

# BRIEFING PAPER

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**SUBJECT:** COMMERCIAL PROPERTY INVESTMENT FUND  
**DATE:** 10 OCTOBER 2019  
**RECIPIENT:** OVERVIEW AND SCRUTINY MANAGEMENT COMMITTEE

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## **THIS IS NOT A DECISION PAPER**

### **SUMMARY:**

1. The authority agreed a property investment fund in 2016, and subsequently an investment of £29.7M was made in commercial property. The return from this investment is formally reported to Council each year as a part of the update on Treasury Management issues within the year-end outturn report. The report this year, made to the July Council meeting, highlighted that to date the authority has purchased three properties. The rate of return on these investment in 2018/19 was 5.95% gross and 2.05% net (after borrowing costs of £1.16M were incurred), which therefore represents a contribution to the revenue account of around £0.61M.
2. The investment made by Southampton in commercial property highlights that local authorities are increasingly reliant on income generating activities as a means to address their funding challenges. Direct property investment is regularly undertaken by local authorities, both within and external to their own boundaries. Property investment provides a means to secure returns above the costs incurred via borrowing (from the Public Works Loan Board), creating a positive and sustainable income stream for authorities.
3. According to the Medium Term Financial Strategy agreed by Council in February, the authority faces a budget gap of around £9.5m in 2020/21, and a way to help address that shortfall, as well as future shortfalls, is via making a renewed use of the property investment fund.
4. The report to Cabinet recommends recommencement of the previous policy.

### **BACKGROUND and BRIEFING DETAILS:**

5. By adding additional resource into commercial property, the main purpose will be to generate additional income, over and above the costs concerned, and which will be expected to provide a healthy income stream over the longer term. It is therefore proposed to allocate £200M into the capital programme, from 2019/20 onwards, to expand the property investment fund previously agreed. Development of the property investment fund will therefore provide greater resilience to the Council's financial position, independent of Government funding decisions and allocations. Adding to the capital programme in the current year will allow the best opportunity for early investments to be made and realising the income they bring.

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6. As applied to previous direct property investments, due diligence will be applied to each potential investment decision, which will include the type of asset, location, ownership, tenure and lease terms, covenant quality, yield and growth in future yield, risks and risk management options to mitigate potential risk and 'fit' within an overall and balanced property portfolio.
7. Within the strategy, the potential will be recognised for investment opportunities that arise which whilst they may not offer the optimum financial return, provide for a number of wider aims to be achieved around investing locally in the economy to assist with regeneration and also the generation of returns from local business rates in Southampton. Local authorities benefit from a share of the growth in their local business rates as a part of the funding system for local authorities. Hence, a flexible approach will be considered but as part of an overarching aim to achieve sound and long term returns for the authority for sustainable funding streams with less reliance on Government funding.
8. A governance process was previously agreed when creating the property investment fund, which will be adhered to regarding the proposed allocation. The process recognises the need for due diligence on all acquisitions, as well as the need for flexibility to ensure opportunities are not missed in a competitive market.
9. The agreed governance process allows the Service Lead - Capital and Assets, delegated authority following consultation with the Leader of the Council and the Council's Capital Board to agree the detail of the business plan for the property fund and future variations to investment criteria. In addition, delegated authority was also given to the Service Lead Capital Assets, again following consultation with the Leader of the Council and the Service Director – Strategic Finance and Commercialisation to approve the acquisition or sale of property or other investments in accordance with the business plan, investment criteria and delivery options. Furthermore, that delegated authority for the Service Lead Capital Assets, following consultation with the Leader of the Council and Council's Capital Board extended to taking decisions on real property acquisitions and disposals irrespective of value. Formal legal advice on acquisition and completion of the relevant legal processes (including money laundering compliance, property title checks etc) will add to the overall governance of acquisition proposals. This process will again be followed and will also include full consultation with the Cabinet Member for Resources.
10. It is proposed the Business Plan for commercial property will be refreshed to reflect the new commitment for investment contained in this proposal.

## **RESOURCE/POLICY/FINANCIAL/LEGAL IMPLICATIONS:**

11. Under this proposal, £200m would be added to the capital programme for further investment in the commercial property portfolio. A full report will be made to Cabinet and Council to secure the necessary approvals and relevant Treasury Management limits reviewed and agreement sought for their amendment as needed to reflect this policy.

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12. The council's 2020/21 revenue budget is expected to include a target level for income to be raised via investing in commercial property, over and above the costs of financing the investment, as a contribution towards balancing the budget.
13. Additionally resource will be required within the Capital and Assessment Management team to undertake appropriate research into the market for investment opportunities. Furthermore, resource will be needed to undertake conveyancing work, either via the in-house legal team or possibly from external solicitors depending on the timescales required and available in-house resource at that point in time. If the council receives an initial introduction from an agent and proceeds with a transaction, it would need to pay a one-off finder's fee.
14. Property investment has already been undertaken by Southampton City Council, as well as other authorities. The policy was adopted in 2016 highlighting the General Power of Competence under the Localism Act.

## **OPTIONS and TIMESCALES:**

15. To generate returns as quickly as possible, it is intended to allocate funds and begin considering investment opportunities as soon as the necessary approval has been given by the Council for the investment sum sought.
16. This option is part of a number of measures that will be needed to ensure future budgets are balanced. If this option were not considered, other proposals would need to be brought forward to meet the legal requirement of a balanced budget which may entail reductions to services.

## **RISK MANAGEMENT IMPLICATIONS**

17. Commercial property investment involves a degree of risk, but whilst this is an inherent part of making investments in can be managed and mitigated. Prices can fluctuate and there are risks around tenant failure. These were recognised as part of the approach with the investment properties held to date and will continue to be recognised by applying checks as part of the due diligence required ahead of each investment (including detailed property and company financial checks etc). Criteria will be applied such as looking at spreading the risk around different sectors of the market; strength and longevity of tenant covenant and location quality. Historically, property rentals have delivered growth and returns and it is intended to re-enter the market as a long term investor, applying a balanced portfolio to manage risks.

## **Appendices/Supporting Information:**

18. None, but a full Cabinet report will be published ahead of the meeting.

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