**APPENDIX 1**

Agenda Item No 7(B)

**Bolsover District Council**

**Executive**

**5th November 2018**

| Investment Strategy |
|---|

**Report of Councillor A. Syrett, Leader and Portfolio Holder for Overall Policy and Strategic Planning**

This report is public.

**Purpose of report**

- To update Executive on the financial pressures facing the Council and summarise the measures being taken to maximise income, reduce costs and redesign services in line with the Transformation Programme.
- Provide outline proposals for a Property Investment Strategy subject to a further report setting out a draft strategy for approval.

## 1. Report Details

1.1 At its meeting on 8 October, Executive considered a report detailing how the Council could choose to further invest in its existing property portfolio in order to generate additional income and/or support economic regeneration and growth.

1.2 Given the financial challenges faced, Executive have indicated a will to progress the development of an investment strategy based around expanding its existing non housing property portfolio. This is in order to develop revenue streams that provide a required level of return to offset the forecast budget deficits for forthcoming years. This approach can also support economic development and regeneration in the District through targeted investment.

1.3 To set the development of an investment strategy in context, Table 1 below shows the general fund budget surplus / deficit for the years 2018/19 to 2021/22. This illustrates the increasing deficit from 2020/21.

1.4 At this point in time the figures do not take into account any additional income from business rates growth or a further business rate retention scheme. Additionally they do not take into account any additional income or cost reduction arising from the Council's Transformation Programme.

**Table 1**.

| | 2018/19 Budget £000 | 2019/20 Budget £000 | 2020/21 Budget £000 | 2021/22 Budget £000 |
|---|---|---|---|---|
| **Budget Shortfall** | **(1,027)** | **34** | **550** | **1,184** |
| Council Tax Increase 2018/19 | (107) | (107) | (107) | (107) |
| *Options Identified:* | | | | |
| NNDR Growth | (1,547) | 0 | 0 | 0 |
| Transformation, Income Generation/Cost Reduction/Business Redesign | 13 | (41) | 0 | 0 |
| Vacancy Management | (86) | 0 | 0 | 0 |
| Total Transformation Options | (1,727) | (148) | (107) | (107) |
| **General Fund (surplus)/Budget Shortfall** | **(2,754)** | **(114)** | **443** | **1,077** |

1.5 Given the importance of ensuring that investment decisions to generate income are sound, it is important that the mechanisms for management of the Council's future budget deficit are properly understood. This is in order to ensure the extent and level of risk arising from any additional investment properly reflects the budget deficit that income generation is aiming to help address.

1.6 As previously stated, the figures presented at Table 1 do not take into account any additional income, or cost reduction, in future years arising from additional business rates growth or delivery of the Council's Transformation Programme. If these issues were factored into the financial projections based on current trends then it's anticipated the deficit position for 2020/12 and 2021/22 would be reduced. This is relevant as it provides an indication that the need to rely on additional investment income, through use of reserves or additional borrowing, is lessened.

Examples of how further business rate growth and retention and the Council's Transformation Programme are expected to reduce the forecasted budget deficit are set out as follows:

- In the financial year 2018/19 the Council was successful in a County wide 100% Business Rates Retention Pilot bid. This secured an additional £1.547m of income to the General Fund, increasing the amount anticipated to be set aside for future projects within the Councils reserves to £2.754m by the end of this financial year.

- Following on from the 2018/19 Pilot the Council is now part of a further bid for 75% Business Rates Retention. The outcome of this further bid for the financial year 2019/20 is awaited and, if successful, will impact positively on the financial position.

- In 2017/18 the Council implemented a revised Senior Management Structure reducing costs by £140,000 across the Strategic Alliance. This secured an ongoing £70,000 saving per annum in management costs for the Council.

- In 2018 the Council ended its Procurement contract with the NHS which cost the Strategic Alliance £70,000 per annum. It then developed an 'in house' team in order to generate income by reviewing contract costs and terms and selling its services to other Councils. A further £40,000 income is anticipated to be generated from this arrangement in due course.

- The Council previously invested £260,000 from its Transformation Reserve to improve the Pleasley Vale reception and the CCTV security system. This investment enabled 'off site' remote monitoring reducing the twenty four hour staff presence. In 2019/20, this investment will generate savings in the region of £70,000 per annum.

- In 2018, as part of a review of the Contact Centre Management arrangements, the Transformation Reserve was utilised to fund a re-structure. This resulted in the reduction of the total number of managers with an annual saving of £33,000.

