

## **SLOUGH BOROUGH COUNCIL**

**REPORT TO:** Council **DATE:** 22 September 2015

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**WARD(S):** All

### **PART I** **FOR DECISION**

#### **RECOMMENDATIONS OF THE CABINET FROM ITS MEETING HELD ON 14<sup>TH</sup> SEPTEMBER 2015**

##### **C. PROPOSED STRATEGIC ACQUISITION STRATEGY**

###### **1. Purpose of Report**

To advise the Council of the recommendation of the Cabinet to introduce a Strategic Acquisition Strategy to enable the Council to undertake asset investment through the acquisition of land and/or property generating income to realise the ambitions and outcomes agreed in the 5 Year Plan and improve the Council's financial resilience.

The report seeks to balance the need for high levels of governance with the requirement to introduce a focussed approach that will allow the Council to respond within commercially focussed timescales, accelerate regeneration objectives and/or strengthen the Council's financial position.

This report also details the acquisition process, market and financial implications associated with such a strategy.

###### **2. Recommendation(s)/Proposed Action**

The Council is requested to resolve that:

- (a) The introduction of the proposed Strategic Acquisition Strategy and associated procedure to enhance the ability for the Council to compete for investment opportunities within commercial timescales be approved.
- (b) To accelerate regeneration objectives, realise local economic development outcomes and provide long-term strategic benefits, it be agreed that all strategic acquisitions should normally be made within the Borough of Slough.
- (c) The Council's Financial Regulations be amended to enable the acquisition of assets by Cabinet up to £25m (inclusive of acquisition costs) and give authority for the capital programme to be amended as required.
- (d) The Strategic Director for Regeneration, Housing and Resources be given delegated authority, following consultation with the Commissioner for Neighbourhoods and Renewals and the Leader of the Council, authority to introduce the proposed Strategic Acquisition Board ("SAB").

- (e) Delegated authority be given to the SAB to make strategic acquisitions in line with the objectives, criteria and governance procedures set out in this report following consultation with the with the Commissioner for Neighbourhoods and Renewals and the Leader of the Council.
- (f) It be noted that in the event that Strategic acquisitions exceed £25m per annum, flexibility is introduced to provide authority to make a bid subject to Council approval.
- (g) A balanced investment portfolio be created in line with set criteria, generating an independent income stream alleviating some of the pressure enforced by central government funding cuts.

### 3. **The Slough Joint Wellbeing Strategy, the JSNA and the Five Year Plan**

The introduction of a streamlined procedure to pursue strategic acquisition would create the conditions for the Council to maximise the value of its existing asset base, acquire land and property that will make a significant contribution to the town centre regeneration strategy, increase business rates and council tax receipts and provide an income stream that could contribute to the provision of front line services.

The acquisition of property assets is a direct way of influencing regeneration and a streamlined procedure creates the conditions to potentially secure the economic wellbeing of the Borough. Whilst acquisitions can be undertaken to extend service delivery, they can also have a financial 'future-proofing' effect, underpinning financial security for the Council by providing an income stream independent of Government funding or Council Tax revenues.

#### 3a. **Slough Joint Wellbeing Strategy Priorities**

Individual acquisitions will be reviewed in line with the Slough Joint Wellbeing Strategy priorities.

#### 3b. **Five Year Plan Outcomes**

Outcome three of the 5 year plan focuses on ensuring that the centre of Slough will be vibrant, providing business, living and cultural opportunities. This workstream is being delivered via the *Changing Views* task and finish group. The introduction of an effective Strategic Acquisition Strategy is a key element of this workstream and will create a mechanism for the Council to assemble land and gain control of key sites that will facilitate broader regeneration and economic development objectives. The acquisition of income generating assets is also closely tied to outcome seven, which seeks to maximise the value of the Council's assets and income.

