopment is likely, there could be an opportunity to market a site on the basis of an arrangement whereby the County would commit the value of their land to a project and a third party (as development partner) pursues planning and full development, with the County receiving a share of the development proceeds and profits. However, the development partner would need to be convinced that there was the scope of opportunities coming forward that would merit this approach and that the risk/reward profile was appropriate. Given additional contract arrangements required, offering only a limited number, or a limited scale, of development opportunities may not encourage a development partner to participate in such a venture.

5.4 A further extension of this principle could see the County Council retaining some of the completed units (i.e. convert its land value and share of development profits into completed fixed assets to retain for generation of rental income).

This process would require new arm’s length corporate structures to be set up for the management of retained housing assets (as opposed to commercial), to avoid the potential for Right to Buy legislation impacting on the created asset portfolio, and be subject to further Member input and Business case reviews. As such, this element should form part of any second phase of implementation, along with any investment activity outside the county, for which a further Cabinet approval will be sought.

5.5 This latter model mirrors the basis of the Surrey County Council’s proposed 15 year joint venture with Places for People that has recently been approved and to which the County Council will have full access subject to the County Councils’ approvals process.

5.6 An example is the County Council owned site at Hindslands Polegate, which is a 2 hectare site with potential for 50+ housing units.

Does the Council wish to i) sell the site now ii) secure planning to leverage value before sale, or iii) move into development activity either directly or through a joint venture arrangement. Each activity has an increasing risk reward, timing and resource profile.

## 6. DEVELOPMENT FOR CORPORATE PRIORITIES /SERVICE NEED

6.1 The County Council has acquired property assets in the past for its own operational service needs (such as education sites) or for statutory reasons (via compulsory purchase) and has an adopted Property Acquisition Policy. Much of this activity has remained focussed on a specific service, but there is an increasing awareness, arising from collaborative working across services and with partners, for the need for assets that support wider project outcomes, as well as regeneration noted elsewhere.

6.2 In essence property is held and, if necessary, will continue to be acquired in accordance with the key priorities of the Council noted as

1. Driving Economic Growth
2. Keeping vulnerable people safe and free from harm
3. Helping people help themselves
4. Making best use of resource

6.3 Whilst the Property Acquisitions Policy outlines key principles and processes, it does not cover in any depth wider delivery opportunities and mechanisms available for services, such as direct or joint venture development or investment arrangements with service or other public/private partner providers

6.4 Where market intervention may be required to insure against market failure, timing of delivery, or even where the County may be able to leverage an existing land ownership, the County should maintain a proactive position where the risk reward of direct investment, development or joint ventures can be part of an approved business case.

Examples include:

Asset or land purchases – to support development of locality facilities - such as securing land for a care or medical facility – enabling the County to not only secure the land interest but also give further consideration to any wider investment or development opportunity that supports local communities, or new and evolving models of delivery.

Sackville House Lewes – an existing office asset owned by the County Council which could be sold for a capital receipt or, alternatively, retained to establish small business and employment units in support of economic development subject to appropriate building and facilities management.

Hailsham - Acquisition of a third party interest to secure a 100% interest in a site where identified for wider service delivery or where a party seeking to extract their capital and not obligated to the longer term plans of the Council

6.5 Approval for all acquisitions would continue to be based on the “five case” model covering Strategic, Economic, Commercial, Financial and Management parameters and thus include core topics such as:

- demonstrating how the spending proposal fits in relation to policies, strategies and plans and furthers the required outcomes

- demonstrating that the spending proposal optimises value to the public purse and outlines both cash and non-cashable benefits or outcomes

- setting out how the “preferred option” will be procured competitively, in accordance with current regulations for public sector procurement

- setting out the capital and revenue requirement for the spending proposal over the expected life span of the asset or service, together with an assessment of any wider impact upon the balance sheet or income and expenditure accounts of the County Council

- demonstrating that the spending proposal is being implemented , where appropriate, in accordance with recognised Programme and Project Management methodologies, and that there are robust arrangements in place for change and contract, the delivery of benefits and the management and mitigation of risk

6.6 In demonstrating this process each business case will also highlight the consultation process undertaken and include an Equalities Impact Assessment, where required.

## 7. DIRECT DEVELOPMENT OR PROVISION OF EQUITY OR DEBT FINANCE

### 7.1 Direct Development

The council can undertake direct development opportunities to create new assets and enhance economic and employment opportunities. Investment in development opportunities will have higher risks than purchasing an asset that is already income producing but could also provide a greater rate of return if successful. Wider benefits can also be achieved such as additional housing development, health solutions or new business premises which will in turn generate additional economic growth and accord with one of the key corporate objectives of the Council.

