

CABINET

15 November 2016

Title: Investment and Acquisition Strategy	
Report of the Cabinet Member for Finance, Growth and Investment	
Open Report with Exempt Annex and Appendices (relevant legislation: paragraph 3 of Part I of Schedule 12A of the Local Government Act 1972)	For Decision
Wards Affected: None	Key Decision: Yes
Report Author: Andrew Sivess, Head of Assets and Investment	Contact Details: Tel: 020 8227 5732 E-mail: andrew.sivess@lbbd.gov.uk
Accountable Strategic Director: Jonathan Bunt, Strategic Director of Finance and Investment	
Summary <p>The Council is facing unprecedented challenges and opportunities. The population of the borough is expected to increase to 220,000 by 2020 and rising further to 275,000 by 2037. Demand for Council services will increase significantly but within the context of falling budgets with an estimated budget gap of £63m to 2020. However, the Borough's growth potential provides a significant opportunity to invest in developments in Barking and Dagenham to generate a financial return that benefits both the Council and the community. This is in addition to the wider anticipated benefits in terms of employment opportunities, educational attainment and better health outcomes.</p> <p>Approximately 42,000 new homes, commercial, industrial and infrastructure assets will be built over the next twenty years. This represents a construction value of c£10.5bn in new residential units alone which will see the borough will be transformed. This scale of development will be delivered in a highly competitive, complex and uncertain environment. Most development will be on land owned by the private sector and by other public bodies.</p> <p>To benefit from this opportunity the Council needs to fundamentally change how it approach investment and regeneration building on a strong record as one of London's most effective regeneration authorities. However, going forward the Council will need to become a proactive developer and investor, helping to support growth opportunities and ensure that the Council and future generations benefit by increasing its ownership of long-term income producing assets. The establishment of Be First as the Council's development management vehicle will be fundamental to help to bring forward the borough's growth potential, set out by the independent Growth Commission.</p> <p>This report proposes the establishment of an Investment and Acquisition Strategy. This will frame an initial £250m investment budget and £100m land and property acquisition budget. The report sets out the Council's investment objectives, how investment decisions will be made and how investments will be managed to ensure that expected</p>	

returns are realised. It is expected that the primary delivery vehicle will Be First (proposed elsewhere on this Cabinet's agenda) which will identify and propose development and investment opportunities in addition to those identified inside the Council or proposed by other organisations such as developers and investment institutions.

The proposed Investment and Acquisition Strategy is at **Appendix 1** and the Land and Property Acquisitions Decision Framework at **Appendix 2**. There is also some supplementary information, including the assessment of the financial implications, in **Annex 1** to this report. These documents are in the exempt section of the agenda as they contain information relating to the financial and business affairs of the Council (relevant legislation: paragraph 3 of Part I of Schedule 12A of the Local Government Act 1972) and the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

Recommendation(s)

The Cabinet is recommended to:

- (i) Approve the Investment and Acquisition Strategy at Appendix 1 to the report;
- (ii) Note that an advisory Investment Panel, with a membership comprising Strategic Directors and external advisers, shall be established to assess and make recommendations on individual investment decisions to implement the Investment and Acquisition Strategy and that details of the purpose, governance arrangements and membership for the Investment Panel shall be the subject of a future report;
- (iii) Approve the establishment of an Investment Budget, initially of £250m, to be borrowed to fund the development and long-term financing of the investment programme identified in this report;
- (iv) Approve the establishment of a Land and Property Acquisition budget and to borrow £100m for a period of three years on an interest-only basis;
- (v) Delegate authority to the Strategic Director of Finance and Investment, in consultation with the Cabinet Member for Finance, Growth and Investment, to make the appropriate borrowing arrangements;
- (vi) Delegate authority to the Strategic Director of Finance and Investment, in consultation with the Cabinet Member for Finance, Growth and Investment, to agree the appropriate source(s) of funding for each investment or acquisition;
- (vii) Note that the parameters of any delegations will be clarified in tandem with the establishment of the Investment Panel and that each investment decision shall be considered individually and may be subject to approval by Cabinet in appropriate circumstances; and
- (viii) Delegate authority to the Strategic Director of Finance and Investment, in consultation with the Cabinet Member for Finance, Growth and Investment and the Director of Law and Governance, to make any necessary and non-material textual changes to the Investment Strategy following the meeting of Cabinet.