### 4 **Other Implications**

#### a) **Financial**

Cash held by the Council is invested in accordance with the Treasury Management policy. As per the Council's policy, the Council has to assess the comparative risks and rewards when investing money. Due to unprecedented low interest rates these cash investments have produced relatively low returns in recent years compared to previous financial cycles. However, at the same time the low cost of borrowing has

created a margin between the investment return and the interest rate payable which the Council can take advantage of e.g. if the Council borrows at 3.5% and purchases an investment using debt generating 6% then the Council will gain the benefit of the margin.

SBC currently owns a portfolio of property and land assets that comprises investment (commercial) and service delivery (operational) assets. Commercial assets are held for the purpose of generating rental income and/or capital appreciation. The portfolio includes light industrial units and secondary retail premises as well as ‘minor’ interests, for example wayleaves, easements and licenses. Whilst the investment portfolio is varied, its net financial contribution is modest compared to other councils.

Subject to approval, the implementation of a Strategic Acquisition Strategy would provide a framework for SBC to secure assets with an income stream that will outperform the current returns the Council receives through its treasury management activities. This will increase the Council’s financial resilience against a background of austerity measures and help to offset the impact of reduced funding from central government.

In addition to establishing an acquisition budget of £25m, it is recommended that a budget provision of £100,000 is made within both the Council’s General Fund and Housing Revenue Account (“HRA”) to be used towards acquisition costs. This type of transaction can result in some abortive costs and will remain a cost to the General Fund and HRA. However, if an acquisition is successful then these costs can be treated as part of the capital cost of acquisition.

Acquisition of assets funded through borrowing will attract interest charges, therefore the ongoing revenue implications will be a key consideration when evaluating individual business cases. The financial appraisal for each potential acquisition will reflect this ongoing commitment and the restrictions this could place on revenue flexibility when considering future Council budgets.

It is anticipated that there will be a requirement to fund strategic acquisitions from a range of options including borrowing funds from the Public Works Loan Board, utilising internal balances, partnership with government agencies, joint ventures with the private sector or receipts from disposals. The actual resources to be used for each acquisition will be set out in the business case.

b) Risk Management

**Risk**

**Legal** – competing priorities could create delays.

Property market risk – property is a riskier asset than other asset classes because of its physical characteristics, which need to be managed and maintained together with the time needed to liquidate time  
The Council may not achieve its target returns if market conditions significantly worsen

**Mitigating action**

Appoint external solicitors to undertake due diligence and provide comprehensive reports on title, deeds, leases etc, as required.

Undertake appropriate due diligence and appoint specialist advisers as required.  
Target assets/locations where income is secured and rental growth identified.

**Opportunities**

Market conditions can go up as well as down, with the Council benefitting from increased returns during an upturn.

<b>Human Rights</b>	No risks identified	
<b>Health and Safety</b>	No risks identified	
<b>Employment Issues</b>	No risks identified	It is proposed to appoint agents to act on behalf of the Council as they offer investment expertise and market intelligence not held internally.
<b>Equalities Issues</b>	No risks identified	
<b>Community Support</b>	No risks identified	
<b>Communications</b>	No risks identified	
<b>Community Safety</b>	No risks identified	
<b>Finance</b> - Abortive costs including legal and survey fees, staff costs, initial feasibility costs.	Whilst efforts will be made to reduce abortive costs it is inevitable that the Council will on occasions incur costs on projects that do not proceed.	
<b>Timetable for Delivery</b> – The existing approach is cumbersome and has added to the inability to pursue strategic acquisitions.	Introduce a Strategic Acquisition Board with the specific remit of considering strategic acquisitions.	The proposed process would speed up timescales and enhance the Councils ability to compete for strategic acquisitions.
<b>Governance</b> – Poor performance	Introduction of specific procedures relating to Strategic Acquisitions, which set out objectives, criteria and delegated authority.	
<b>Performance</b> –	No risks identified	

b) Human Rights Act and Other Legal Implications

The Council's powers to acquire land are governed by statute. Section 120 of the Local Government Act 1972 permits the Council to acquire by agreement any land whether situated inside or outside its area of operation. It does not matter that the asset is used immediately for the intended purpose and may be used for an alternative purpose in the interim.

c) Equalities Impact Assessment

There are no equalities issues associated with this report. However the accessibility of properties will be one of the factors for consideration in deciding between investments.