7.2 Such development can be undertaken solely by the council or with a development partner. A shared development would result in the Council receiving a proportionate share of the assets created, and the risks and rewards in accordance with the share of development funding provided.

### 7.3 Development loans

There may be opportunities for the council to undertake an indirect approach to property investment through the provision of development loans to public partners or third party organisations (subject to state aid legislation) where this contributes to the achievement of improved economic outcomes in the county.

7.4 The Council, as debt provider, receives a fixed rate of return determined by the interest rate on the loan and the amount invested. The loan is typically secured against the property being developed. Development loans are typically made over short periods of time, linked particularly to the construction period of an asset, allowing the capital and interest earned to be repaid and reallocated to a further project.

7.5 Third parties proposing schemes in county that meet the council’s corporate objectives could be interested in such arrangements, in the absence of the traditional sources of bank finance. Borough and District Councils have equal access to the Public Works Loan Board (PWLB) as the County and therefore may be only interested in joint funding arrangements.

7.6 Development projects could be undertaken in partnership with others, for example the Council is a shareholder in Sea Change Sussex, a not for profit organisation with 19.9% equity ownership held by ESCC, Rother DC and Hastings BC, a 30.1% holding by the University of Brighton and the balance held by a number of local business and local voluntary sector. This strategy should not compete nor conflict with the projects that this organisation is currently delivering.

## 8. DIRECT ACQUISITIONS OF EXISTING LET INVESTMENTS (Phase 2)

8.1 Given reductions in grant funding, many local authorities have adopted income generation strategies. East Sussex County Council has a well-established Income Generation Group and the intention is, during 2018/19, to broaden its focus into wider ‘commercialisation’, to help enable the County Council to operate successfully in a largely self-financing local government finance environment.

8.2 An increasing number of councils have developed property investment strategies as a means of securing sustainable long term revenue streams, but with differing attitudes towards risk, return, geographies and methodology. Typically the net income returns from property investment are higher than long term PWLB lending rates, and as such, direct property investment has the potential to generate a positive net income return.

8.3 Costs will also be incurred – in terms of staff costs, investment and other specialist advisors - and there may be occasions when there is a tenant void meaning that the council will pick up the cost of business rates and service charges, or additional capital expenditure is required to refurbish the property. The forecast returns will therefore need to be sufficient to cover the associated cost of finance for any additional borrowing required. A shared investment with another party would mean a proportionate share of the risks and rewards in accordance with the share of the asset.

8.4 An example of such a strategy would be the purchase of Caburn House in Lewes, an office investment building that adjoins Sackville House (an ESCC owned property with lettings to third party tenants). The property was on the market recently at a guide price of £2.5m, and currently produces c£200,000 of rental income, at a gross yield of c7.45% (after deducting costs of purchase).

8.5 Following a high level review of the East Sussex investment market in 2016, property consultants CBRE concluded that there was limited scope to acquire institutional quality commercial properties in county. The scope to increase the quantum of opportunities might be improved if one included areas within the immediate hinterland of the county e.g. Brighton, Crawley, Haywards Heath and Worthing. To include areas outside county would in all likelihood require the formation of a property company, as permitted by the Localism Act 2011, which permits councils to undertake activities for a commercial purpose, such as making property investments. However, if such an activity is to form a minor part of the overarching strategy, the costs associated with establishing such a vehicle and the internal and external resource/cost of running an effective company might limit the net returns to the portfolio as a whole.

8.6 The provision of appropriate resource to any company established will need to be considered, along with the level of income that is to be generated. Such revenue could be derived from either commercial investments or investments in residential units developed out as part of the adopted first phase of the investment strategy. This will be considered as a second and separate phase to the investment strategy and will be the topic of a separate Cabinet report after a period of reflection on the performance of phases one.

8.7 In comparison to an investment strategy of acquiring investments across geographies and across commercial sectors, an investment/development approach within the County will inherently attract a higher degree of risk, but such an approach should be compensated with an appropriate level of return. The blended return of lower risk direct investment in assets already producing an income and higher risk development investment would need to be managed appropriately to ensure that the risk profile is within acceptable limits.

## 9. LEGAL FRAMEWORK

9.1 The Council can acquire property under s.120 of the Local Government Act 1972, provided the acquisition is supported by a rationale which is in line with the function of the Council, which includes purchases that are for the benefit, improvement and development of the County.