Reason(s)

The investment strategy supports the corporate objective of growing the borough and enables development of a long-term income stream which contributes the Council financial sustainability.

1. Background

1.1. Challenges

- 1.1.1. The Council faces major financial challenges and opportunities from population growth, the development of significant numbers of new homes and reducing financial support from central government. The Council's response to these challenges were set out in its Ambition 2020 programme. A major component of this vision is the establishment of an Investment and Acquisition Strategy (IAS) to help the Council benefit from and influence the expected level of new residential and commercial development in the borough over the coming decades.
- 1.1.2. The borough is set to change radically with the population expected to grow from 198,000 people in 2014 to 230,000 people by 2020 and by a further 25% to 275,000 people by 2037. It has one of the youngest demographic patterns in the country with the fourth highest proportion of people aged 10 -19 and an expected 25% increase in people aged 20 -29. A major priority is to ensure that these age groups benefit from the scale of economic activity expected in the borough through both the generation of income that supports Council services and through employment and educational opportunities that benefit local people.
- 1.1.3. The key is to ensure that the Council frames the scale and direction of development through our role as Local Planning Authority, as developer of new projects and by becoming a key investor in new developments. Its involvement will allow the shaping of the strategic direction and pattern of development, ensure that construction activity provides employment and skills development opportunities and that new homes support healthy living, supports educational achievement and protects the environment. The financial impact on the Council, from demographic changes and reduced financial support from the Government, mean that it will spend 50% less in providing services in 2020 than in 2010. It is imperative that the Council generates new sustainable income streams through participation the Borough's growth potential.

1.2. 2020 Strategic direction

- 1.2.1. To help address these challenges a key element of the 2020 strategic vision is to ensure that new housing developed in the Borough provides a wider, diversified tenure mix. This is required to meet local requirements, London's diversity and to support existing and new local business development. A key tool to achieving these objectives is for the Council to become a proactive investor in new mixed-use developments. This will allow it to benefit financially, to shape how schemes are designed, built and managed ensuring that new development contributes to the financial, environmental and social sustainability of the Borough.

1.2.2. To be able to effectively participate and benefit from the borough's growth opportunities, there is a need to fundamentally change how the approach investment and regeneration. The Council has a strong record as one of London's most effective regeneration authorities, having become London's sixth largest developer of intermediate housing. However, to build on this track record and to be able to participate in the borough's growth potential, it is necessary to build on the strengths and experience and create a robust and sustainable organisation capable of growing and managing the Council's asset base within a highly competitive environment. This requires the establishment of a new regeneration and development organisation that can identify new opportunities and speed-up development and alongside the Council becoming a proactive investor to both support and benefit from the expected level of growth.

1.3. **Barking and Dagenham Reside**

1.3.1. The Council's approach to redevelopment and property investment has been to develop large sites in our ownership through a series of project specific Special Purpose Vehicles (SPVs). Collectively these SPVs comprise Barking and Dagenham Reside though, in actuality, all SPVs within Reside are separate legal entities governed by directors appointed by Cabinet. The directors are legally required to govern each SPV to achieve the objectives agreed by the Council for each scheme.

1.3.2. This approach provides a flexible structure, allowing sites to be re-developed through specific financing, construction and management arrangements. Development and operational risk is ring-fenced to each SPV individually. A different solution can be adopted for each site, enabling the most appropriate solution to be developed that best meets the requirements of the Council, its partners and the changing regulatory environment. Institutional investors and private developers typically adopt this approach to development and long-term investment.

1.3.3. Developing and holding assets through SPVs allows the Council to make effective use of its legal status as a local authority and of its commercial strength as property owner and funder to bring in private sector resources that may otherwise not be available to the Council. This includes development expertise and the ability to finance schemes from Council borrowing and in partnership with private sector funding institutions where this produces better outcomes.

