

**CABINET – 15TH SEPTEMBER 2017****DRAFT CORPORATE ASSET INVESTMENT FUND STRATEGY
2017/18****REPORT OF THE DIRECTOR OF CORPORATE RESOURCES****PART A****Purpose of the Report**

1. The purpose of this report is to seek the Cabinet's approval of the proposed Corporate Asset Investment Fund Strategy (attached as Appendix A to this report). This sets out the approach to future asset investments utilising the Council's Corporate Asset Investment Fund (CAIF), which currently totals £60.8m made up of £23.8m of rural estate, £12m of commercial estate, and £25m of pooled property investments.
2. The report also sets out investment property transactions and development proposals under negotiation which have been supported by the Corporate Asset Investment Fund Advisory Board (the Board) and seeks the Cabinet's approval of these investments and other proposed development plans.
3. The Cabinet is asked to agree some revisions to the existing delegations to officers to enable the Authority to respond in a timely way to investment opportunities.

Recommendations

4. It is recommended that:
 - (a) The Corporate Asset Investment Fund Strategy as attached at Appendix A to this report be approved;
 - (b) The investment acquisitions and development projects detailed in paragraphs 28 to 42 of the report be approved;
 - (c) The proposed amendments to the delegations to the Director of Corporate Resources as set out in Appendix B to this report be approved;
 - (d) The Cabinet receives an Annual Report on performance of the Corporate Asset Investment Fund.

Reasons for Recommendations

5. The Corporate Asset Investment Fund is increased to enhance the Authority's financial resilience and deliver other benefits, such as economic development. Given the level of investment now proposed it is necessary to have a detailed Strategy in place to govern the approach taken in respect of future investments and the development of these utilising the CAIF.
6. Property transactions are often time sensitive, so seeking the Cabinet's approval of each transaction is not always practicable. Delegating authority to the Director of Corporate Resources, following consultation with the Board, to agree any future investments utilising the CAIF will ensure that the Council can take advantage of investment opportunities as they arise.

Timetable for Decisions (including Scrutiny)

7. This report will be considered by the Scrutiny Commission at its meeting on 13th September 2017 and the Commission's comments will be reported to the Cabinet.
8. It is intended that annual performance reports would be submitted to the Cabinet and to the Scrutiny Commission.
9. The asset investments set out in this report are at different stages of progression and, subject to due diligence, will be completed as soon as possible.

Policy Framework and Previous Decisions

10. The creation of the CAIF was included in the Medium Term Financial Strategy 2014/15-2017/18 (MTFS), which was approved by the County Council in February 2014. This has been renewed and increased annually in the MTFS.
11. In May 2014 the Cabinet established the Corporate Asset Investment Fund Advisory Board, comprising five Cabinet members.
12. The Council's Corporate Asset Management Plan 2016/17 was approved by the Cabinet in June 2016. This promotes the rationalisation of the Authority's property assets, reducing property running costs, generating new property income streams, ensuring cost effective procurement of property and property services, and creating capital receipts to support capital programme or other beneficial investment proposals.
13. The Medium Term Financial Strategy 2017-21 Capital Programme was approved by the Council on 22nd February 2017. It includes provision of £35.5m for corporate projects, £25.32m of which, spread over the four years from 2017/18 to 2020/21, was allocated to the CAIF.

Resource Implications

14. The County Council faces a very difficult financial outlook including a savings requirement of £66m of which £23m is currently unidentified. This gap is expected to grow in later years.
15. The proposed Strategy envisages growing the CAIF from its current value of £60.8m to around £200m over the next 5 to 10 years, the exact level of investment being dependent on the availability of good investments and funding. The expectation is that the returns (both revenue income and capital growth) generated by the CAIF would have a meaningful impact on the Council's funding gap with a targeted return of 7% generating circa £14m per annum.
16. More detail on resources implications is given in Part B of this report, below.
17. The Director of Law and Governance has been consulted on this report.

Circulation under the Local Issues Alert Procedure

18. None.

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PART B

Background

19. The Council has owned and managed 'investment properties' in the form of the existing Industrial and County Farms estate for many years. These properties are held for the purposes of supporting the delivery of various economic development objectives and also to generate revenue and capital returns to the County Council.
20. In May 2014, the Cabinet approved the establishment of the Corporate Asset Investment Fund and associated governance arrangements. The CAIF would be used to purchase commercial properties to the Council's portfolio of property and land assets with a view to:-
 - a) Ensuring that there is a more diverse range of properties available to meet the aims of economic development
 - b) Increasing the size of the portfolio
 - c) Improving the quality of land and property available
 - d) Ensuring the sustainability of the County Farms and industrial portfolio by replacing land sold to generate capital receipts and
 - e) Generating an income/surplus to support County Council services.
21. The Cabinet also established the Corporate Asset Investment Fund Advisory Board, chaired by the Cabinet Lead Member for Resources and comprising four other Cabinet members. The Board is supported by an officer group formed from strategic property, finance and legal services to provide advice on risks, deliverability and financial implications. Specialist property investment support and advice is also available to provide an independent view and robust challenge.

