

**REPORT CONSIDERED BY CABINET AT THE MEETING HELD ON 28 JANUARY 2020**

**TITLE OF REPORT: PROPERTY ACQUISITION & DEVELOPMENT STRATEGY**

REPORT OF THE SENIOR ESTATES SURVEYOR

EXECUTIVE MEMBER: EXECUTIVE MEMBER FOR ENTERPRISE AND CO-OPERATIVE DEVELOPMENT

CURRENT COUNCIL PRIORITY: ATTRACTIVE AND THRIVING / PROSPER AND PROTECT

NEW COUNCIL PRIORITY: BUILD THRIVING AND RESILIENT COMMUNITIES / ENABLE AN ENTERPRISING AND CO-OPERATIVE ECONOMY

**1. EXECUTIVE SUMMARY**

1.1 To seek Cabinet's approval of the Property Acquisition & Development Strategy to Full Council.

**2. RECOMMENDATIONS**

2.1. That Cabinet recommends approval of the Property Acquisition & Development Strategy, including Appendices, to Full Council.

**3. REASONS FOR RECOMMENDATIONS**

3.1 To give effect to the Property Acquisition & Development Strategy so NHDC has in place a clear basis for pursuing property opportunities that are for the purposes of its functions or the benefit, improvement or development of its area.

3.2 To put in place a framework of robust and practical guiding principles that apply governance and rigorous appraisal to property acquisition and development decisions by NHDC, in order to safeguard the necessary capital expenditure and taxpayers' resources.

**4. ALTERNATIVE OPTIONS CONSIDERED**

4.1 No reasonable alternative options available.

**5. CONSULTATION WITH RELEVANT MEMBERS AND EXTERNAL ORGANISATIONS**

5.1 NHDC's Political Liaison Board (PLB) was consulted on the draft Strategy on 5<sup>th</sup> November 2019.

5.2 The Executive Member for Enterprise and Co-operative Development has been regularly updated throughout the drafting of the Strategy.

## **6. FORWARD PLAN**

6.1 This report contains a recommendation on a key Executive decision that was first notified to the public in the Forward Plan on the 14<sup>th</sup> November 2019.

## **7. BACKGROUND**

7.1 This report introduces the Property Acquisition & Development Strategy with a view to its adoption by NHDC for the next 5 years.

7.2 The report summarises the following key elements of the Strategy:

- NHDC's core goal and objectives for property acquisitions and developments.
- Funding the acquisitions and developments.
- Risk management and governance.
- Due diligence.

7.3 In addressing these key elements, the report presents the framework for the governance and appraisal of NHDC's property acquisition and development decisions.

7.4 Executive Members of the PLB supported the principles of the Strategy. One comment raised advised adding a provision to the Strategy addressing managing potential conflicts of interest. The comment has been acted upon by including a suitable provision early on in the Strategy. The provision requires, from the outset, all those involved in implementing the Strategy, be they Council Members, directors, officers or external advisers, to familiarise themselves with, and abide by, NHDC's Managing Organisational Conflicts in Council Roles & Duties, NHDC's Code of Conduct for Members and NHDC's Employee Conflicts of Interest Policy as appropriate.

## **8. RELEVANT CONSIDERATIONS**

8.1 This report focuses on the Property Acquisition & Development Strategy by setting out NHDC's core goal and objectives for pursuing property acquisitions and developments during the next 5 years. See Appendix A for the Strategy. The Strategy builds on the Commercial Strategy previously adopted by NHDC.

8.2 The Property Acquisition & Development Strategy's core goal is to secure property opportunities that fulfil NHDC's functions or provide benefits, improvement or development of NHDC's area. The goal is expressed through a set of objectives in the Strategy. By way of example, acquiring property in support of a regeneration programme that generates enterprise and employment is one objective.

