SLOUGH BOROUGH COUNCIL

REPORT TO:	Cabinet	**DATE:** 19 December 2016	
CONTACT OFFICER:	Stephen Gibson, Head of Asset Management		
(For all enquiries)	(01753) 875852		
WARD(S):	All.		
PORTFOLIO:	Housing & Urban Renewal Leader of Council		- Cllr Ajaib - Cllr Munawar

PART I
KEY DECISION

PROPOSAL TO INTRODUCE AN ASSET MANAGEMENT COMPANY

1. **Purpose of Report**

1.1 During the meeting held on 14 November 2016, Cabinet agreed the recommendation to provide an additional £25m budget to purchase property and land assets. This included additional flexibility to acquire investment assets outside Slough. Since borrowing finance to assemble a significant portfolio of assets out of borough could be deemed as the authority acting for commercial purposes, the Council is required to undertake this form of commercial asset management through a trading company.

1.2 This report seeks approval to introduce a wholly owned Asset Management company that will acquire, own and manage strategic assets outside Slough.

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

Cabinet is resolved to resolve:

(a) That an Asset Management Company be developed, limited by shares and wholly owned by the Council, to acquire own and manage and dispose of strategic assets located outside the operating area of Slough Borough Council.

(b) That the proposed governance arrangements for the Asset Management Company including the Shareholder Agreement set out in Appendix Two be approved.

(c) That the Head of Legal Services, following consultation with the Commissioner for Housing & Urban Renewal and the Leader of the Council be delegated authority to develop Articles of Association and incorporate the Asset Management Company based on the content of this document and;

(d) That Joe Carter, Assistant Director Assets, infrastructure & Regeneration be appointed as the founding director of the company in order to enable the company to be registered (as this requires at least one named director) and basics to be established (such as setting up banking arrangements).

(e) That the Head of Legal Services, following consultation with the Commissioner for Housing and Urban Renewal and the Strategic Director Housing, Regeneration & Resources, are authorised to commence the incorporation of the Asset Management Company, select the company name in order to do so (which will be subject to availability at Companies House) and complete all necessary documentation as set out the report.

(f) That the Assistant Director of Finance & Audit be delegated authority to develop the draft Heads of Terms for the Facility Agreement for the Council to provide loan and equity finance to the Asset Management company and following consultation with the Leader, be authorised to finalise the Facility Agreement and to enable all amounts agreed by full Council to be lent to the Asset Management Company.

(g) That the Assistant Director of Finance & Audit be responsible for the Council's Shareholder function.

(h) That the Assistant Director Finance & Audit be authorised to agree prices for services provided by the Council (such as Asset Management and Finance), between the Council and the Asset Management company.

(i) That the request to provide an overdraft facility of £50,000 to establish the company, which will be repaid in 18 months from the company going operational, be approved.

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

3.1 The introduction of a wholly owned company to pursue strategic acquisition will allow the Council to acquire land and property throughout the UK and compete on commercial terms with local authority peers that are now active in this market. The income stream generated via interest payments and dividends will create an independent income stream that will reduce the impact of cuts in central government funding and safeguard frontline services that contribute to wider strategic priorities.

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

The introduction of the Asset Management Company will create a mechanism for the Council to assemble a material property and land portfolio outside Slough that will generate a new income stream and is therefore closely tied to Outcome 7, which seeks to maximise the value of the Council's assets and income.

4 Other Implications

a) Financial

The rationale for introducing an Asset Management Company is to provide a vehicle to invest in income generating assets to deliver an ongoing return to the Council in order to protect service provision.

The current Medium Term Financial Plan has a budget shortfall of £12.4m in 2017/18. The income generated via lending funding to the company will directly contribute to the reducing this shortfall.

The Council introduced an initial a budget for strategic asset purchases in September 2015 and approved an additional budget of £25m in November 2016. Since it is assumed that this budget facility will be available to the new company (if required), this report does not require additional capital funding. However, to cover initial set-up costs and to provide funds for pre-investment activity including a provision for specialist advisors, the report requests an overdraft facility of £50,000 for the first 18 months operation of the company, which will be repaid.