1.3.4. The following schemes have been developed through a Barking and Dagenham Reside SPV.

Scheme	Status	Units	Tenure	Funding
King William Street & Eastern End Thames View	Completed	477	Social Rent and Intermediate Rented	Institutional
Abbey Road 2	Completed	144	Intermediate Rent	European Investment Bank
Gascoigne Phase 1	Construction	252	Social Rent, Intermediate	European Investment

			Rent, Shared Ownership	Bank
Kingswood	Planning	Subject to detailed design	Shared Ownership	PWLB
Gascoigne Phase 2	Planning	285	Social Rent, Intermediate Rent, Shared Ownership	PWLB
Sebastian Court	Pre-Planning	Subject to detailed design	Shared Ownership, Intermediate Rent	PWLB
Total		1,156		

2. Investment and Property Acquisition Strategy

2.1. Summary

2.1.1. The purpose of the Investment and Acquisition Strategy (IAS) is to increase the Council's income generating assets to support the long-term financial sustainability of the authority. The core objective is to achieve a target average net investment return of 5%, with an initial target to produce £5m net annual income. It should be noted that this is a target and not a cap and where good investment opportunities exist, projects would continue to be financed beyond the level needed to generate the £5m income objective. Consequently, there will be no artificial cap on the level of borrowing and investment schemes where our investment criteria are satisfied would continue to be funded. An initial allocation of £250m is recommended in this report for investment schemes and any increase to that would require additional Cabinet approval.

2.1.2. The intention is to invest inside the Borough to support regeneration and economic development programmes and this will be the primary focus for the Strategy. Investments will also be sought outside Barking and Dagenham to diversify investment risk and to support out of Borough initiatives. The proposed IAS is contained in Appendix 1 in the exempt section of the agenda.

2.2. Investment targets

2.2.1. To achieve the target investment return the Council will construct an investment portfolio across a range of asset classes covering residential, commercial, industrial and energy assets. The aim is to create a balanced and diversified investment portfolio to deliver the overall investment target.

2.3. Creating the Investment Portfolio

2.3.1. Constructing the portfolio in the proportions set-out above is required to achieve robust levels of returns in operational assets. This approach increases the likelihood of achieving the required average 5% level of returns. Investing in a portfolio of projects with different levels of returns diversifies risk and enables

higher yielding assets to compensate for the lower risk but lower return assets such as affordable housing.

2.3.2. This approach is of fundamental importance to sustainably achieving the net income target of £5m per annum. At least 50% of the portfolio will be invested in intermediate housing. Returns in this asset class in the early years of each project are likely to be relatively lower in net cash terms but over time rental growth inflation means that net rental income should grow significantly. However, due to the low yielding nature of such investments (reflecting the relatively low risk) relative to higher yielding but higher risk assets, the Council will need to invest in other higher yielding asset classes to help generate the required level of income required.

2.3.3. In addition to showing how each project would contribute to achieving the target net return of 5%, each proposal will also need to address the following factors to be considered for funding:

Customers	▪ what demand(s) will be met now and in the future
Place making	▪ new and existing places which meet customer needs, provide value and support effective operational management
Development	▪ quality design and construction to deliver place making objectives over the medium and long term
Funding	▪ capable of being developed and managed within budget to achieve expected returns

2.3.4. The approach to constructing the Council investment portfolio will combine an assessment of proposals to achieve expected financial returns appropriate and an assessment of how proposals will contribute to the Council’s wider objectives of creating sustainable, quality places that meet the needs of people and business and that are capable of cost effective development.

3. Portfolio and Asset Management

3.1. Key to realising expected returns is effective portfolio and asset management (financial and operational performance). This is essential to ensure that returns continue to be generated and that if expected returns do not materialise then ultimately assets are redeveloped or sold to ensure that overall portfolio returns are maintained.

3.1.1. Assets held within the Council investment portfolio will be managed within the following framework and scheme of delegation:

Category	Details	Responsibility
Fund management	<ul style="list-style-type: none"> • Strategic management of the investment fund • Approval of investment decisions • Acquisitions and disposals • Portfolio performance management 	<ul style="list-style-type: none"> • Investment Panel

Portfolio management	<ul style="list-style-type: none"> • Investment management of assets within the portfolio • Monitoring of portfolio level returns and risk exposure management • Performance management and financial/ pricing models of underlying assets • Adjustment of portfolio structure to ensure returns are realised • Acquisitions and disposals 	<ul style="list-style-type: none"> • Strategic Director Finance and Investment • Head of Assets and Investment • Expert external support
Asset management	<ul style="list-style-type: none"> • Investment management of individual assets within the portfolio (not taking into account portfolio structure) to maximise financial performance and achievement of expected returns 	<ul style="list-style-type: none"> • Head of Assets and Investment • Expert external support
Property management	<ul style="list-style-type: none"> • Operational asset management to ensure end user satisfaction and maintenance of the assets 	<ul style="list-style-type: none"> • My Place