1.7 The above examples illustrate that the Transformation Programme is delivering income maximisation, reducing costs and supporting service redesign. Going forward the programme will bring together and further develop the ideas generated by Members and Officers to deliver further financial benefits that will help to reduce future budget deficits. Alongside increased Business Rates growth and retention the Council's overall financial position and future forecasts should continue to improve.

1.8 It is clear the development of the Council's Transformation Programme, and growth in business rates and increased retention, will enable a more positive financial projection in due course however risk, uncertainty and volatility remain. Consequently any decisions for further property based investments need to be based around a clear and understood criteria and process. This is in order to make sure that Councillors, as community leaders are able to assess the total risk exposure in each case.

1.9 Given the need to ensure any such investment is properly appraised and consistent with the Council's appetite for 'risk' and 'reward', an investment strategy should be developed and agreed by Executive. In the development of such a strategy a number of key factors require consideration in order to shape an approach that ensures due diligence is undertaken. The strategy must also reflect requirements within the 'Statutory Guidance on Local Government Investments issued under Section 15(1) (a) of the Local Government Act 2003', which came into force April 2018. Further details of this statutory guidance are available at:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/678866/Guidance_on_local_government_investments.pdf

1.10 Table 2 below sets out a summary of the statutory guidance requirements to be covered in an investment strategy:

**Table 2**

| **Requirement** | **Considerations** |
|---|---|
| Clearly show how investments contribute to Council's objectives | • Need to align with Corporate Plan priorities<br>• Clarify purpose and extent to which it supports deficit reduction and /or economic regeneration in the District |
| Strategy must include indicators to show how Cllrs have assessed the total risk exposure on decision | • How is it funded<br>• Rate of return expected and why (benchmarked)<br>• Show additional debt costs<br>• Risks over the repayment period<br>• Extent of support for deficit gap<br>• Mitigation if returns fail and / or borrowing increases<br>• Assessment of capital depreciation |
| Clearly show how the investment is proportionate? | • Loan corresponds in size or degree (terms/rate/returns)<br>• Risk exposure is reasonable and accepted<br>• Within agreed and defined 'affordability ' limit |
| Risk assessment should be robust | • Market assessment (competition, demand, trends)<br>• Proper quality external advice and expertise<br>• Credit ratings |
| Contingency | • Loss of investment return / Increase in loan repayments<br>• Capital depreciation<br>• Extra costs and budget impact<br>• Loss of revenue stream - service delivery impact |

1.11 In developing the strategy, consideration must also be given to a number of essential elements which will inform acceptable investment choices, specifically:

- Ethical investment (for instance, prohibiting investment in alcohol and tobacco production or sale, animal exploitation, gambling, sex establishments, arms trade or environmentally damaging practices)
- Geographic spread of investments
- Limits of individual and cumulative risk
- Timescales for the achievement of objectives
- The level of losses that can be tolerated
- The degree to which the Council can realistically become reliant on the income stream to provide services

1.12 In addition to reflecting the statutory requirements and the essential elements to inform acceptable investment choices the strategy will need to reflect how property investment choices have been made. Therefore a strategy should be based around key factors such as:

- **Location** – location of the property is critical to ensure it is an attractive position, so that in the long term it optimises its ability to re-let/re-sell if capital is required, or is strategically located for re-development. The location of the property will affect the ability of the Council to undertake inspections and to deal with management issues without the need to employ specialist agents. It will also affect income to the Council from Business rates, Council Tax and New Homes Bonus, depending on the type of investment.

- **Covenant Strength** - the quality of the tenant and, more importantly, their ability to pay the rent on time and in full is essential. This is particularly important where the Council has borrowed against the investment, and minimum acceptable financial strength for any given tenant will be determined through a financial appraisal of company accounts and the use of appropriate methods of risk assessment and credit scoring. It is however worth noting that the Council, as a public body, may not wish to invest in properties where the occupiers are generally seen to be undertaking business which is contrary to its corporate values.

- **Lease length** - the unexpired length of the term of the lease is of key importance in ensuring that the landlord's revenue stream is secure and uninterrupted. The Council will take into consideration the risks associated with a tenant vacating and the potential to attract good quality replacements tenants at acceptable rental levels.

1.13 In order to assist with the decision making process and the assessment and appraisal of property investment opportunities the strategy should include a matrix to 'score' investment opportunities through an agreed and established criteria. This criteria can be weighted in order to score an opportunity on its 'acceptability' providing a first stage in determining if it should be further progressed. An example of the type of criteria to be included in an investment strategy and the associated weighting mechanism is set out at appendix 1.