Financial Resources

Corporate Asset Investment Fund

22. The MTFS 2017-21 Capital Programme included a provision of £25.32m spread over the four years 2017/18 to 2020/21 for the CAIF. In addition, £2.97m has been carried forward from 2016/17 (approved by the Cabinet on 23rd June 2017 as part of the 2016/17 financial Outturn) giving a total of £28.3m. £15.22m of this is to cover specific projects, such as Airfield Business Park – Phase 1 and the Coalville Workspace, with the remaining £13.07m for more general asset acquisitions/investments and rural workspace projects.

Future Developments Fund

23. The MTFS 2017-21 also allocated £16.74m for wider Future Developments (i.e. broader than just asset investments). This Fund was supplemented by an additional £8.51m from 2016/17 underspends and a further £10.1m based on initial budget monitoring for 2017/18 (both approved by the Cabinet on 23rd June). A further £1.05m was previously allocated into a specific reserve to support the LUSEP. These funds together total £36.4m.

24. The proposed investment, outlined in the table at paragraph 28 below, will require funding of £47.93m. It is proposed that this is met from the remaining £13.07m within the CAIF and the £34.86m set aside for the Future Developments Fund. This would mean that there would be no need to undertake any borrowing to support the proposed investments listed above.
25. The report to Cabinet in June identified other projects requiring funding over the next 4 years. These include investment in community speed enforcement depending on the outcome of the pilot, a new records office and collection hub, major IT system replacements (mainly Oracle which the Council has had in place since the early 1990's) and additional investment in the CAIF and the energy efficiency programme to generate ongoing revenue savings and additional income.
26. If the Future Developments Fund is used entirely to support the acquisitions/ investments listed in the table below, then to support these other projects, additional opportunities will need to be taken to increase available funding. Initially, any additional income (net of management and running costs) generated from the acquisitions/investments could be recycled to fund these other projects. Depending on the timelines for when the investments come to fruition, there is the potential for this to be around £7m in total over the lifetime of the current MTFS including £0.8m per annum from pooled property investments. However, in later years this income stream (estimated to be around £3m per annum on current investments, excluding Lutterworth East) will need to be built into annual budgets to reduce the amount of further savings required to balance the MTFS.
27. Other potential options for additional funding will be considered as part of the new MTFS for 2018-22, currently being developed. This will include reviewing existing earmarked funds, potential further MTFS contributions, additional capital receipts and, if necessary and the investment is worthwhile, prudential borrowing funded from external loans or internal borrowing.

Proposed asset acquisitions/investment in 2017/18

28. New proposed assets acquisitions/construction costs/investments expected to be committed in 2017/18 are outlined in the table below and brief details are provided in the subsequent paragraphs.

Lutterworth East	£4.50m
LUSEP, Loughborough	£22.00m
Leaders Farm, Lutterworth	£6.00m
Tamworth House, Tamworth	£2.35m
Lichfield South office park, Lichfield	£10.80m
	£45.65m
Acquisition costs (stamp duty, fees etc.) – estimated at 5%	£2.28m
Total	£47.93m

Lutterworth East

29. The Council is in the process of acquiring 23 acres from Hallam Land Management to help to ensure deliverability of the Strategic Development Area (SDA). The price is £4.5m. This land will then be added to the Council's existing landholding of 265 acres. The County Council is promoting the SDA land through the emerging Local Plan for housing (2,750 homes), 20 hectares of industrial land, 2 schools and a retail centre. A new bridge over the M1 would also be needed in order for the development can be completed. The overall capital receipt is expected to be in the range of £25-30m. The Board has previously been provided information on the purchase.

Loughborough University Science and Enterprise Park (LUSEP)

30. The Council is negotiating with the University to be its partner to bring forward a 100,000 sq. ft. HQ office development for a software company. The University is not seeking to sell its freehold but instead would grant the Council a long lease (on terms to be agreed) on the land.
31. The proposed tenant is The Access Group. It is intended that they will take a 15-year lease at a rental of £1.6m, giving an estimated internal rate of return (IRR) of 7.5% on a project cost of £22m. The IRR is a measure of assessing the profitability of potential investments taking into account annual income and expenditure and the residual capital value of the investment at a future date.
32. Once the land deal, tenant deal and build costs have all been agreed and finalised, the Council will then then procure the new building and let it to the tenant. The Board has expressed support for this investment.