3.1.2. Assets held within the investment portfolio need to be actively managed, across the investment management categories set-out above, to ensure that expected returns are achieved. This will be a new approach for the Council similar to that used by institutional investors. This will require external support to help develop the Council's internal skill base and to subject the investment management process to external scrutiny. Where a project fails to meet its returns targets, it will be considered for disposal if the situation cannot be rectified.

4. **Investment Governance**

4.1 The implementation of the investment process will be led by an Investment Panel, with a membership comprised of strategic directors and external advisers. The Investment Panel will consider individual investment decisions and strategies and make recommendations to Cabinet or to appropriate directors in order to implement the Investment and Acquisition Strategy. The Investment Panel is yet to be created, its objectives, key terms of reference, governance arrangement and membership of the Panel will be the subject of a future report. The Panel will also be responsible for decisions concerning the management of the investment portfolio to ensure that the expected returns set-out above are achieved.

5. Development and delivery capacity

- 5.1. A significant risk to achieving the investment objective to generate £5m net income per annum is the Council's delivery capacity. Although the scale of investment is subject to change as schemes are brought forward the programme anticipates a level of investment in excess of c£750m and this will require a step-change in the capacity and skills to successfully deliver on this scale.
- 5.2. Although the Council has built a strong reputation in delivering complex regeneration schemes, the existing capacity will not be sufficient to deliver the objectives in this report. Development in the Borough will be undertaken within an increasingly competitive environment and the Council will need to attract and retain the skills necessary to undertake development and investment in this environment.
- 5.3. The proposal, elsewhere on this agenda, to establish Be First as the Council's wholly owned development and regeneration vehicle is key to achieving our investment strategy objectives. Be First will be tasked with identifying and delivering regeneration and investment schemes on commercially acceptable terms within the investment framework set out in this report.
- 5.4. In terms of residential development, an aspiration flowing from the IAS will be for Be First to be generating 2,000 new intermediate and market rented residential units that will be owned by a Reside vehicle(s) by 2021. This equates to Be First delivering 400 completed units per annum just for Reside. This is substantially in excess of the capacity of the Council currently.

6. Financial Implications

- 6.1. The financial implications are covered in **Annex 1** in the exempt section of the agenda.

7. Legal Implications

Implications completed by Suzan Yildiz, Legal Services Manager

7.1 General powers of competence, investment and prudential borrowing

- 7.2 The Council has a wide range of powers concerning borrowing, investment and dealings with property which would empower the Council to pursue the proposed Investment Strategy.
- 7.3 Section 1 of the Localism Act 2011, the general power of competence ("GPC") empowers local authorities to do anything that an individual can lawfully do provided that is not expressly prohibited by other legislation. Activities authorised by the GPC can include investment, trading or charging decisions which may be undertaken through commercial (corporate) vehicles with the primary aim of benefiting the authority, its financial management, its area or its local communities. The power is fairly wide and provided that investment activity is not expressly restricted or proscribed by other legislative provisions, it is likely to encapsulate the primary objectives of the Investment Strategy which are predicated upon ensuring the

effective management of the authority's finances in order to optimise outcomes for the development and regeneration of its areas for the benefit of local communities.