1.14 In addition to the application of the matrix and weighting mechanism there are a range of other factors which should be considered when appraising an investment opportunity and therefore need to be reflected in the strategy. These are:

- **Yield/Rate of return** – is the net rate of return from the property (e.g. through the annual rental income). If the cost of prudential borrowing can be fixed over the length of the lease or longer, at substantially less than the property yield, it will generate an annual revenue surplus. It is essential to ensure sufficient margin between cost of borrowing and income should interest rates rise in the future. It is important to note that net yield is the return on capital having taken account of the full cost of acquisition, ie Stamp Duty, legal fees, external valuations and structural surveys.

- **Risk** – any borrowing needs to balance against the risk of the return. In general, the higher the sought level of return from an investment, the higher level of risk that it carries. The intention of an investment strategy is to minimise the risk to the Council on any investment.

- **Growth** – property investments have the potential for both revenue and capital growth. The Council will take into account that potential when assessing the strength of the investment opportunity. However Property values can fall as well as rise and mechanisms to minimise revenue reductions should be identified. Monitoring and review of the portfolio and any anticipated trends, will be required given how the market can change over time.

- **Sector and trends** - information as to the sector of use of the property (e.g. office, retail, retail, warehousing, industrial, and leisure) and trends in demand will assist in deciding on the risks associated with specific properties and the mix of sectors within the portfolio.

1.15 Based on the information set out in the report recommendation (i) indicates that a further report will be provided to Executive in due course, setting out a more detailed draft investment strategy. This draft will reflect the key issues outlined and the requirements arising from the Statutory Guidance on Local Government Investments. It will set out options for how the strategy could be delivered and mechanisms for the consideration and approval of property investment opportunities within the Council's statutory governance structure.

1.16 As Executive have recognised the potential property investment can offer to generate income, it is important to fully understand the performance of its existing non housing related property stock. This will enable full and detailed consideration of how well the Council is placed to take on additional risks associated with further property investments. Consequently a report will be provided for consideration at a future Executive meeting setting out details of occupancy levels, voids, return rates and percentages, maintenance and capital depreciation costs, debt write offs, and trends and demands.. This is reflected in recommendation (ii) of the report.

1.17 In addition to consideration of the development of an investment strategy to acquire further property Executive is asked to consider other areas of investment that could support delivery of its Corporate priorities. In particular Executive may wish to consider areas where investment could assist with delivery of wider corporate aspirations and objectives. Examples for further consideration and appraisal are:

- Determining viable options for the future of the Pleasley Vale facility and site and the development of an agreed plan that could maximise income, reduce costs and support economic development, regeneration and tourism
- Delivery of the Regeneration Frameworks for the four principles Towns and how the use of Council resources could support wider investment
- Identifying areas where direct investment would address long standing social and economic problems within local communities
- Determining opportunities for the use of a Joint Venture vehicle to support the further development of residential and commercial properties within the District

1.18 Recommendation (iii) reflects the request for Executive to consider these other areas of investment in order to prioritise further more detailed appraisals and discussions.

## 2. Conclusions and recommendations

2.1 As set out in the report, the development of an investment strategy requires consideration of a number of key issues to ensure it reflects the requirements of the statutory guidance and enables Councillors to make informed 'risk based' decisions. The strategy will also need to include key factors to be considered when determining investment opportunities and a mechanism to appraise these. Consequently it is recommended that a further report be submitted to Executive setting out more detailed proposals for an investment strategy.

2.2 Understanding the performance of the Council's existing non housing property is essential in determining how further property investment opportunities should be approached. This information will enable Executive to give full consideration to areas of risk and reward within the management of existing stock, in order to determine and how well placed the Council is to expand its 'commercial' property portfolio activity. This is reflected in recommendation (ii).

2.3 The report highlights the uncertainty of the Council's future financial position but illustrates the managed process in place through the Transformation agenda. Given the need to consider how best to maximise the transformation reserve in delivery of the Council's Corporate priorities, Executive are asked to consider other areas of strategic investment. This consideration will assist in prioritising areas where further more detailed appraisal and discussion is necessary. This is reflected in recommendation (iii).

## 3. Consultation and Equality Impact

3.1 None directly from the report, however future investment decisions will require consultation proportionate with the extent and nature of the proposal. Additionally any investment decisions will require consideration by the Council of its legal duties to eliminate unlawful discrimination, advance equal opportunities and promote good relations between people. The Council will also need to ensure when making financial investment decisions, that it considers the needs of all members of the community.