5 **Supporting Information**

**Background**

5.1 As a consequence of sustained reductions in funding from central government being matched by growing demand to provide public services, local government is becoming increasingly adept at operating within a commercial environment to generate income streams. The introduction of Slough Regeneration Partnership ("SRP") is an example of how Slough has responded to the prevailing environment. Through the joint venture with Morgan Sindall Investments Limited, the Council maximises the value of its asset base by receiving both a capital receipt and a 50% share of net profits for each commercial development undertaken by SRP. Whilst this delivery method has been highly successful, there is scope for this approach to be complemented by a strategy to acquire investment assets that will generate a commercial return.

- 5.2 In addition to meeting financial objectives, an overarching strategy that identifies key land acquisitions will provide staff and Council with a clear and comprehensive framework for decision making. It will allow Slough to be more strategic, opportunistic and prepared for future land acquisition opportunities that arise.
- 5.3 The Council is well placed to follow the example of its peers and have greater involvement in property and entrepreneurial activities. However, the inflexibility of the existing policy does not facilitate a proactive approach. Consequently Slough has a very limited track record in pursuing strategic acquisition and commercial investment opportunities. This report outlines an approach to acquire a mixed portfolio of properties that provide a commercial return and/or land purchases that fall within the definition of strategic acquisitions.

### **Investment Property Market Outlook**

- 5.4 Soaring demand for UK commercial real estate continued in Q1 2015. Investment of £16.8 billion across 850 deals marked a nine year first quarter high and a 12% increase from Q1 2014. Although seasonal factors meant a 29% drop from the record £26.6 billion invested in Q4 2014, the momentum continues, with property still proving very attractive to investors on a relative value basis. As the first quarter is normally the quietest of the year, 2015 could potentially go on to and surpass 2014's all time high.
- 5.5 There were several standout themes in the last quarter, with the rise of multi region portfolios prominent among them. A record £5.9 billion poured into this type of deal in Q1, double Q1's 2014's figure and well above the 5-year quarterly average of £2.2 billion. The seven largest deals were all portfolios, as vendors looked to capitalise on competitive pricing, and buyers – mainly from the US – sought to invest large chunks of capital all at once in the hope of outsized returns. Rising demand for 'alternative assets' was another key theme in Q1, with investors increasingly willing to embrace sectors outside of the traditional big three of office, retail and industrial. A record £2.2 billion was spent on student accommodation during the quarter, more than five times the five year average, while hotel investment doubled to hit a quarterly high.
- 5.6 Yields must be mentioned. Although pricing remains highly competitive in London, average yields outside the capital expanded in all sectors in Q1. Reasons include a declining pool of available prime assets – following 2014's accumulation of deals – and an increasing craving for risk. Next quarters results will determine whether or not this trend is an anomaly.

### **Economic Trends**

- 5.7 The last year has seen the UK commercial property market shift, powered by improved economic essentials which drive the primary occupier base. The improvement of economic growth, which has been aided by low inflation, has seen improvements in both consumer and business confidence, which will lead to rental growth where demand outweighs supply.

Reports indicate that the industrial sector is now showing similar performance increases to the office sector. Office total returns for the last 12 months are at 23% with capital growth of 16.8%, compared to the industrial sector which has delivered a total return of 22.7% boosted by capital growth of 15.1%, driven mainly by yield compression.