Under State Aid Rules the Council will not be permitted to give the companies any form of financial assistance unless they do so on terms which are generally available in the market place or unless the Council are able to rely on exemptions contained within those rules. There are "de minimis" rules permitting assistance not exceeding 200,000 euros in aggregate for all assistance by the Council in any three year rolling period and exemptions, subject to compliance with conditions, for assistance related to provision of affordable housing.

b) Risk Management

Risk	Mitigating action	Opportunities
Legal – competing priorities could create delays.	Appoint external solicitors to undertake due diligence and provide comprehensive reports on title, deeds, leases etc, as required.	
Property market risk – property is an inherently riskier asset than other asset classes because of its physical characteristics, which need to be managed and maintained. The Council may not achieve its target returns if market conditions significantly worsen	Undertake appropriate due diligence and appoint specialist advisers as required.	Market conditions can go up as well as down, with the Company benefitting from increased returns during an upturn.
Human Rights	No risks identified	
Health and Safety	No risks identified	
Employment Issues	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.
Equalities Issues	No risks identified	
Community Support	No risks identified	
Communications	No risks identified	
Community Safely	No risks identified	
Finance - 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.	

Timetable for Delivery – The existing approach is cumbersome and has added to the inability to pursue strategic acquisitions.	Introduce an Investment Committee 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.
Governance – Poor performance	Introduction of specific procedures relating to Strategic Acquisitions, which set out objectives, criteria and delegated authority.	
Governance – The Governance structures do not allow appropriate decision making and/or enable the project to be properly set up or delivered	Expert legal advice has been sought to introduce appropriate governance structures. Final Governance arrangements are proposed within this report.	
Performance –	No risks identified	

c) Human Rights Act and Other Legal Implications

Under Section 120 of the Local Government Act 1972 the Council may acquire by agreement any land whether situated inside or outside their area. It may do so for the purpose of (a) any of their functions under that or any other enactment or (b) for the benefit, improvement or development of their area. However, the reference in Section 120 to the benefit of the area requires some more direct connection with the property acquired than the mere fact that income from it could in future be applied to the provision of local services. Accordingly the Council may not rely on this provision to acquire property outside their area simply for the purposes of generating revenue to support services.

Under Section 12 of the Local Government Act 2003, however, the Council may invest (a) for any purposes relevant to its functions under any enactment or (b) for the prudent management of its financial affairs. Investment is generally considered to mean the acquisition of an asset to be used as a source income or alternatively the asset may be a source of capital gain. Accordingly the Council may invest in property, regardless of the location of the property under this provision if it does so for the purpose of the prudent management of its financial affairs.

What the Council may not do, however, is to conflate its powers under Section 1(b) of the Local Government Act 2003 to borrow for the purposes of the prudent management of its financial affairs with its powers under Section 12(b) to invest for the purposes of the prudent management of its financial affairs in order to be able to borrow money for the purposes of investment only, without any relation to any other specific function. In order to borrow purely for the purposes of investment it must rely upon its general powers of competence in Section 1 of the Localism Act and as acquisition of property for the purposes of generating profit would amount to doing something for a commercial purpose and would need to be done through a company, as required by Section 4 of the Localism Act 2004, if this power is to be relied upon

The constraints upon the Council in exercising its investment powers under Section 12 of the Local Government Act 2003 are that it must always comply with ordinary “Wednesbury” principles i.e. it must act reasonably and have regard to relevant matters which, in this context, would include the Guidance issued by the Secretary of State relating to local government investments, which has statutory force under Section 15, and to regulations made under that section. This guidance calls in particular for the production of an appropriate investment strategy and the Council would then need to adhere to that strategy unless there are sensible reasons for not doing so.

d) 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 has become increasingly adept at operating within a commercial environment to generate income streams. A report in October 2016 highlighted that local authorities have spent more than £780m this year to acquire a variety of investment assets including shopping centres, retail units and offices, which is more than the previous three years combined (Financial Times, October 2016).

5.2 In recognition of the financial and regenerative advantages of acquiring a portfolio of investment assets, Slough Borough Council ("SBC" or "the Council") introduced the Strategic Acquisition Board ("SAB" or "the Board") in September 2015 and provided an initial budget of £25m to purchase strategic assets. Cabinet approved a subsequent report in November 2016 that provided an additional £25m budget allocation and amended the scoring criteria. Whilst the minimum score of 240:400 (60%) for assets inside Slough was retained, it was confirmed that (in order to secure a balanced portfolio and improve the Council's financial resilience) the SAB has additional flexibility to acquire out of borough assets provided they score a minimum of 300:400 (75%).

