

COMMERCIALISATION SCRUTINY PANEL

28TH NOVEMBER 2019

Report of the Strategic Director of Corporate Services

ITEM 8 UPDATE ON COUNCIL'S COMMERCIALISATION STRATEGY

Purpose of Report

At the meeting of the Scrutiny Panel on 28th November 2019 the Panel requested that the Strategic Director provided an update regarding the justifications for why the Council was focussing on commercial property as the preferred strategy, what opportunities were available in this field and a breakdown of the types of properties to be considered with potential returns, taking into account their square footage to the Panel at its next meeting.

Background

Commercial investments - why the initial focus on commercial property?

There are in theory a wide range of commercial investments that the Council could make so it is valid to ask why the Council believes that investment in commercial property is the correct approach in the short term. The paragraphs below set out the rationale for this approach.

The Council's overarching objective is to provide public services in line with its duties and powers as a district council to the residents of Charnwood. Commercial activities are undertaken with a view to supporting this objective, and in particular, to supplement the Council's revenue streams in order that services to the public may be enhanced or maintained as far as possible. The latest version of the Medium-Term Financial Strategy (covering financial years 2020-2023) set out the likely scale and timing of financial challenges facing the Council in the short and medium term. Although the precise quantum and timing of these challenges is inevitably somewhat speculative, it is clear that if commercial activities are to contribute significantly to their mitigation then:

- Income needs to be achievable at a scale that makes a difference
- Income needs to come on stream at significant scale within a relatively short time (realistically within the 2020/21 financial year)

There are also other factors relating to risk, opportunities, and the internal skills and capacity available to the Council. Taking into account these factors, and with the requirement for commercial income to be achievable at scale and in the short term, this allowed the following criteria to be derived when assessing potential commercial opportunities.

Criteria for assessing commercial opportunities

1. Can income be generated at scale?
2. Can income streams be developed (at scale) within the next financial year?

3. Can the income streams be delivered with relative certainty?
4. Are there significant financial risks associated with the opportunity?
5. Is there a track record within the Council – or other local authorities – which demonstrate the opportunity is viable?
6. Does the Council have any commercial advantage in addressing an opportunity compared to the private sector (or – potentially – neighbouring local authorities or other public bodies)?
7. (Conversely) is the Council at a commercial disadvantage compared to existing players in the market who may have existing brands, infrastructure or track record of service delivery?
8. Could the private sector respond to the Council entering the market by competing aggressively – e.g. through price competition - such that an initial or extended period of trading losses might ensue?
9. Does the Commercial opportunity come with significant legal or regulatory risk?
10. Does the Council have skills and capacity within the existing workforce that enable the delivery of the commercial opportunity?
11. Could the Council easily access skills and capacity from the employment / interim / consultancy markets that enable the delivery of the commercial opportunity?
12. Are there political or ethical reasons which may constrain the Council's ability to provide services on a commercial basis?

Other factors may also be considered depending on the specific opportunity being assessed but the above criteria have been applied to commercial property investment as set out below.

Commercial property investment – assessment against commercial opportunity criteria

	Criteria	Comments	RAG rating
1	Can income be generated at scale?	Yes (assuming that sufficient investment funding is made available).	G
2	Can income streams be developed (at scale) within the next financial year?	Yes – if properties are acquired with an existing tenant (as is envisaged) then income streams commence immediately.	G
3	Can the income streams be delivered with relative certainty?	Yes – these can be calculated with reference to existing tenants.	G
4	Are there significant financial risks associated with the opportunity?	Yes – in that the level of investment required is substantial and there are no guarantees in respect of ongoing income. However – although losses are possible (and we would expect to minimise these through due diligence	A

	Criteria	Comments	RAG rating
		and appropriate professional advice) it is unlikely that a large proportion of an individual investment would be lost, as investment would be in an underlying physical asset (in contrast to many financial instruments). Going forward the risk of losses on individual properties is mitigated as the overall portfolio of investment properties increases.	
5	Is there a track record within the Council – or other local authorities – which demonstrate the opportunity is viable?	Yes – a large number of local authorities have successfully developed commercial property portfolios.	G
6	Does the Council have any commercial advantage in addressing an opportunity compared to the private sector (or – potentially – neighbouring local authorities or other public bodies)?	Yes – compared to the private sector the Council has a lower cost of capital (which can be demonstrated by the Council's ability to access funding through the Public Works Loan Board).	G
7	Is the Council at a commercial disadvantage compared to existing players in the market who may have existing brands, infrastructure or track record of service delivery?	The Council will need to develop a track record with agents and prospective vendors of completing major transactions, but the track record of other local authorities does suggest that this issue is not insurmountable.	G
7	Could the private sector respond to the Council entering the market by competing aggressively such that an initial or extended period of trading losses might ensue?	Not considered a significant issue – in the short-term income is protected through the tenancy agreement.	G
8	Does the Commercial opportunity come with significant legal or regulatory risk?	The Council will need to be clear as to the legal basis on which property is being acquired but this is an issue managed by other local authorities.	G
9	Does the Council have skills and capacity within the existing workforce that	The Council has some skills but limited additional capacity outside current business as usual activity.	A

	Criteria	Comments	RAG rating
	enable the delivery of the commercial opportunity?		
10	Could the Council easily access skills and capacity from the employment / interim / consultancy markets that enable the delivery of the commercial opportunity?	We believe that skills and capacity can be acquired externally (and some has already been accessed).	G
11	Are there political or ethical reasons which may constrain the Council's ability to provide services on a commercial basis?	Not considered a significant issue – although tenant business activity will need to be considered as part of the due diligence within the acquisition process.	G

The types of properties to be considered with potential returns, taking into account their square footage.

- A list of property types has not been created yet – although it is likely there will be more focus on industrial and office type opportunities, rather than retail.
- We will be developing a process (with appropriate professional support) that will result in suitable properties being identified – in practice it is likely that this will start with the evaluation of an opportunity, which would probably filter out (say) prospective retail purchases, rather than starting from the premise that we wish to specifically look at / not look at properties of a certain type.
- In respect of square footage, whilst there is an obvious correlation between area and rental income, this is unlikely to be a principal driver of purchasing decisions.

Conclusion

Based on the above it is considered that investment in commercial property is an appropriate initial approach in respect of commercial income generation.

It should be noted that the focus on commercial property investment does not preclude other commercial activity but does reflect that the Council's internal capacity to pursue other opportunities is limited.