## Indicative Yields

5.8 The table below shows the commercial property yields:-

<b>Sub-Sector</b>	<b>Equivalent Yields</b>
Prime Shops	4.25%
Retail Parks: prime - open user	4.25%
Prime Offices (South-East)	5.00%
Prime Shopping Centres	4.75%
Good Secondary Shops	6.00%
Prime Industrial (Exc Heathrow and London)	4.75%
Secondary Estates	6.75%

### Definitions:

5.9 A strategic acquisition can be defined as the acquisition of land or properties that will allow the Council to expedite key outcomes contained within the 5 Year Plan. To be considered strategic, it is suggested that acquisition must make a significant contribution towards regeneration objectives and/or provide a commercial return on investment that will improve the financial resilience of the Council:

### Property Investments

5.9.1 Under commercial investment objectives, a strategic acquisition would typically:

- Generate income through a satisfactory level of return, with a net initial yield range between 5% and 9%, and/or
- Improve investment value of commercial assets over time in addition to the level of returns through rental growth.

The type of property assets that are likely to fall within this definition will include (but not be limited to) properties let to local businesses including retail, finance, professional services and other public sector bodies. Assets already owned by the Council that are subject to long-term leases to third parties will also fit with this strategy subject to there being a strategic, financial or economic development benefit to buy back the lease.

### Regeneration

5.9.2 Under regeneration objectives, a strategic acquisition will typically:

- Deliver large scale development that will provide attractive, accessible places to live and work and do business; or
- Allow the redevelopment of smaller development sites in key locations that have stalled, or
- Enable the Council to acquire land required to deliver infrastructure projects, or
- Enable collaborative working with adjoining owners to maximise land value; or
- Improve the image of Slough to a status that fully recognises the strategic importance and benefits offered by the town as a sub-regional gateway to and from London.

- Generate additional capital and revenue income to support the financial projections set out in the Medium Term Financial Plan.

Whilst the acquisition of strategic regeneration sites will typically be dependent on land becoming available for sale, the Council will be proactive and will consider off market acquisitions and the use of Compulsory Purchase Orders as required.

- 5.10 Since the purpose of this strategy is specifically linked to the 5 Year Plan, for economic development and regeneration purposes, it is recommended that acquisitions outside the Borough of Slough should not normally be considered unless there are exceptional circumstances.

### **Policy Context**

- 5.11 Cabinet approved the existing Asset Management Plan (“AMP”) and a suite of associated policies in February 2014. The AMP sets out the objectives and targets to be applied to the management of the property portfolio.

The AMP confirms that all acquisitions, whether planned, opportunistic or via the use of Compulsory Purchase, must be made in accordance with the Council’s Disposal, Investment and Acquisition Policy. This policy describes the process by which land and property are acquired by SBC, the powers used and the arrangements followed to ensure acquisitions support the Council’s corporate priorities. In accordance with the policy, land and property acquisition will occur when:

- A need is identified for the acquisition of a specific asset in response to an approved strategy, programme or capital project, or
- An opportunity arises to purchase an asset where the Council would secure an operational, financial or strategic benefit, or
- A Council scheme is identified, for example a Highways-led regeneration project that effectively ‘blights’ areas or land and/or properties<sup>1</sup>.

### **Strategic Acquisition Board – membership, roles and responsibilities**

- 5.12 In order to balance the objectives of introducing a streamlined approach (to avoid losing acquisition opportunities through delays in process) with high levels of probity, it is recommended that a Strategic Acquisition Board (“SAB”) is introduced.

- 5.13 The SAB will be a sub-group of the Capital Strategy Board. It will meet on a monthly basis and will be chaired by the Strategic Director for Resources, Housing and Regeneration. The standing members of the SAB will include the:

- Leader of the Council
- Commissioner for Neighbourhoods & Renewals
- Strategic Director Regeneration, Housing & Resources
- Assistant Director Assets, Infrastructure and Regeneration
- Assistant Director Housing & Environmental Services
- Directorate Finance Manager Customer & Community Services, Regeneration & Housing
- Head of Asset Management

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<sup>1</sup> Source: SBC Asset Management Plan 2014-2017

5.14 The SAB will have a remit to:

- Consider acquisition recommendations put forward by the Head of Asset Management (or delegate).
- Review proposed land acquisition and/or property investment proposals, taking into account the extent to which the proposition fulfils the Council's policy objectives against a set of agreed criteria.
- Make strategic acquisition and investment decisions on behalf of the Council.
- Oversee and monitor the performance of approved acquisition and investments.
- Report acquisitions to the Capital Strategy Board and Cabinet.

