BUDGET SCRUTINY PANEL

1ST DECEMBER 2020

Report of the Strategic Director, Commercial Development, Assets and Leisure

ITEM 8 Commercial Property Acquisitions - Process

On 29th October 2020, the Budget Scrutiny Panel requested further information regarding Commercial Property and the related elements of the Capital Strategy 20/21:

- the criteria for assessing the suitability of properties, how it is determined that a net income of 3.5% will be achieved, the checks and balances that will be done and its impact on council tax rates in relation to commercial property acquisition

- an explanation of the rationale behind increased funding that has been allocated for Commercial property acquisition, Enterprise Zone and Town Deal.

A training session on Commercial Property was conducted for Members on 2nd November 2020, and Democratic Services have circulated the materials presented in that training. These materials cover these topics extensively and will assist Panel Members with understanding.

Furthermore, The Capital Strategy 2020/21 and Capital Plan 2020-23 were approved at a meeting of full Council on 9th November 2020 and are also useful as reference to the additional information requested.

1. Assessing suitability

The process guiding the investment activity is well established and successfully used at other Local Authorities. Consisting of seven distinct steps, these provide a framework to guide transactions in a controlled fashion and to ensure risks are identified, understood and managed. Those steps are:

1. Identification
2. Tenant covenant analysis, financial modelling, lease and title analysis
3. Business case
4. Approval and Bid
5. Further legal due diligence
6. Surveys
7. Completion

Each step requires satisfaction of key criteria before progressing to the next.

The main criteria used to identify a potentially suitable investment are:

- Is the property single-let (i.e. one tenant in occupation) or let to a small number of tenants only? (a small number of multiple tenants may be acceptable in the case of, say, an attractive office block opportunity)
- Is the tenant financially robust and stable as determined by an independent market assessor, such as Dun & Bradstreet?
- Is the lease for the property full repairing and insuring, with clear and distinct obligations on the part of the tenant?
- Does the financial model and cashflow appraisal of the investment meet the net return target within 0.5% less at a minimum? (With a net return target of 3.5%, this would be 3.0%). If not, what is the benefit (risk management)?

2. Due diligence

An extensive range of due diligence is undertaken:

- Modelling of the financial performance of assets is undertaken in two forms – A strict asset model and a financial performance model. Examples of these are contained in exempt appendices to reports submitted to the Scrutiny Commission for a meeting on 16 November 2020 and are available via the Council's Mod.gov site.

- A suite of due diligence is undertaken by lawyers representing the Council, including a legal review of all lease and title documents, replies to CPSE enquiries, reports on lease and title, etc.

- The subject property is visually inspected, and a suite of surveys are commissioned, including building inspection reports, measured surveys, environmental surveys and other specialist surveys, if required.

- Tenant covenant analysis is undertaken to ensure that the tenant is financially viable, able to meet the obligations of the lease, and likely to remain in the property.

3. Impact on Council Tax rates

This investment activity has no direct correlation to Council Tax rates or the setting thereof.

4. Rationale of increased limits – commercial property

Given the current financial strain facing the Council's Medium Term Financial Strategy and the requirement to address shortfalls in funding, the Council must use a mix of cost reduction strategies and income generation strategies to meet the challenge.

The investment activity delivers net surplus (income) to the Council's General Fund Revenue account and reduces the pressure on the Budget. Without income generation, the only options open to Members would be service reduction and/or service elimination.

With the increase of investment levels in the Capital Plan 2020-23, more income can be generated. However, there is a question of proportionality that must be addressed, i.e. what is the appropriate level of investment given the Council's financial size and situation? This is analogous to obtaining a mortgage on a house – given a person's income, how large a mortgage can that person afford? There is no distinct formula or method to determine what this should be. However, there is Statutory Guidance and Code that applies to Local authorities that assist officers and members in managing the Council's Capital Plan and capital spending.

Some well-known councils have invested very large sums that have raised questions and concern. Charnwood's current level of planned investment is far, far below these levels.

5. Rationale of increased limits – Town Deal and Enterprise Zone

The Town Deal and Enterpsie Zones provide exciting opportunities for job-creation and regeneration in Charnwood. Most of the projects that may come forward will be private sector led, and any project must be based on a business case.

At times, these business cases will not "stack up" or be financially viable. In these instances, additional funding will be required to create the financial outcomes required.

In cases such as this, Charnwood will, with the increased spending limits in the Capital Plan, be able to evaluate and assist some of these projects. Any money provided would not be invested on a grant basis; a positive net return to the Council will be required, although the level of that return can be modulated by the delivery of social value.

Without having an approved spending level set out in the Capital Plan, the Council would find it procedurally impossible to invest in these types of projects.

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