

## CABINET

17 September 2019

<b>Title:</b> Investment and Acquisition Strategy Update	
<b>Report of:</b> Report of the Cabinet Member for Finance, Performance & Core Services	
<b>Open</b>	<b>For Decision:</b> Yes
<b>Wards Affected:</b> All	<b>Key Decision:</b> Yes
<b>Report Author:</b> David Dickinson, Investment Fund Manager	<b>Contact Details:</b> Tel: 020 8227 2722 E-mail: <a href="mailto:david.dickinson@lbbd.gov.uk">david.dickinson@lbbd.gov.uk</a>
<b>Accountable Director:</b> Helen Seechurn, Interim Director of Finance	
<b>Accountable Strategic Leadership Director:</b> Claire Symonds, Chief Operating Officer	
<b>Summary:</b> <p>In September 2017 and October 2018 Cabinet approved an updated Investment and Acquisition Strategy (IAS) to support the Borough's growth opportunities and to ensure that the Council, and future generations, benefit by increasing the Council's ownership of long-term income producing assets.</p> <p>The key objective of the investment strategy is to generate net income of £5.12m by 2020/21. Be First will be the main vehicle for completing the development of a number of planned residential developments required to deliver this objective and will be responsible alongside the council for identifying new investment opportunities.</p> <p>This report highlights the financial constraints and opportunities within the IAS. It stresses the importance of bringing schemes into operation as soon as possible to ensure both the regeneration of the borough, and the availability of funding available for subsequent schemes.</p>	
<b>Recommendation(s)</b> <p>Cabinet is recommended to:</p> <ul style="list-style-type: none"><li>(i) Note the progress being made in meeting the Investment and Acquisition (IAS) income target;</li><li>(ii) Note the governance and controls that are in place to management the IAS;</li><li>(iii) Note the addition of a Lease and Lease Back asset class to the IAS;</li><li>(iv) Note the limitations that impact the IAS through the net interest requirement; and</li><li>(v) Approve the updated IAS contained in Appendix 1.</li></ul>	
<b>Reason(s)</b> <p>The proposals in this report will support the regeneration and economic growth of the borough and will help to support the long-term financial sustainability of the Council.</p>	

## **1. Introduction and Background**

- 1.1. The Council's first Investment and Acquisition Strategy (IAS) was agreed by Members in November 2016 as part of the Council's response to the unprecedented challenges it faced from Government cuts to public sector spending. The strategy has been subsequently reviewed in October 2018.
- 1.2. The purpose of the IAS is to support the Borough's growth opportunities and to ensure that the Council, and future generations, benefit by increasing the Council's ownership of long-term income producing assets.
- 1.3. The scale of investment opportunity within the Borough is significant with in excess of 50,000 new homes to be built over the next twenty years. This will be accompanied by increased demand for employment space and sustainable energy providing the Council with a key leadership and investment opportunity.
- 1.4. The IAS provides the Council with the ability to make investments that have the potential to support economic growth and / or deliver economic regeneration within the borough. In some cases, schemes with lower returns may be considered for strategic reasons.
- 1.5. To accelerate the Council's regeneration, a development company, Be First, was created in October 2017. They have reviewed and reconfigured the development pipeline, have brought new investment opportunities to Council and have identified a new asset class to support private sector led regeneration.
- 1.6. In line with Government Guidance on Local Authority investment activities this report provides an update in delivering investment objectives and sets-out the criteria to approve and finance investment opportunities going forward. The Strategy will be reviewed and brought back to Cabinet for approval annually.
- 1.7. It is intended, going forward, to combine the Treasury Management reporting with the IAS reporting. This reporting will be as follows:
  - i. Annual Outturn and Review (June) - the investment strategy will be formally reviewed and reported to Cabinet and Assembly annually and will include performance of operational assets against forecast levels of return at both individual asset and portfolio levels.
  - ii. Mid-Year Review (December) - progress in implementing the investment strategy will be reported to Cabinet and Council Assembly every six months. The report will highlight any potential performance issues and provide a mid-year forecast on the strategy's return.
  - iii. Annual IAS Strategy Update (February) – this will provide an update on the IAS strategy, including updating the IAS budget, assets classes and will highlight changes in the wider economy and specific investment markets. The Strategy update will be based on the Be First Business Plan.
  - iv. As the Council enters more investments, additional Prudential Indicators will be factored into the MTFS.

## 2. Proposal and Issues

### 2.1. Investment and Acquisition Strategy

2.2. In April 2018, the Government issued revised statutory guidance to help local authorities ensure that their investment strategies are transparent, minimise risk and support delivery of Council objectives.

2.3. As a result of this guidance the strategic objectives of the investment strategy were restated as follows. Members are asked to note that these returns are in addition to any Be First return target:

- *To support and unlock regeneration and economic growth opportunities within the borough.*
- *To establish a property portfolio to generate long-term revenue and capital growth targeting an initial cash return of £5.2m by 20/21 and indexed at CPI thereafter.*

These objectives reflect the predominantly affordable housing nature of the investment opportunity in the borough. Affordable rent housing often needs capital grant to achieve financial viability and will take several years before schemes becoming cash positive.