5.15 It will be the responsibility of the SAB to monitor the performance of the investment portfolio, ensuring that individual assets are performing thereby maximising rental returns and selling assets when they no longer perform. The investment portfolio will grow on an annual basis and where assets have been sold, the capital receipts will be re-invested into property.

### **Acquisition Process**

5.16 When a strategic acquisition is identified the Acquisition Protocol outlined in Appendix One will be followed.

5.17 It should be recognised that in some instances officers will have to submit an expression of interest and/or make a conditional offer on acquisitions within tight timescales. This will be after consultation with the Leader of the Council and Commissioner for Neighbourhoods & Renewals. Final offers will be subject to approval from the SAB.

5.18 All Strategic Acquisitions will be reported to the next scheduled meeting of Cabinet.

### **Assessment Criteria – Investment Properties**

5.19 When acquiring assets of this nature, it is important to have a well balanced portfolio which can counteract significant market changes. Each asset acquired would need to be considered in line with the existing portfolio e.g. if the majority of the portfolio were industrial then it would need to be balanced with further office and retail property, or if the portfolio income was very insecure then it could be balanced by investments with longer projected income.

5.20 Officers will apply a defined list of property specific criteria when making recommendations to the SAB on investment acquisitions using the proposed criteria set out in the table within Appendix Two of the report to Cabinet from 14<sup>th</sup> September 2015 (which was noted in Part II as it contained exempt information).

5.21 With the Strategy's objective to buy investment assets within the Borough for the economic development or regeneration purposes, the Council should have the discretion to buy assets that may fall outside the investment criteria outlined above if there is an overriding strategic benefit.

### **Assessment Criteria – Strategic Land Acquisition**

5.22 To establish a strategic land acquisition mechanism that provides a framework and methodology for the Head of Asset Management (or delegate) to nominate site



specific and non site specific land targets to the SAB it is important to identify and agree a set of qualitative guidelines and agreed criteria. These were set out in Appendix Three of the Cabinet report considered on 14<sup>th</sup> September (Part II, contained exempt information).

5.23 All land acquisitions will be presented using an acquisition pack which will contain:

- Current market research and agent advice on values,
- Acquisition budget estimating any proposed construction expenditure,
- Financial models of the assets anticipated financial performance including cash flows forecasting anticipated expenditure and returns,
- An acquisition checklist designed to ensure that every acquisition is considered in respect of a range of potential risks i.e. legal, ground conditions, flooding etc.

5.24 Once approved the figures agreed in the acquisition pack will become a cap in terms of what can be offered for the property.

5.25 If an acquisition is successful the acquisition pack will become the measure against which its performance and management are assessed.

### **General Principles**

5.26 All acquisition opportunities presented to the SAB will be supported by a financial appraisal and business case to establish the financial and budgetary implications. Before approving any acquisition, the SAB will require confirmation that the acquisition will not increase the Council's ongoing revenue costs, including the cost of borrowing and officer time.

The appraisal and business case will assess how the strategic acquisition will be financed and will:

1. Consider if the investment achieves corporate objectives.
2. Confirm that for the acquisition of land the price is reasonable (allowing for a special purchase consideration) and supported by an independent valuation.
3. Confirm that for the acquisition of a standing investment the price is reasonable and supported by an independent valuation (reference will be made to previously identified added value opportunities).
4. Confirm there is a market requirement.
5. Where appropriate, there is secure rental income taking into account risks associated with the security of future payments, including (where appropriate) sensitivity analysis for void periods.
6. Identify whole life costs (where appropriate).
7. Identify the most appropriate funding source(s) and confirm availability.
8. Clarify that the Council's Finance Section has assessed the business case and confirmed a suitable return on investment.