- 7.4 Whilst the General Power of Competence will permit the Council to invest in property for a return, such activity is likely to be deemed as 'activity for a commercial purpose' which cannot be undertaken directly by the authority and must be undertaken through a company structure within the meaning of Section 1(1) of the Companies Act 1996 (s.4 Localism Act 2011). Operating through a company structure will have the advantage of ring-fencing financial risks, however, there are also attendant corporation and income tax liabilities which will need to be addressed in a full business case as individual investment decisions are pursued by company vehicles. The formation of each investment company vehicle would be the subject of a detailed business case which will consider the financing of the company, tax and any state aid implications. Notably, the Investment Strategy proposes that Be First, a regeneration vehicle to be created by the Council, will act as development manager and the main vehicle for implementing and delivering development focused elements of the Investment Strategy. The creation and governance arrangements of Be First are not the subject of this report, but a full business case is being developed and will be presented for decision to Cabinet in the near future. To the extent that other special purpose vehicle companies (SPVs), being subsidiaries of the parent company, are created their purpose, creation and activities would be the subject of future decisions.
- 7.5 Section 12 of the Local Government Act 2003 ("Power to Invest") enables a local authority to invest for any purpose relevant to its functions under any enactment, or for the purposes of the prudent management of its financial affairs. Whilst speculative borrowing to invest purely for profit will not be authorised under this power as relevant to the authority's functions, investment in land or property, for example with a view to regeneration, and in line with CIPFA's Prudential Code for Capital Finance would enable the prudential investment of funds borrowed for the purpose of expenditure in the reasonably near future. The CIPFA Code contains detailed recommendations about this procedure in the context of prudent borrowing practice, which will be considered as individual investment decisions are made. In exercising the power to invest under s.12(b) the Council should have regard to the CLG Guidance on Local Government Investments. The Guidance advocates the preparation of an investment strategy which the Council is expected to follow in decision making unless a sensible and cogent reasons exist for departing from it.
- 7.6 Section 1 of the Local Government Act 2003 ("Power to Borrow") provides local authorities with the power to borrow for any purpose relevant to their functions under any enactment or for the purpose of the prudent management of its financial affairs. The Power to Borrow has similar constraints to the investment power under the 2003 Act. Borrowing primarily to achieve a return is unlikely to be deemed connected to functions of the Council or prudent financial management. Caution should be exercised in making individual decisions to ensure that new investments financed with borrowing do further functions of the Council and are consistent with prudent management of the Council's financial affairs.
- 7.7 Section 111 of the Local Government Act 1972 ("Incidental Power") enables a local authority to do anything (whether or not involving the expenditure, borrowing or lending of money) which is calculated to facilitate, or is conducive or incidental to, the discharge of any of their functions.

7.8 Investment and borrowing for the sole purpose of creating a return would not be deemed pursuant to the functions of the authority as required under the above powers. However, the report has clearly set out the primary objectives of the investment activity are connected with shaping the strategic growth and economic development of the area to meet the needs of a growing local demographic and shape local communities. Therefore, investment and borrowing in respect of property assets would be prudent and authorised pursuant to the authority's functions, when used as regeneration tools, alongside other financial measures, to provide a suitable diversified housing mix for the growing local population, to regenerate areas and to create employment and education opportunities. It is critical that the primary policy objectives of any investment activity, such as building new homes, regenerating an area or creation of employment opportunities, are furthered and public funds are not exposed to unnecessary or unquantified risk.

7.9 **Property Acquisition Powers**

7.10 The Investment and Property Acquisition Strategy (IPA) is a critical element of the Council's overall Investment Strategy. The aims of IPA are to increase the Council's income generating assets to a target net investment return of 5% in order to support the long-term financial sustainability of the Council. The aim of IPA is not merely to generate a commercial return; the primary aims are to support regeneration and economic development programmes in the Council's area by reinvesting net yields within the borough and potentially outside the borough. Therefore, the IPA strategy has a double bottom line of generating a return on investment for the purposes of securing the sustainable financial management of the Council for the regeneration and economic development of the Council's area. As such the IPA and investment decisions pursuant to the Strategy are likely to fall within the parameters of the General Power of Competence providing that its core aims of supporting regeneration and economic development are progressed. The Department for Communities and Local Government has produced Guidance on Local Government Investments (2010 edition) which advises that local government investment priorities should be based on security, liquidity and yield in that order.

7.11 Notably, many individual investment and acquisition decisions will be made in implementing the various strands of the Investment Strategy. Individual decisions will be the subject of future reports and full consideration will be given to the Council's powers of investment and acquisition, any relevant guidance such as the CIPFA Code and the aims of this Investment Strategy.

7.12 To the extent that strategic land required for regeneration supported by planning policy cannot be assembled through voluntary acquisitions, which forms a key part of the Investment Strategy, the Council may also consider recourse to its various compulsory purchase powers. However, acquisitions by compulsory purchase are beyond the remit of this report which is focused on voluntary acquisitions. Suffice it to say that such decisions would be individually reported for decision following careful consideration of the relevant enabling powers and constraints imposed by public law and relevant guidance.