2.4. To minimise investment risk and to ensure that invested capital can be realised, the allocation of investment funds will be guided by the following investment objectives. These objectives frame the evaluation, management and monitoring of all investment and funding opportunities considered by the Council.

**Security:** ability of assets to hold and increase their capital value in line with inflation

**Liquidity:** ability of invested funds to be realised through the sale or refinancing of the asset reflecting the illiquid nature of direct property ownership

**Yield:** ability of assets to generate positive Net Operating Income and positive net returns after debt service within [market normative ranges]

2.5. Investments will made into the following asset classes. Investments will be expected to make minimum levels of returns. These are set out in detail in the IAS attached as Appendix A.

Asset class	Sector
Residential	Affordable Rent
	Shared Ownership
	Market Rent (secondary)
	Market Sale
Commercial	Offices (good secondary)
	Retail (good secondary)
	Industrial (good secondary)
	Student & Creative Arts
	Hotel & Leisure
Infrastructure	Energy
	Infrastructure
Commercial Lending	Debt

## 2.6 Delivering the £5.125m income target

The Council is on track to achieve the investment income target of £5.125m by 2020/21 and then £5.891m by 2021/22 in cumulative terms. A reserve, from prior year investment surpluses, has been set up to cover any shortfalls that may result from delays in developments becoming operational.

Table 1 summarises the current net income arising from the IAS and the interest to support the strategy. The net requirement does increase from £1m in 2019/20 to £2.2m and this reflects the cost during a significant part of the development stage. Overall the IAS is expected to outperform the net investment cost and to provide significant surpluses in 2023/24 onwards.

**Table 1: Investment and Acquisitions 2019/20 to 2022/23**

£'000s	2019/20	2020/21	2021/22	2022/23
	Forecast	Forecast	Forecast	Forecast
General Fund Interest Payable	12,500	15,600	21,071	24,513
Interest Receivable	-7,674	-8,374	-13,395	-16,387
<b>Net Interest</b>	<b>4,826</b>	<b>7,226</b>	<b>7,676</b>	<b>8,126</b>
<b>Investment Income</b>	<b>-3,733</b>	<b>-5,125</b>	<b>-5,891</b>	<b>-5,891</b>
<b>Net Investment Cost</b>	1,093	2,101	1,785	2,235

## 2.7. Investment Programme

Be First is now established as the Council primary delivery agent for the delivery of current programme and identification of new investment schemes. The development programme has been reviewed, development densities increased where appropriate and additional investment opportunities have been identified which are being actively pursued. Table 2 below summarises the current development programme.

**Table 2: Be First Business Plan Summary 2019/20 to 2022/23**

Year	Development Requirements	Be First Total Annual Return	Units
	£000s	£000s	
2019/20	79,794	5,622	112
2020/21	220,325	10,835	208
2021/22	216,504	11,070	790
2022/23	148,695	10,710	823
<b>Total</b>	<b>665,318</b>	<b>38,237</b>	<b>1,933</b>

This programme requires approximately £665.3m net cost to be funded reducing to £522.8m after deduction of sales. Additional commercial investment opportunities have also been identified; these will be reported to Cabinet for approval as scheme details are finalised. Each scheme's cashflow includes debt repayment and debt repayment and this remains a fundamental part of the IAS.

## 3. Consultation

### 3.1. The Cabinet Member for Finance, Performance and Core.

## **4. Financial Implications**

Implications completed by: Helen Seechurn, Interim Director of Finance

### Development period and long-term borrowing

- 4.1. Due to the scale and timing of the development programme the initial schemes will be funded by borrowing from the Public Works Loan Board (PWLB). As the scale of development increases funding using institutional funders or bond issuance will be considered to limit the amount of development period exposure to the Council. This approach would allow the Council to limit funding to a defined development programme and to refinance schemes, subject to market conditions, when fully let and stabilised to release capital growth for reinvestment in other projects or elsewhere in the Council.
- 4.2. Bond rates are at historically low rates and the demand for long-dated, inflation linked returns remains strong from institutional investors

### Medium Term Financial Strategy

- 4.3. The Council's balance sheet is currently £1bn in value. To fund the Investment Strategy, the Council will be heavily geared and the debt to asset ratio could be as high as 3:1 during the development period. This ratio will decrease as assets are built and let and are then included on the Council's balance sheet.
- 4.4. In line with the prudential code, the Council will need to demonstrate it can afford to carry the cost of borrowing to fund for both the construction period as well as the initial years before each of the schemes become cash flow positive. All borrowing will be profiled against the individual schemes, ensuring that the cash is available during the construction stage but that the repayment of the debt is included as the schemes generate income from rental and sales over the economic life of the asset. Borrowing will also be made over a period and will be dependent on the requirement but may also be made as and when rates are low.
- 4.5. The Investment Panel will review all schemes and investment proposals individually based on the Terms of Reference previously agreed by Cabinet.
- 4.6. Property acquisitions may be held on the Council's balance sheet or, where more financially advantageous, acquired through a Barking and Dagenham Reside SPV. Acquisitions will be supported by detailed legal and tax advice for each proposal.