## 4. Alternative Options and Reasons for Rejection

4.1 An alternative option would be to not progress the development of an investment strategy and not consider other high level investment opportunities. Whilst this approach would limit any risks associated with the use of Council resources or additional borrowing for investment, it could restrict the ability to generate additional income or deliver key corporate priorities.

## 5. Implications

### 5.1 Financial and Risk implications

5.1.1 None directly from the report, however given the Council's financial position, future pressures and uncertainties, it is essential any investment decisions are fully and properly considered. The proposed investment strategy will help to ensure that when making decisions the Council can demonstrate compliance with the statutory expectations and evidence awareness of the risks and rewards.

### 5.2 Legal Implications including Data Protection

5.2.1 As set out the development of the Council's investment strategy will need to give due regard to the provisions contained within the Statutory Guidance on Local Government Investments issued under Section 15(1) (a) of the Local Government Act 2003. External specialist legal and financial advice will be taken to ensure the strategy complies with the requirements to prepare and publish an Annual Investment Strategy consistent with the Treasury Management Code principles. This advice will also ensure the strategy sufficiently reflects the importance of security, liquidity and yield ensuring gross debt is proportionate to net service expenditure, in order to prevent over-extension of investment activities.

5.2.2 Furthermore any future property investment decisions will need to be taken in line with the Council's established governance structure and provide a sufficiently robust evidence based business case.

### 5.3 Human Resource Implications

5.3.1 None directly from the report.

## 6. Recommendations that Members

6.1 Consider the information set out in the report and request that a further report be provided setting out a draft Investment strategy for approval;

6.2 Receive a detailed analysis of how the Council's non housing property stock is performing including details of occupancy levels, voids, return rates, maintenance and capital depreciation costs, debt write offs and trends and demands;

6.3 Give regard to other areas of investment that could support delivery of the corporate aspirations in order to prioritise further, more detailed appraisals and discussions.

## 7. Decision Information

| | |
|---|---|
| **Is the decision a Key Decision?**<br>A Key Decision is an executive decision which has a significant impact on two or more District wards or which results in income or expenditure to the Council above the following thresholds:<br>*BDC:* *Revenue - £75,000* ☐<br>*Capital - £150,000* ☐<br>*NEDDC:* *Revenue - £100,000* ☐<br>*Capital - £250,000* ☐<br>☑ *Please indicate which threshold applies* | No |
| **Is the decision subject to Call-In?**<br>(Only Key Decisions are subject to Call-In) | No |
| **Has the relevant Portfolio Holder been informed** | Yes |
| **District Wards Affected** | All indirectly |
| **Links to Corporate Plan priorities or Policy Framework** | All |

## 8 Document Information

| **Appendix No** | **Title** |
|---|---|
| 1 | Example Property Investment Matrix |
| **Background Papers** (These are unpublished works which have been relied on to a material extent when preparing the report. They must be listed in the section below. If the report is going to Cabinet (NEDDC) or Executive (BDC) you must provide copies of the background papers) | |
| Statutory Guidance on Local Government Investments issued under Section 15(1) (a) of the Local Government Act 2003 | |
| **Report Author** | **Contact Number** |
| Dan Swaine | 2462 |

**Appendix 1 Example Property Investment Matrix**

| Criteria | Maximum score |
|---|---|
| Location | 15 |
| Tenant covenant | 20 |
| Lease terms | 15 |
| Lease length | 15 |
| Building quality | 10 |
| Tenure | 10 |
| Tenant repair obligations | 10 |
| Lot size | 5 |

As previously highlighted the score for each of the criteria could be weighted at application, in order to reflect how the opportunity ranks. Table 4 below sets out details of how the weighted process could work

| | | |
|---|---|---|
| **Excellent** | 5 | 100% |
| **Good** | 4 | 80% |
| **Acceptable** | 3 | 60% |
| **Marginal** | 2 | 40% |
| **Poor** | 1 | 20% |

Based on the proposed criteria and the weighting an example of its application is set out below.

- If 'opportunity' scores 5 on a criteria it achieves 100% of the weighting – so 5 for location achieves 15 points
- If 'opportunity' scores 4 on a criteria it achieves 80% of the weighting – so 4 for location achieves 12 points
- If 'opportunity' scores 3 on a criteria it achieves 60% of the weighting – so 3 for location achieves 9 points