7.13 For the sake of completeness, in addition to the General Power the following land acquisition powers are relevant and available to pursue individual projects in line with IPA:

7.13.1 Section 111 of the Local Government Act 1972 enables the Council to do anything which is calculated to facilitate, or is conducive or incidental to, the discharge of any of its functions, whether or not involving expenditure, borrowing or lending money, or the acquisition or disposal of any rights or property.

7.13.2 In accordance with the Local Government Act 1972, Section 120, the Council is empowered to acquire by agreement

(a) any land situated inside or outside its area for the purposes of any of its functions stipulated by the 1972 Act or other statutory provisions or

(b) for the benefit, improvement or development of its area, and notwithstanding that the land is not immediately required for that purpose. Until the land is required for the purpose acquired, it may be used for any purposes associated with of any of the Council's functions.

7.14 The Council's Constitution, Part 4, Chapter 4 sets out the Land Acquisition and Disposal Rules. In accordance with paragraph 2.1, all strategic decisions about the use, acquisition and disposal of land and property assets are generally within the remit of the Cabinet. Formulation of strategic decisions is overseen by the Property Advisory Group (PAG) and the Cabinet. Such decisions, depending on the value of assets to be acquired may also be key decisions which would be publicised on the Council's forward plan ahead of the decision. Individual decisions on strategic acquisitions pursuant to the Investment Strategy / IPA would be made by Cabinet, in accordance with the Council's Constitution and its Land Acquisition and Disposal Rules.

7.15 **Governance Implications**

7.16 Section 9D(2) of the Local Government Act 2000 as amended establishes the functions of Executive Cabinets. This enables a Cabinet to carry out decisions on any function unless reserved by order of the Secretary of State. Investment decisions of an authority are not a reserved function. Under part 3 Chapter 1 paragraph 1.2 of the Council's Constitution, the Cabinet can in turn delegate its functions to an officer if it so determines or authorise the officer to take investment decisions subject to established parameters, such as the need to consult prior to making a decision. In the case of investments there can be a need to move quickly to make the best of opportunities. Therefore, authorising the section 151 Local Government Act 1972 Chief Financial Officer to make relevant investment decisions is a wide spread practice.

7.17 The current recommendations authorise the Strategic Director of Finance and Investment to allocate the required investment budgets and make arrangements for borrowing up to £100m. Further delegations may be deemed necessary in due course or in tandem with presenting the Investment Panel report. Nevertheless, the need to observe the recording of key decisions and use of the forward plan remains and will be subject to the overview and scrutiny committee.

8. Other Issues

- 8.1 **Risk Management** – each potential investment and land acquisition opportunity would be subject to a full evaluation and risk analysis process as part of the approvals process.
- 8.2 **Contractual Issues** – sites acquired in advance of planning permission being granted would be acquired under a Call Option arrangement or through outright purchase depending on the commercial evaluation and opportunity provided by each site.
- 8.3 **Staffing Issues** – additional staff may be required to implement and manage the anticipated level of investment and consequent investment portfolio. Any additional staffing costs would be funded from investment returns.
- 8.4 **Corporate Policy and Customer Impact** – the proposals in this report would help to achieve the Council's growth objectives and would help to achieve financial sustainability of the Council.
- 8.5 **Safeguarding Children** – Purchase of land in advance of planning permission could potentially lead to the development of additional family housing which could improve help improve the life chances of children through a healthier environment and better domestic space in which to study.
- 8.6 **Crime and Disorder Issues** – successful implementation of the Investment and Acquisition Strategy would lead to developments being influenced by or in the Council's control where 'designing out crime' can be an explicit objective.
- 8.7 **Property / Asset Issues** – The proposal sin this report would help the Council increase its asset base and would help to address other asset management issues and opportunities within the Council's existing property holdings.

Public Background Papers Used in the Preparation of the Report: None

List of appendices:

- **Annex 1:** Supplementary information (exempt document)
- **Appendix 1:** Investment and Acquisition Strategy (exempt document)
- **Appendix 2:** Land and Property Acquisitions Decision framework (exempt document)