5.3 For those assets which are based outside of Slough the formation of a company may be required to ensure that the Council remains within its powers for certain property acquisitions. As set out in the legal section a number of powers (section 120 of the Local Government Act 1972 or section 12 of the Local Government Act 2003) permit the Council to directly acquire property (whether the intention is commercial or otherwise). These powers do not require the Council to form a company. However, the circumstances which must be satisfied for the Council to directly acquire property outside of the Borough may be more difficult to satisfy (compared to those within Slough) and CIPFA guidance relating to those acquisitions under the Council's investment power (section 12 LGA 2003) may be difficult to satisfy where the Council is borrowing from the Public Works Loan Board ("PWLB"). The formation of the Company may be undertaken under the General Powers of Competence, it is now recommended that the Council forms a wholly owned Asset Management Company. The formation of a company will require the preparation of a business case that considers tax liabilities, state aid issues and financing arrangements.

Role of Asset Management Company

5.4 The role of the company will be to acquire land and property assets located outside Slough and make subsequent decisions regarding management, investment and disposal. It will:

- Make strategic acquisition and investment decisions,

- Review proposed acquisition and investment proposals, taking into account the extent to which the proposal to fulfils the investment objectives of the company, and
- Report funding decisions annually to Cabinet.

Investment Strategy

5.5 When acquiring investment assets, 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. In times of uncertainty and revenue pressures sector balance becomes less critical to acquiring assets that provide secure income leased to an occupier with a low risk of business failure – the market refer to this as buying defensive stock.

5.6 Officers will apply a defined list of property specific criteria when making recommendations to the board on investment acquisitions using the same criteria adopted by Cabinet when introducing the SAB, which is included as confidential Appendix Three.

5.7 The aim of the Investment Strategy is to secure and realise the benefits of the effective management of investments , which include:

- Increasing annual returns and create new additional revenue income streams;
- Acquire properties that provide long-term investment in accordance with the Medium Term Financial Plan and long-term financial/corporate objectives,
- Maximise return whilst minimising risk through prudent management
- Adopting an approach of risk awareness not risk adverse.
- Prioritise properties that yield stable income and optimal rental growth.
- Protect capital invested in acquired properties through reinvestment /Asset Management as required.

5.8 Asset Management, supported by independent specialist professionals where appropriate, will identify potential investment opportunities and provide advice on each proposal coming forward to the Directors of the company for consideration. All acquisition opportunities presented to the board will be supported by a financial appraisal and business case to establish the financial and budgetary implications. The appraisal and business case will assess how the strategic acquisition will be financed and will:

- Consider if the investment achieves business objectives.
- Confirm that for the acquisition of land the price is reasonable (allowing for a special purchase consideration) and supported by an independent valuation.
- Confirm that for the acquisition of a standing investment the price is reasonable and supported by an independent valuation.
- 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.

- Identify whole life costs (where appropriate), including VAT and other costs incurred as a result of acquiring through the Asset Management Company 'vehicle'.
- Identify the most appropriate funding source(s), risks/financial exposure, and confirm availability.

Company Model – Limited by Shares

5.9 Subsidiaries are separate, distinct legal entities for the purposes of taxation regulation and liability. The most common way that control of a subsidiary is achieved is through the ownership of share in the subsidiary by the parent (in this case the Council). These shares, along with governance measures below give the Council the necessary means to exercise control.

5.10 The advantage of a Company Limited By Shares is that it can be grouped with the Council for Stamp Duty Land Tax ("SDLT") and therefore transfers between the two organisations would not be taxable.

5.11 Whilst the Council could seek to enter into a partnership with an equity investor via some form of joint venture, the most effective way to control the company is to incorporate a wholly owned subsidiary. With such a model, the Council will have the maximum possible degree of control over the future activities of the subsidiary company and the Council (as sole shareholder) will have the ultimate sanction of either removing the Board Members and appointing replacements or, ultimately resolving to wind up the company. However, such a model means that the risks will not be shared.

Governance Arrangements

5.12 The Asset Management Company will consider business cases that contribute to the delivery of a defined Investment Strategy.