9.2 Section 1 of the Localism Act 2011 introduced a new General Power of Competence. Under the provision, a local authority has the power to do anything that individuals generally of full legal capacity may do. The Act is drawn very widely and includes reference to commercial activities and does not have to be in benefit of the local authority's area. However an activity that is undertaken purely on commercial grounds has to be delivered through a company.

9.3 On the understanding that the primary focus of any adopted investment strategy is within county, this report does not provide in any detail the mechanisms and governance processes for establishing a property investment or holding company. This would be kept under review in line with any progression to phase two or any further adaptation of the adopted strategy.

## 10. FINANCIAL FRAMEWORK

10.1 The Council may fund its investments through using its reserves, capital receipts and prudential borrowing. Any borrowing would need to be made in accordance with the conditions of the Prudential Code, which requires borrowing to be affordable, sustainable and provide value for money. The return on any investment will therefore need to be in excess of the capital financing costs of the borrowing, which consist of the interest payable and the Minimum Revenue Provision that sets aside funds for the repayment of the borrowing. As the council does not hypothecate (match) funding sources against individual projects or acquisitions the capital financing cost will be based upon the council's weighted average cost of capital and informed by the Treasury Management Strategy. All investments will require a robust business case and will be assessed against the council's identified and current corporate priorities.

10.2 Where the Council acquires or develops an investment asset, it will ensure that the net income from the asset exceeds the costs – both the capital financing costs payable and all associated management costs.

10.3 Adoption of phase two of the strategy, the purchase of institutional grade investment property purely for its commercial return, could generate an annual return of between 1-2% pa (net of costs). It is important therefore to be realistic about the scale of contribution that this phase can make to the Council's medium-term financial plan, but it is an important means by which risk can be diversified across the activities proposed in phase one.

10.4 With a phase one concentrated on the development of investment assets, revenue returns will take longer to achieve and so in the early stages there will be a net cost to the council. This will be need to considered as part of the Council's financial planning process.

10.5 Additional resources will be required to deliver the strategy, particularly within the Property and Finance teams, which will require funding to the extent to which it is not offset by the income being generated.

## 11. GOVERNANCE

11.1 At the point property assets are released by services, Cabinet or Cabinet Member approval is secured declaring them surplus to operational need and they are released for sale with the sale delegated to the Chief Operating Officer.

11.2 Under the existing Scheme of Authorisation, the Chief Operating Officer has delegated authority to the Chief Property Officer disposals of up to £250,000 or the grant of a lease up to £25,000 per annum. In the case of an acquisition of land, authority is delegated up to a limit of £100,000 or in the case of a lease, £25,000 per annum, to the Chief Property Officer following consultation with the Chief Operating Officer.

11.3 To further promote the transparency of property decisions made, it is proposed that decisions on the disposal of any asset over and above the threshold set under the existing Scheme of Authorisation will first undergo a thorough options analysis that will be reported to, and agreed by, a newly formed Asset and Investment Board.(AIB)

Similarly all investment and development decisions will be taken by AIB. The Board will be chaired by the Chief Operating Officer and will comprise:

Assistant Chief Executive (Council Monitoring Officer)

Chief Finance Officer (S. 151 Officer)

Chief Property Officer

Assistant Director, Economy

Officer support will be provided and drawn from :

Head of Strategic Finance (Business Development & Investment) and
Property Investment and Disposal Manager.
Appropriate Assistant Director of Service for area of service need

11.4 The Asset and Investment Board will consider all proposals that contribute to the delivery of the strategy and will be responsible for:

- Ensuring that direct and indirect investment opportunities, outside the approved Capital Programme, are thoroughly evaluated, ensuring that there is an acceptable balance between risk and reward and that the participation/acquisition contributes to the achievement of the strategy.
- Recommending to Cabinet, property development projects, investment acquisitions and disposals, as well as property investment management activities and expenditure.
- Monitoring the progress made in respect of achieving the aims of the strategy and the financial performance of the portfolio created.

11.5 Prior to being presented to the Investment Board, each business case for a service and/or development opportunity will be reviewed by the Officer led Capital and Strategic Asset Board and will be supported by the Corpotate Management Team (CMT) and hence will follow existing governance process.

11.6 For direct and indirect property investments, opportunities that have met the Investment priorities will be presented direct to the Asset and Investment Board for recommendation to Cabinet. The process will be subject to periodic review to ensure decision timeframes meet the vendor's aspirations and is market compliant.