- 8.3 It is important the Strategy has a clear goal and set of objectives because these enable NHDC to identify which statutory powers apply to property acquisitions and developments and what funding sources can be deployed.
- 8.4 It is inevitable that NHDC will need to borrow funds to purchase or develop properties at the scale intended. The Strategy makes clear two important legal restrictions on the deployment of borrowed funds:
- (i) NHDC can only use borrowing to acquire or develop property if acquisition or development is for the purposes of any of NHDC's functions or for the benefit, improvement or development of its area.
  - (ii) NHDC cannot borrow to acquire or develop property only for the purposes of achieving net income.
- 8.5 These restrictions will limit the properties that NHDC can purchase or develop with borrowed funds, and significantly limit buying properties outside NHDC's district with borrowed funds other than in exceptional cases. However, the legal restrictions do not necessarily preclude NHDC generating a surplus from property acquired or developed pursuant to the Strategy. Indeed a surplus should be considered a suitable recompense for the level of risk being taken on.
- 8.6 Property acquisition and development offers a range of advantages to NHDC and its community. As well as enabling NHDC to perform its functions or creating benefit, improvement or development of the area, property generally offers stable returns over the longer-term from both rental income and capital value appreciation. Achieving a return on capital is a key requirement in order to ensure that the provision of NHDC's functions or community benefit is sustainable. Property acquisition and development, though, also poses risks. Greater illiquidity is one example of risk. Acquiring and developing property requires careful planning and rigorous evaluation to achieve the core goal and objectives of the Strategy whilst mitigating risk.
- 8.7 This Strategy establishes a robust framework for the identification and safe delivery of suitable property acquisition and development opportunities, in pursuit of the Strategy's core goal and objectives. It sets out a rigorous risk management and governance process and principles for NHDC to safeguard the capital expenditure on property and protect taxpayers' resources.
- 8.8 The risk management and governance addressed by the Strategy focuses on four fundamentals of property assets to be appraised prior to spending capital or borrowed funds on property. The four fundamentals are listed below:

- (i) Security of capital deployed in acquiring or developing a property asset.
- (ii) Security of income generated from the asset.
- (iii) Liquidity of asset.
- (iv) Management intensity.

8.9 These fundamentals translate as follows:

- Risk of loss of capital.
- Rental income sustainability and growth to ensure capital is used efficiently and viably.
- Cost and time to access the capital through a property disposal.
- Cost and resource implications of managing properties once in NHDC possession.

8.10 The Strategy's risk management and governance requires an appraisal of the yield (return) from properties that are being considered for acquisition or development. Yield gauges a property's ability at meeting the four fundamentals. The Strategy acknowledges no property will simultaneously meet all four fundamentals as they can be mutually exclusive.

8.11 In acquiring and developing property, NHDC will be operating in a highly competitive property market. The Strategy is structured to enable NHDC to pursue suitable properties with the agility and efficacy required in the competitive marketplace.

8.12 An integral component of this agile structure is the Strategy's introduction of the Property Scrutiny Group (PSG). See Appendix B. The PSG comprises a core group of NHDC directors and officers whose main role is to implement the risk management and governance process by:

- Conducting appraisals of property opportunities based on the principles, core goal and objectives of the Strategy.
- Recommending properties to pursue and reject, based on the Strategy.

8.13 The Strategy details the PSG's Terms of Reference, which primarily focus on how the risk management and governance process must be carried out, including:

- The requirement to produce a comprehensive business case on each property acquisition or development recommended by the PSG.

8.14 The final key element of the Strategy is due diligence. This outlines the principles for building a property portfolio which:

- Reinforces the four fundamentals of property assets.
- Is sensibly proportioned and diversified between property sectors to help ensure a balanced portfolio and achieve the Strategy's goal and objectives.