## **5. Legal Implications**

Implications completed by: Dr. Paul Feild Senior Governance Lawyer

- 5.1 The Local Government Act 2003 is the key legislation for local authority investment regulation and section 15 of the Act requires that the Secretary of State issues Statutory Guidance on investments the most recent being issued in April 2018. For each financial year, a local authority should prepare an investment Strategy and follow disclosures and reporting requirements specified in the guidance. The Secretary of State recommends that the Strategy should be presented for approval prior to the start of the financial year.

The Council has a wide range of powers concerning borrowing, investment and dealings with property which would empower the Council to pursue its Investment Strategy. 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 the activity 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.

- 5.2 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 2006 (s.4(2) Localism Act 2011).
- 5.3 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. Speculative borrowing to invest purely for profit will not be deemed directly relevant to fulfilling the authority’s functions and will not, therefore, be authorised under this power, however, 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 in the context of prudent borrowing practice, which should be considered as individual investment decisions are made. In exercising the power to invest under s.12(b) the Local Government Act 2003 the Council should have regard to the 2018 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 sensible and cogent reasons exist for departing from it.
- 5.4 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 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 the 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 the functions of the Council and are consistent with prudent management of the Council’s financial affairs.
- 5.5 Section 111 of the Local Government Act 1972 (“Incidental Power”) enables a local authority to do anything (whether 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.
- 5.6 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 relate to shaping the strategic growth and economic development of the area to meet the needs of a growing local demographic and to 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 local 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 the creation of employment opportunities, are furthered and public funds are not exposed to unnecessary or unquantified risks.

- 5.7 Notably, many individual investment and acquisition decisions will be made in implementing the various strands of the Investment Strategy. Individual decisions will be taken by the Chief Operating Officer, advised by the Investment Panel, pursuant to delegated powers in respect of 'corporate and strategic finance, treasury management, investments, and the capital programme...' (Part 3, Chapter 1, paragraph 8.1(g) of the Constitution). To the extent that such decisions are key decisions, or urgent action is taken to acquire land (under paragraph 4, chapter 16, Part 2 of the Constitution) such decisions will be reported or notified to Cabinet in future reports. At all times, full consideration will be given to the Council's powers of investment and acquisition, any relevant guidance such as the CIPFA Code and the overall aims of this Investment Strategy.
- 5.8 The Council's Constitution, Part 4, Chapter 4 sets out the Land Acquisition and Disposal Rules. In accordance with paragraph 2.1, Part 2: Articles, Chapter 6 of the Constitution all key decisions and strategic decisions falling within the Land Acquisition and Disposal Rules as to the use, acquisition and disposal of land and property assets are generally within the remit of the Cabinet.
- 5.9 Formulation of strategic decisions is, at this time, overseen by the Property Advisory Group (PAG) and the Cabinet. Given the creation of the Investment Panel, to the extent that acquisition decisions are taken for investment purposes pursuant to the IAS, the Panel will advise and make recommendations as to such decisions either to COO (to the extent of the delegated powers available) or to Cabinet. Such investment driven acquisition 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 of the decision. Decisions on strategic acquisitions pursuant to the Investment Strategy / IPA would be made by Cabinet or COO, advised by the Investment Panel, in accordance with the Council's Constitution and its Land Acquisition and Disposal Rules and the Scheme of Delegation. For the sake of efficiency, Cabinet is expected to approve an investment programme on a rolling basis (as set out in Appendix A) and to delegate any necessary authority to the COO, advised by the Investment Panel, to implement individual decisions in respect of individual schemes within the investment programme.
- 5.10 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 deciding. 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 wide spread practice.

## 6. Other Implications

- 6.1 **Risk Management** - each potential investment and land acquisition opportunity will be subject to a full evaluation and risk analysis process as part of the IAS approvals process and scheme development Gateway review mechanism. This will be managed on behalf of Cabinet by the Investment Panel. The Investment Panel will be supported by external professional advisors
- 6.2 **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. Each such proposed acquisition will be subject to the review process set out in Appendix A.
- 6.3 **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.
- 6.4 **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. In addition, the investment and regeneration programme facilitated by the IAS will underpin the creation of new communities within the borough and will increase housing choices and housing affordability. In turn, this will help to address fuel poverty and help improve household health and educational outcomes.
- 6.5 **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.
- 6.6 **Health Issues** - the provision of new housing has demonstrable health and wellbeing effects for occupants.
- 6.7 **Property / Asset Issues** - the proposals in this report will help the Council increase its affordable housing and income generating asset base. The proposals would also help to address physical and social obsolescence asset management challenges within the Council's existing property holdings and in the private sector.

**Background Papers Used in the Preparation of the Report:** None.

### List of appendices:

- Appendix A: Investment and Acquisition Strategy