11.7 The Asset and Investment Board, its decisions and the performance of the investments and developments will be subject to the scrutiny of the Audit, Best Value and Community Services Scrutiny Committee, supported by key officers as outlined above.

## 12. RESOURCE IMPLICATIONS

12.1 The Property Asset and Investment Strategy will be delivered and supported by key officers in Orbis Property, Finance and Legal Services. There are a number of aspects to the resources required, split broadly between;

- Sourcing, evaluating and completing activities (including the financing arrangements), and

- Managing the portfolio of activities undertaken on an ongoing basis. For example, project management of any development, partner, tenant or agency management, financial monitoring and forecasting (and running a separate trading company if such is required as a result of a subsequent Cabinet decision).

12.2 A key constraint to delivering growth is the availability of specialist resource and therefore it will be important to assess required capacity for both an Operational and Investment portfolio of activities as outlined in the four quadrant diagram.

12.3 Resource modelling options (in house, outsourced or a joint approach ) will be considered by officers in Property, Legal and Finance and evaluated against the following criteria –

- Extent of control & strategic oversight
- Access to consistent expert advice
- Access to investment opportunities
- Cost / value for money
- Scalability
- Risk management & access to market intelligence.

12.4 Returns to the Council will be impacted by the level of resource required and the particular option adopted. Options will be reported to the Investment Board during the first half of 2018-19.

12.5 With regard to finance and legal resources, key activities will be delivered in house in order to provide reassurance to the council ensuring that there are appropriate checks and balances in place. Where appropriate, specialist external suppliers and advisors will be utilised – for example for more complex legal transactions and the provision of specialist tax advice.

12.6 The cost of resources required, whether internal or external, will need to be recognised in the expected performance of the portfolio and where work is undertaken for any subsidiary company the cost must be charged to the company ensuring that there is no subsidy.

## 13. RISKS AND RISK MITIGATION

13.1 There are inherent risks in property ownership and capital receipts/revenue derived from property and their capital value will increase and decrease in line with the market and their location and specification attributes (and in respect of existing let investments, the length of the lease and the covenant strength of the tenant).

13.2 The Options Analysis undertaken on all surplus assets will consider the risks of the ongoing property ownership whilst such a strategy is pursued, weighed up against the potential level of returns expected, taking into account the point in the market cycle.

13.3 In the event that development (either for onward sale or let) or for a service use is pursued, additional risks relating to the construction and management of any build contract and letting/sale risk will need to be factored into the business case and articulated to the Investment Board to aid in the decision making process.

13.4 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 to include rent collection, facilities management, service help desk and ongoing estate/ asset management and valuation processes.

13.5 By adopting this strategy, ESCC will be undertaking a new level of asset management activity for which it has limited experience, in both the decision making and implementation aspects.

13.6 The Investment Board will be supported by external advisors, where required, and together with officer support drawn from Property, Legal and Finance will report on the performance of the Strategy and provide forecasts on the level of future receipts and returns, and thus provide insight into the future direction that the council should take in ensuring a diversified and balanced level of activity occurs across the four identified quadrants.

13.7 By seeking to support economic growth within the county, the Council is potentially stepping in to the market either to become a lender of last resort (in the case of indirect development) or possibly through any direct development/investment. The Council will equally be exposing itself to reputational risks in the event of any business failure where the Council is landlord. This is particularly acute in the case of any public health, care home and the charity sector where local authorities would be expected to support ongoing services directly in the event of any market failure. This will be key criteria for the Investment Board to consider in the making of any development/investment decisions.



## 14. CONCLUSION AND RECOMMENDATIONS

14.1 The financial returns delivered from the strategy will support the Council in its delivery of essential services to residents. The proposed approach is based upon the following key principles;

- Retaining assets where appropriate and undertaking effective property and asset management and the promotion of the asset through the planning process to enhance income or capital receipts.

- Participate in schemes that have the potential to support the County Councils priority outcomes through securing either equity and/or debt stakes.

- To promote uses that are identified in the corporate strategy and other services on appropriate County owned surplus assets where appropriate to do so.

- A longer term aim to invest in income producing assets within the County, creating a diversified commercial and residential portfolio to manage risks and secure an annual return.

14.2 The development of a portfolio of assets covering investment in surplus assets, assets already producing an income and in development opportunities that supports the Council's ability to enhance its financial resilience in the longer term and act as a catalyst for improved economic outcomes for the County will form the first phase of the adopted strategy.

14.3 The Council will manage these investments by establishing an Investment Board (AIB), the Membership of which is referenced in section 11 of this strategy.