- 8.15 The Strategy does not attempt to recommend a static target apportionment between the different property sectors in building a portfolio. Instead, it prefers a more agile and reliable case-by-case decision-making process based on the risk-return profile of each property sector at the time an acquisition or development is contemplated.
- 8.16 The Strategy emphasises reviewing NHDC's property portfolio in the context of both its existing portfolio and NHDC's Investment Strategy. This is to avoid NHDC becoming over-exposed to any one particular property sector and subjecting its capital, or revenue due to loan repayments, to unmanageable risk.
- 8.17 Continuing the due diligence theme, the Strategy recommends each property opportunity is appraised for selection or rejection based on key qualitative and quantitative asset criteria. Refer to Appendix C. The criteria are placed in a Scoring Matrix where they are assigned a Weighting. See Appendix D. The Weighting is based on the four fundamentals of property discussed earlier and the priority given to them by this Strategy.
- 8.18 In conclusion, the Strategy establishes a practical framework providing NHDC with clear purpose and rigorous governance and appraisal principles for acquiring and developing property. The Strategy will therefore help fulfil NHDC's duty to safeguard the capital, borrowed funds and taxpayers' resources deployed in future property transactions. Annual reviews of the Strategy will help NHDC to uphold this duty.

## **9. LEGAL IMPLICATIONS**

- 9.1 The Local Authorities (Functions and Responsibilities) (England) Regulations 2000 sets out functions that should be undertaken by Council, the Executive, or can be undertaken in conjunction with each other. Regulation 4 covers functions that are not to be the sole responsibility of the Executive, in particular:
- (b) .....formulating a plan or strategy for the control of the authority's borrowing, investments or capital expenditure or for determining the authority's minimum revenue provision.

As this is a new Strategy which links to the Capital spend programme of up to £20 million, then it potentially falls under Regulation 4, and it is recommended that this Strategy is considered and approved by Full Council.

- 9.2 The main statutory powers acknowledged by the Strategy are listed within the relevant documentation, with detail in Appendix E to this report.

## **10. FINANCIAL IMPLICATIONS**

- 10.1 Due to legal restrictions in relation to the proposed Strategy, NHDC can only use borrowed funds to purchase properties that are for:
- the purposes of NHDC's functions, or
  - the benefit, improvement or development of NHDC's area.

NHDC is precluded from using borrowing to purchase properties that are not for the purposes of NHDC's functions or benefit of its area. These other properties may otherwise provide equally strong or better levels of rental income and financial return.

- 10.2 Further, the restrictions on using borrowing will significantly reduce NHDC's ability to purchase properties located outside its area. In turn, this will reduce NHDC's ability to diversify its property portfolio, at least by location. Limiting diversification reduces NHDC's ability to spread the risk of its property portfolio by exposing it to the performance of a narrower (locational) market.
- 10.3 The restrictions, however, do not necessarily preclude NHDC generating a surplus on those properties that it acquires or develops through borrowing for the purposes of its functions or the benefit, improvement or development of its area.
- 10.4 Property generally offers stable returns over the longer-term from both rental income and capital value appreciation. The latter is achievable on disposal and can only be used for future capital expenditure.
- 10.5 Capital receipts from property are achieved upon their disposal. The time and cost of disposal depends on the liquidity of property. Realising the capital from less liquid property will take longer and the capital receipt may be suppressed if the property market declines during the marketing period. The higher marketing costs of less liquid property will also need factoring in. These obstacles to disposal will impact on NHDC's plans for recycling the capital realised.
- 10.6 Acquiring, developing, managing and disposing of properties will incur NHDC costs. Examples are Stamp Duty Land Tax and agent fees.
- 10.7 Fees and expenses of the external advisers recommended by the Strategy for appraising property opportunities will be incurred. These costs will vary from year to year according to the number and complexity of properties being considered. Funding is currently available from the corporate budget and the general commercial property budget.
- 10.8 The Investment Strategy (which incorporates the proposed Capital programme) includes an allocation of £20 million of capital funding over 5 years, at £4 million per year. Subject to this being approved by Full Council in February 2020, this will provide the funding for the acquisition and development of property. The phasing of this funding will limit the opportunities for larger investments, unless these take place in later use and make use of carried-forward funding. Specific property acquisitions and developments will require approval in accordance with the limits set out in the Constitution and Financial Regulations.