5.13 It is envisaged that the board of the Asset Management Company will include a mix of elected members and suitably experienced officers and will mirror the board membership of the SAB. As follows:

- Leader of Council
- Commissioner for Housing & Urban Renewal
- Strategic Director Regeneration, Housing & Resources
- Assistant Director Assets, Infrastructure & Resources
- Head of Finance (Transformation)

5.14 The Articles of Association for the company will be created in accordance with these governance arrangements, with operational decision-making residing with the Directors of the Company. As part of this operational decision-making the Directors will be authorised to undertake asset and property management functions to maintain and improve performance.

5.15 The Directors will be authorised to make capital expenditure decisions on refurbishment and enhancement to improve annual returns, subject to expenditure being identified and approved in the annual business plan for the company and/ or within agreed thresholds of spend at the discretion of Directors.

Relationship Agreement between SBC and Subsidiary Companies

5.16 The Council's relationship with each the Asset Management company will primarily be governed by the Council's rights under the Memorandum and Articles; a Shareholders Agreement to be entered into by the Council and the company and future credit/funding financial agreements. In this report the following terms are used:

- The Funding Role,
- The Shareholder Role,
- Service Level Agreement, and
- The General Role.

Each of these roles are described in detail in sections 5.17 - 5.27 below.

5.17 **The Funder Role** is where the Council acts as a funder and would in determining whether to lend money to the company. To provide resilience and deal with potential conflicts of interest it is recommended that the Funder Role is discharged by the section 151 officer. In effect the Funder Role will act as a bank credit committee. The Funding Role's primary task will be to assess viability (as an entity) for each acquisition for which loan funding will be used for and using this analysis to determine whether to release loan funding.

5.18 It will also be necessary for the Funder Role to regularly monitor and analyse financial information generated by the company during the lifetime of each loan to ensure that it does not breach any of the key financial requirements (which will be stipulated as funding conditions/covenants in each loan). For State Aid reasons the Council and its Funder Role will need to establish that for each loan a notional private lender would make that loan in identical circumstances to the Council.

5.19 The Funder Role also will have to satisfy itself that each particular loan is made in compliance with State Aid requirements and that any statutory or constitutional changes (e.g. a change in the Secretary of State's consent regime and internal changes to the Council's constitution and procedures) would not render a proposed loan and/or proposed development ultra vires. For these assessments the Funder Role is likely in part to rely upon the Council's General Role and functions such as legal services.

5.20 **The Shareholder Role** is the Council acting as the shareholder in the company and ensuring (as a shareholder would) that it delivers on key requirements (see Appendix Two, terms of reference). It will be concerned that the Asset Management Company maximises its economic performance. It will also be interested in the Asset Management Company:

- Complying with good company governance, financial management/audit practices;
- Having due regard for "brand"/reputation the consequences of their business practices; and
- It may at some point have to make difficult decisions such as whether to sell all or part of its interest to a private sector organisation, cease expansion of either company’s activities and/or in extreme circumstances consider dissolution/winding one of the companies.

5.21 Whilst the Shareholder Role is not a vehicle for the Council to remotely manage the company, it provides a framework within which it operates and runs its business. This will include approving the annual business plan.

5.22 This particular Shareholder Role may be very different from those which the Council typically operates. This is because the involvement of Officers and Members in other entities may focus more on policy and community outcomes rather than be purely commercially driven. The Shareholder Protocol could include a statement which sets out why exercising the Shareholder Role for the Asset Management Company is different.

5.23 To minimise conflict of interest the person appointed to undertake the Shareholder Role in the Council should ideally not be a Director of the company. This is because part of the Shareholder Role will be to hold the company's performance into account and a Director of the Asset Management Company will be responsible for that performance.

Avoiding Conflicts of Interest

5.24 As set out above, if an officer or Member is required to make decisions about approving funding to the Asset Management Company or hold performance to account (either through the Shareholder Role or monitoring) then there will be a conflict in that same individual acting as a Director. This is because as a Director, that individual must in that role must put the interests the company first. This would prove difficult and create the potential for conflicts of interests in a number situations (where the named post is also a Director) including:

- An officer or Member considering whether to agree a loan from the Council for an acquisition;
- An officer or Member monitoring/reviewing financial/commercial performance (as a Director they would be responsible for that performance);
- An officer or Member or member reviewing a business plan in the Shareholder Role (such a plan may seek expansion which could conflict with other Council funding priorities).