5.27 The financial appraisal will identify all costs and assumed income to assist informed decision making on whether the acquisition is suitable. In the case of revenue generating assets, this will be assessed by comparing the anticipated net income against the rate of return the Council could otherwise expect to achieve on its capital.

5.28 On reaching agreement as to the terms of acquisition, a final report will be prepared for approval by the Strategic Director for Resources, Housing and Regeneration in

consultation with the Leader. In all instances the final report must be supported by advice from the Section 151 Officer.

## **Resourcing**

- 5.29 The Council identifies potential acquisition opportunities through a combination of in-house knowledge of the local market and selling agents that present potential investment opportunities to the attention of Asset Management. Whilst the Council is aware of land opportunities for regeneration, the Asset Management section is not adequately resourced to identify and investigate in detail suitable investment opportunities. It is proposed that the Council will appoint external advisors to provide expert advice, funded initially from the proposed £100k budgets for acquisition costs.
- 5.30 As the investment portfolio develops it will need to be asset managed. Whilst this will initially be done in-house by Asset Management, consideration will need to be given to appointing external advisors to undertake this role. Whilst this process is in its infancy, external advisors can be appointed on an *ad hoc* basis but will need to be more formalised once the portfolio grows and factored into the financial appraisal.

## **6. Comments of Other Committees**

- 6.1 This report was considered by the Cabinet at its meeting held on 14<sup>th</sup> September 2015 along with further appendices containing exempt information relating to the Scoring Criteria for Investment Asset and Strategic Land Acquisition Criteria. The Cabinet agreed to recommend the adoption of a Strategic Acquisition Strategy to Council and resolve the matters in section 2 (a) to (g) of this report accordingly.

## **7. Conclusion**

- 7.1 This report recommends the introduction of Strategic Acquisition Strategy. If approved it will become part of the Council's overall property Asset Management Strategy and will provide a mechanism by which the Council can compete on a commercial footing to acquire key regeneration sites and/or build a commercial investment portfolio that will provide a material return via annual revenue.
- 7.2 The acquisition of strategic sites within Slough has the potential to provide an income stream that will help to reduce the £36m funding gap identified in the Council's Medium Term Financial Plan and accelerate the regeneration of the town.
- 7.3 The report suggests the introduction of a £25m budget for strategic acquisitions. Cabinet could decide to retain the existing approach or set a lower limit, however this would undermine the ability of the Council to secure long-term income streams. However it should be stressed that the impact of approving this report is that the Council will need to increase its borrowing requirements in the medium term.
- 7.4 In order to acquire assets, commercially sensitive negotiations may need to take place quickly with key decisions required outside normal meeting cycles. The introduction of a procedure to acquire assets within an agreed protocol will improve the Council's ability to operate within commercial timescales, enhance its ability to complete strategic acquisitions and/or investments and alleviate the risk of losing opportunities as a consequence of delays in process.

## **8. Appendices**

1. Acquisition Protocol

## Appendix One – Acquisition Protocol

Property identified as a potential Strategic Acquisition by Asset Management and/or external advisor



Asset Management to advise SAB members of a prospective asset purchase.



**Pre-offer stage:** circulate template of information on full details and cash flow of the potential acquisition to SAB and legal services and financial implications of purchase are fully understood, before proceeding



Request approval from SAB & 151 Officer to enter into the bidding process.



To update SAB as necessary and thereafter agree Heads of Terms where bid is successful and commission independent surveys, purchase report and valuation



Subject to any final observations from SAB request their authority to accept the offer subject to contract.



Once the bid is confirmed by SAB, Asset Management to instruct solicitors and when contracts are agreed, seek final approval from SAB to exchange.

### Note:

It should be recognised that some of these actions are likely to be simultaneous