## **11. RISK IMPLICATIONS**

- 11.1 The Strategy acknowledges the risks inherent in acquiring and developing property. The main risks include:

- The value of any property may fall as well as rise. NHDC may fail to recoup its initial capital outlay. Value largely depends on market and economic conditions beyond NHDC's control, but for which the Strategy helps prepare NHDC.
- Rental income may reduce or be delayed, for example during tenant voids or upon tenants defaulting on their rent payment obligations in their leases.
- Void periods may incur direct costs to NHDC including business rates, facilities management, repairs and maintenance, insurance and utilities. Such costs may not be balanced by income during void periods.
- Obsolescence or deterioration may incur unexpected capital expenditure for NHDC.
- No suitable properties may be found within NHDC's area.
- NHDC may require additional resources to manage, and report on, a larger property portfolio.
- Change in law or guidance may further limit NHDC's ability to borrow for the purposes of the Strategy.
- Changes to taxation of property.

11.2 The Strategy outlines practical measures to help mitigate risk. These include:

- Acquire across range of property sectors to avoid over-exposure to illiquid property.
- Avoid high yield high risk properties, as likely to signify significant illiquidity.
- Avoid specialist properties and those inflexible for adapting to new tenant markets.
- Avoid acquiring properties subject to onerous conditions or charges.
- Make use of specialist external advice, even though this will cost money up-front

## **12. EQUALITIES IMPLICATIONS**

12.1. In line with the Public Sector Equality Duty, public bodies must, in the exercise of their functions, give due regard to the need to eliminate discrimination, harassment, victimisation, to advance equality of opportunity and foster good relations between those who share a protected characteristic and those who do not.

12.2 Some properties presenting themselves as opportunities may not fully comply with the Equality Act 2010, for example regarding disabled persons' needs. The due diligence process outlined by the Strategy will help ensure such issues are identified prior to the acquisition or development of these properties. It may be prudent to conduct equality assessments when making appraisals of property opportunities.

## **13. SOCIAL VALUE IMPLICATIONS**

13.1. The Social Value Act and "go local" requirements do not apply to this report.

13.2 Achieving some or all of the Strategy's objectives has potential to generate social value. For example, acquiring property to support or underpin enterprise, employment and public well-being in NHDC's area.

## **14. HUMAN RESOURCE IMPLICATIONS**

- 14.1. The Strategy recommends setting up the Property Scrutiny Group (PSG). This will comprise a core group of directors and officers from NHDC.

## **15. APPENDICES**

- 15.1. Appendix A - Property Acquisition & Development Strategy.
- 15.2. Appendix B - Property Scrutiny Group (PSG): Terms of Reference.
- 15.3. Appendix C - Asset Criteria.
- 15.4. Appendix D - Scoring Matrix.
- 15.5. Appendix E - Statutory Powers & Provisions.

## **16. CONTACT OFFICERS**

- 16.1. Christopher Robson, Senior Estates Surveyor [christopher.robson@north-herts.gov.uk](mailto:christopher.robson@north-herts.gov.uk); ext 4252.
- 16.2. Ian Couper, Service Director: Resources [ian.couper@north-herts.gov.uk](mailto:ian.couper@north-herts.gov.uk); ext 4243.
- 16.3. Jeanette Thompson, Service Director - Legal & Community [jeanette.thompson@north-herts.gov.uk](mailto:jeanette.thompson@north-herts.gov.uk); ext 4370.
- 16.4. Gavin Ramtohal, Legal Commercial Team Manager & Deputy Monitoring Officer [gavin.ramtohal@north-herts.gov.uk](mailto:gavin.ramtohal@north-herts.gov.uk); ext 4578.
- 16.5. Reuben Ayavoo, Policy and Community Engagement Manager [reuben.ayavoo@north-herts.gov.uk](mailto:reuben.ayavoo@north-herts.gov.uk); ext 4212.
- 16.6. Kerry Shorrocks, Corporate Human Resources Manager [kerry.shorrocks@north-herts.gov.uk](mailto:kerry.shorrocks@north-herts.gov.uk); ext 4224.

## **17. BACKGROUND PAPERS**

- 17.1. None.