5.25 To avoid these potential conflicts, the Council will avoid appointing individuals responsible for the Funder Role, the Shareholder Role or 'scrutinising' the performance of the company's performance as a Director.

Service Level Agreement

5.26 The underlying intent of a Service Level Agreement ("SLA") is to provide reassurance that there is transparency in relation to the use of the Council's core staff and facilities for purposes which relate to the activities of the subsidiary company and ensure there is a robust mechanism for recovery by the Council of all associated costs. The SLA will set out the range of services (for example office space, IT support, Housing Services, Legal Services and Asset Management support) that will be provided and clarify the cost of each element.

The SLA will be reviewed annually and approved by the Assistant Director Finance and Audit on behalf of the Council in consultation with the Commissioner for Housing & Urban Renewal and Leader of the Council.

5.27 **The General Role** is the Council's ordinary governance (including financial governance) role.

Summary of Roles & Responsibilities

5.28 In the event that Cabinet approves the introduction of the Asset Management Company, detailed arrangements will be put in place to demonstrate high levels of governance and operational effectiveness. The agreements will be required to demonstrate that:

- The group structure is established in a way that allows the Council to meet its statutory obligations,
- The strategic planning process allows the Council to guide the activities of the company in the management and delivery of services,
- The Council manages the performance of the subsidiary to ensure that standards are consistent.
- There are formal mechanisms for the control of the quality of service delivery by the company.
- There are appropriate opportunities for Councillors to be involved in decision making at a strategic level and ensure that appointments made to its subsidiary board is as transparent as possible.
- Costs are allocated correctly to the subsidiary company in order to get an accurate assessment of the total costs incurred,
- Financial reporting to the Council, include preparing ‘group’ accounts that will be consolidated into the Council’s annual financial statement, and assessing results against group budgets and reviewing performance against key financial targets is undertaken.

5.29 The Role & Responsibilities of each party will be set out in the above agreements. These will include but are not restricted to:

Council	Subsidiary Company
• Approval of the overall strategy of the Group, • Following sign-off by the Chairperson of the subsidiary, approval of the subsidiary’s accounts, • Consideration and approval of subsidiary organisations’ annual Business Plans and annual budgets, • Monitoring the performance of the subsidiary against financial and performance targets, • Consideration and approval of all constitutional changes, and • The establishment of governance policies for the subsidiary, including standing orders and codes of conduct for board members.	• Works within limits approved by SBC- but with operational independence from SBC. • Purchases staffing and other services from SBC. • Provide high quality, effective and customer- focused services • Comply with all the agreements in place between the subsidiary and the Council.

Risk Management

5.30 The implementation of the Asset Management Company will expose the Council to a variety of governance and financial risks. Having established the SAB in 2015, the Council is already familiar with the inherent risks and therefore the approach will be to create a balanced portfolio of investments. However, the creation of a balanced portfolio is dependent on a combination of the availability of resources to invest, increased competition and opportunities coming to the market.

5.31 A series of governance processes were introduced to manage the SAB process, which are described above. These will be replicated by the company to ensure that all investment opportunities undertaken by the company are subject to the same degree of scrutiny as those that the Council undertakes in its own right.

5.32 Acquiring land for housing-led regeneration (especially without the benefit of planning) will introduce a greater risk than investing in existing assets but will also provide the opportunity for a greater rate of return – however it should be stressed that this is likely to be a medium-long term return and may introduce holding costs.

6. **Comments of Other Committees**

This report has not been considered by any other committees.

Conclusion

7.1 This report seeks approval to introduce a new wholly owned company with the specific purpose of acquiring land and property assets outside the operating area of Slough Borough Council. The company will be wholly owned by the Council and will generate an independent income stream that will complement investment income already generated via the existing strategic asset purchase scheme.

8. Appendices Attached

The following appendices contain exempt information and are in Part II of the agenda.

8.1 Appendix One - Proposed Shareholder Function
8.2 Appendix Two - Draft Heads of Terms - Shareholder Function
8.3 Appendix Three - Investment Criteria

9. **Background Papers**

None