Report to: **Audit Committee**

Date of meeting: **19 November 2021**

By: **Chief Operating Officer**

Title: **Property Asset Disposal and Property Update**

Purpose: **To provide Audit Committee with an annual report on proposed disposals and other key work activities.**

RECOMMENDATIONS

The Audit Committee is recommended to:

1. **note the contents of this report;**

2. **consider, and recommend any actions that should be taken in response to the contents of this report;**

3. **identify any new or emerging items for consideration.**

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1 Background

1.1 The County Council's strategic framework for its assets is set out in the Council's Property Management Asset Plan 2020-2025. The document is attached as Appendix A.

1.2 The Strategy provides the Council with three principal activities:

i. the ability to drive added value from its current estate from disposal activity;
ii. the option to retain assets to support corporate or service needs; and
iii. enable investment in new assets or projects in support of economic growth opportunities.

2 Supporting Information

These principal activities are outlined in more detail below.

<u>The Council's disposal strategy.</u>

2.1 The Council has adopted a programme approach for its assets that are either surplus to operational requirements or will be surplus at a future date. The Council's Capital Strategy which is updated annually and for 2022/2023 is being revised as part of the RPPR process to set the budget for next year, as well as the medium-term financial planning process. Part of the capital programme includes securing capital receipts secured from surplus assets to help part fund the programme for the Council's basic need capital programme.

2.2 The programme approach for prioritising disposal of surplus assets to secure capital receipts is paying dividends. In this financial year (up to 30 October 2021) gross capital receipts of £8.90 million have been produced, with further capital receipts due before 31 March 2022. Last year's annual audit report highlighted the target of securing £16 million by end of 2023/24. The concentrated resources used since the last annual property update have driven capital receipt delivery. A summary of the current disposals is included in the Exempt report at a later item on the agenda.

2.3 A refined process has been established to look at additional assets that will become surplus that are not already committed in the capital receipts programme. These assets will be subject to a feasibility process to consider their potential for income, capital value or community benefit. A couple of surplus assets with low potential capital receipt outcomes were also re-purposed this financial year for a different operational use.

2.4 A list of additional assets that will become surplus to operational requirements will be presented to the Capital Board in December 2021 for consideration. It is intended this will occur on a regular basis. In the last year, five surplus assets that ceased to be required for core operational use have been let commercially to secure rental income. Over the next year, there will be a structured programme of asset reviews of the Council's non-school operational properties to examine where there is scope for co-sharing, greater space utilisation or opportunities for rental income.

2.5 This approach will yield opportunities to increase rental income from under-utilised properties, so it allows the Council to grow its investment portfolio from its existing asset base. The split from operational to non-operational portfolios (investment properties) will gradually change.

<u>Property advice to services on best use of assets</u>.

2.6 Understanding business needs is still a top priority and what this means for asset requirements. Property continues to focus on delivering asset solutions as part of the Council Plan 2021/2022. Property has a greater understanding of current and proposed service delivery in different parts of the organisation through numerous transformation programmes. Client management engagement has been improved. Over the last 18 months, significant work has been undertaken to ensure all buildings provide safe and Covid secure places for East Sussex County Council (ESCC) staff, visitors, and residents to use. Central government legislation and guidance has changed on how services can operate frontline services which minimises health and safety risks during the pandemic. Property re-structured its facilities management services in early 2020 and this service has adapted well to the changing needs for staff working in assets during the pandemic.

2.7 Property Services continues to respond to the change in focus of the organisation and how it uses its asset base. However, there were some capability and capacity issues in Property, so the Assistant Director of Property has just finalised restructuring Property's Senior Management Team. This allows Property Services to re-align current administration goals following the May elections and to increase the skills base in key areas. All Property staff will have greater understanding of Carbon Zero commitment and how carbon reduction must be driven forward in all aspects of property delivery and solutions.

2.8 There will be a small team that focuses on asset review and measuring property portfolio performance to aid property decisions for the corporate estate, service held assets and for the wider school estate.

2.9 The Workstyles programme is also looking at hybrid working including new service models for its office hubs. Significant engagement has occurred since Spring 2021 and revisions to the space layout and use will be implemented in early 2022 and there will be opportunities for excess office accommodation to be made available to be let to public partners.

2.10 Property and Communities, Economy and Transport (CET) are working together to deliver carbon efficiency projects. Following Cabinet approval in November 2021, additional capital investment will be available to invest in the asset base to reduce carbon emissions.

Council’s asset investment strategy.

2.11 The County Council determined in summer 2020 not to follow the route of purchasing commercial assets to produce commercial rental income. The primary reason, at that specific time, was there was significant uncertainty about commercial property markets at the start of the pandemic with national lockdowns. The commercial investment market was badly affected with uncertainty in the short and medium-term with impacts on rents, yield returns and commercial tenants’ ability to pay rents. The commercial property markets now in 2021, are still adjusting. Whilst there has been some recovery in some commercial sectors, e.g., warehouses and industrial units, there are sectors such as primary and secondary offices and retail high streets that have high void rates and yield performance has deteriorated.

2.12 As a reminder, the legislation context for local authorities acquiring commercial assets for income is set out in Local Government Act 2003 and the Localism Act 2011. This legislation sought to encourage local authorities to adopt more commercial approaches. It is important to note that prior to the pandemic, other local authorities had acquired commercial assets within their localities, but others had invested in geographical areas which presented potential high rental income growth but not in their administration area. The majority of newly acquired commercial assets purchased by local authorities were wholly or partly funded by the Public Works Loans Board (PWLB).

2.13 In context, the National Audit Office undertook a formal review in February 2020 in respect of Local Authority Investment in Commercial Properties. There were several findings in the report including several local authorities that were exposed to significant financial and reputational risks if there were to be a downturn in the economy as the commercial assets they had acquired would be badly impacted. In addition, PWLB consulted stakeholders about a proposed new approach for access to local authority loans for commercial asset acquisitions in November 2020.

2.14 The National Audit Office report revised criteria for securing loans from PWLB. These included revised loan rates and increasing the breadth of information required within the business cases. The emphasis is now on wider regeneration benefits and housing outcomes. PWLB remit has therefore been amended so a business case for a local authority to acquire commercial assets purely for rental income will be significantly harder to achieve and to be prudent with a local authority’s Treasury management strategies. CIPFA are currently consulting on the Treasury Management Code and Capital Prudential Code, which may have an impact on the ability of authorities to borrow and investment in the future

2.15 At this moment in time, there are no proposals to seek to acquire commercial assets for rental income, although the authority is open to explore opportunities that may present themselves. Several local authorities have been financially exposed where income from commercial properties have dropped due to pandemic and economic conditions and investment values have dropped. There are a few reasons it is not recommended for the Council to acquire commercial assets:

i. there is uncertainty in the commercial property market regarding rental levels, voids and yield performance.
ii. there are other pressures on the Council's capital programme for capital investment in a wide range of projects and infrastructure.
iii. access to external funding e.g., PWLB is more difficult and there will be an impact on the Council's Treasury Management Policy.

2.16 For information, the Council will continue to acquire assets/land for its operational delivery in relation to highway projects and school basic need requirements, but this will require a business case.

3 Conclusion and recommendations

3.1 Audit Committee is asked to note the contents of this report and the further information provided in the later agenda item and consider and recommend any actions that should be taken in response to the contents.

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