

Classification: Public

Key Decision: N/A

Gravesham Borough Council

Report to: Full Council

Date: 11 October 2016

Reporting officer: Chief Executive
Director (Corporate Services)

Subject: Commercial Property Acquisitions

Purpose and summary of report:

To approve the amendments to the Property Acquisition Strategy agreed by Full Council on 23 February 2016.

Recommendations:

Full Council approves that;

- A maximum of £500,000 flexibility be made available, over and above the existing fund of £10 million of investment balances for such purchases.
- The net initial yield generated, on acquisition, is amended from a minimum level of 6% to 3% above the prevailing 25 year PWLB fixed maturity rate.
- The wording regarding the classification of properties that can be purchased under the scheme be amended to those detailed in the body of this report.

1. Background

- 1.1 In view of the reducing Government grant that the authority has and will continue to see and in light of the need to find alternative income streams, which is also recognised in the Corporate Plan under the theme “Sound and self-sufficient council”, a report was taken to Cabinet on 1 February setting out a Property Acquisition Strategy. This strategy was subsequently adopted by Full Council on 23 February 2016.
- 1.2 This strategy established a £10 million fund within the authority’s capital programme, to be funded from investment balances, which was made available for acquiring properties in order to generate a revenue return.
- 1.3 The strategy set out the following criteria for selecting investment assets
 - 1.3.1 The investment provides a regular income with the net initial yield exceeding a minimum level of 6% (i.e. for each £1,000,000 of investment, the net income from that investment should be equal to or exceed £60,000 per annum), and after taking into account all costs associated with the acquisition.

- 1.3.2 That the purchases be from the retail, industrial and business (i.e. office premises) sectors.
- 1.3.3 That a maximum amount of £10 million be invested in such assets as long-term cash-flow modelling shows this cash to be available for the authority to use on a long-term basis.
- 1.3.4 Acquisitions are not limited to being within the Borough of Gravesham.

2. Property Acquisition to Date

- 2.1 Since Full Council approved the adoption of the Property Acquisition Strategy on 23 February, one property has been acquired and the purchase of a second is nearing completion. A number of other properties have been considered but either discounted or offers have been rejected.
- 2.2 The first property purchased was Network House in Gillingham and this completed on 25 May 2016.
- 2.3 The purchase of units A4-A5 and C1-C6 at Springhead Enterprise Park was agreed by the Property Acquisitions Cross Party Working Group on 26 September 2016. Contracts are expected to be exchanged on 3 October 2016, with completion due two weeks later on 17 October 2016.
- 2.4 Including fees and other associated costs, the authority will have spent approximately £7.4 million on the purchase of these two properties, leaving £2.6 million of the original £10 million allocated for this purpose.
- 2.5 Property Services are currently looking at further properties for purchase. Due to the remaining budget, they are focusing their efforts on smaller scale properties in the region of £1 million to £1.5 million. If two suitable properties were identified towards the top end of this bracket, the remaining budget would be insufficient.
- 2.6 In order not to overly restrict the potential properties available for purchase, it is recommended that additional flexibility of £500,000 be provided for such acquisitions, taking the funds available to a maximum of £10.5 million. This will allow a prudent level of tolerance to facilitate further acquisitions; modelling has confirmed that these additional funds will not have a material impact on the authority's cash flow forecasts and treasury management position.

3. Minimum Yield

- 3.1 In the Property Acquisition Strategy, one of the criteria for selecting the investment assets states that the investment should provide a regular income with the net initial yield exceeding a minimum level of 6%, after taking into account all costs associated with the acquisition.
- 3.2 The purchase of Network House has generated an initial yield of 6.72%
- 3.3 Since the strategy was set and the purchase of Network House has completed, there have been some significant changes that have impacted upon the overall UK economy.

- 3.3.1 The cost of borrowing dropped to an all-time low due to market volatility and amid expectations of lower growth, lower base rate and the restarting of quantitative easing.
- 3.3.2 The Bank of England Base Rate was reduced from 0.50% to 0.25%, with commentators speculating that there may be a further reduction to 0.10%.
- 3.4 These factors make investing in property more affordable and a mechanism for securing a higher return. As a result there are now more investors seeking suitable properties which is pushing up prices and in turn is seeing yields decrease.
- 3.5 The level of PWLB borrowing in June 2016 increased significantly to £1.326 billion compared to £74.289 million in May 2016 which is an indication that other local authorities are in part borrowing in order to purchase properties.
- 3.6 The negotiations undertaken by Property Services in relation to the units at Springhead further serves to highlight the difficulty in continuing to achieve a yield of 6% on acquisitions.
- 3.7 The purchase of the Springhead units will see an initial yield of 5.97%. Given the yield was below the level stipulated in the strategy, the Chair of Overview and Scrutiny was consulted in accordance with Constitution. Agreement to continuing the process of purchase was given. Subsequently all members of the Property Acquisitions Cross Party Working Group were fully supportive of the decision to proceed with the purchase.
- 3.8 At the meeting of the Property Acquisition Cross Party Working Group it was agreed that in the current economic circumstances, review of the minimum yield was appropriate.
- 3.9 In order not to require Full Council approval of a change in yield, as and when economic changes or changes in the base rate dictate, it is considered more appropriate to link the yield to a margin above PWLB borrowing, as at the point in time .
- 3.10 Given the nature of the acquisition, it would be most appropriate to link the yield to a longer term loan rate such as the 25 year fixed maturity rate. As at 31 August 2016 (the date the successful bid for Springhead Enterprise was submitted), this rate was 2.21%. Specifying a margin of 3% above the rate, would mean that the current net initial yield would need to exceed a minimum of 5.21%. The actual rate is 5.97% so it exceeds the minimum.

4. Clarification of the Investment Asset Categories

- 4.1 Further clarification on the types of assets that can be purchased within the parameters of the strategy have been sought by Property Services.
- 4.2 The strategy refers to “purchases being from the retail, industrial and business (i.e. office premises) sectors”. However, there are some assets which do not necessarily lend themselves to fitting into one of these categories, yet there may be genuine reasons why the Council may wish to consider purchasing them such as Petrol Stations, Hotels and Public Houses etc.

4.3 Therefore in order to remove any confusion, it is suggested that the wording is amended to specific “purchases be from the retail, industrial, office and any other conventional business sectors”.

5. Background Papers

5.1 There are no background papers relating to this report.

IMPLICATIONS		APPENDIX 1	
Legal	As specified in the body of the “Property Acquisition Strategy” report to Cabinet on 1 February 2016.		
Finance and Value for Money	As specified in the body of the “Property Acquisition Strategy” report to Cabinet on 1 February 2016.		
Risk Assessment	As specified in the body of the “Property Acquisition Strategy” report to Cabinet on 1 February 2016.		
Equality Impact Assessment	Screening for Equality Impacts		
	Question	Answer	Explanation
	a. Does the decision being made or recommended through this paper have potential to cause adverse impact or discriminate against different groups in the community?	No	
	b. Does the decision being made or recommended through this paper make a positive contribution to promoting equality?	No	
	c. What steps are you taking to mitigate, reduce, avoid or minimise the impacts identified above?		Not applicable
<i>In submitting this report, the Chief Officer doing so is confirming that they have given due regard to the equality impacts of the decision being considered, as noted in the table above</i>			
Corporate Business Plan	Links with Corporate Objective 4 – Sound & self-sufficient council		
Crime and Disorder	There are no crime and disorder implications arising from the recommendations contained in this report.		