Leaders Farm, Lutterworth

33. The Council is bringing forward a phased development of the 3.51 hectare site to the south of Lutterworth. The site has outline consent for 102,000 sq. ft. of office and light industrial space.
34. A tenant has been identified for Phase 1 (0.54 hectares) which will include the build out of the infrastructure works at an estimated cost of £2.15m and the office development cost of £3.5m. The infrastructure works will be constructed at the beginning of the development and pay back will be appraised on an apportioned pro rata basis, based on phased development and the site size.
35. The apportionment of the infrastructure works included in the initial appraisal of the office space for the identified end user is 15%. The total scheme cost is £3.8m for Phase 1 including the infrastructure.
36. The rent levels are £18.00 per sq. ft. for the offices and a capitalised figure for the additional car parking which equates to an average of £21.50 per sq. ft. The rental income is £344,000 per year which equates to a yield of 8%.

37. Based on a market rental figure of £6.25 per sq. ft. for industrial workspace and £14 per sq. ft. for offices, and development costs totalling £15.35m based on the Council's financial appraisal, the project will produce an estimated IRR of 7.4% for the whole site. The Board has expressed support for this investment.

Tamworth House, Venture Park Road, Tamworth

38. The Council was successful in bidding for a standalone 15,500 sq. ft. office investment in Tamworth. It is let to one tenant (Midland IVI Limited) which occupies it as an office/IVF clinic and is on a 10-year lease paying £183,000 per annum. The estimated IRR on this investment is 7.8%. The acquisition is subject to contract. This is supported by the Board.

Lichfield South office park, Lichfield

39. The Council was successful in bidding for phase 2 of a mixed use development to the south of Lichfield. Phase 1 comprises a hotel, drive-through coffee, gym and restaurants.
40. Phase 2, which the Council is seeking to acquire, comprises 3 office buildings extending to approximately 43,000 sq. ft. with 215 car spaces on circa 1.6 hectares.
41. With the exception of the first floor of one of the offices, the scheme is fully let and produces an income of £750,000 per annum (rising to £810,000 in 2019). The estimated IRR for this investment is 7.9%.
42. Contracts are almost ready for exchange. Once finalised the Board will be consulted on the proposal.

Approvals and Delegations

43. The investments listed in the table at paragraph 28 above are at different stages of progression. Tamworth House and Lichfield South are quite well progressed in that offers have been made and due diligence is being undertaken. Subject to there being no problems identified contracts can be exchanged in the near future.
44. With respect to LUSEP and Leaders Farm, negotiations are ongoing with prospective tenants. The actual investments will only be progressed should the negotiations lead to an acceptable position for the County Council in line with the expectations laid out in the CAIF Strategy, recognising that in these cases there would also be a benefit to the local economy over and above the specific financial benefits that are used to assess the investment. Approval for the LUSEP initiative in particular needs to reflect the initial long lease purchase for the land, the construction and other associated costs, and the ability to enter into a lease with the prospective client.
45. The decision to purchase the additional land at Lutterworth East has already been supported by the Board.

46. Given the nature of these transactions, once negotiations have been concluded, it may be necessary to progress and finalise such deals quite quickly in order to secure the agreed terms and thus it might not be practical to bring a report to the Cabinet in accordance with the normal processes. It is therefore important to ensure the correct delegations are in place to enable the Director of Corporate Resources following consultation with the Board to proceed with such investments but, at the same time, ensuring there are adequate checks in place to ensure all such investments are transparent and can be properly monitored on a regular basis.
47. To this end, a number of changes are recommended to the Scheme of Delegation in order to regulate and clarify the process of approval for expenditure in relation to Asset Investments and Future Developments separate from those currently in place to support operational property transactions for schemes within the approved capital programme. These changes are outlined in the Appendix B.

Governance

48. The existing governance arrangements whereby the Board has a key advisory role in relation to capital investments will remain in place. The CAIF performance is also formally reported to the Board bi-annually.
49. An annual report will be submitted to the Scrutiny Commission and the Cabinet that will show fund performance against the agreed Strategy.

Risks

50. The Strategy seeks to minimise the risk principally by ensuring robust governance arrangements are in place and that investment decisions are only made in light of the appropriate financial/commercial and legal advice. However, property investment and development will always have an element of risk much of which is outside the control of the council as it relates to the strength of the wider economy. The County Council is not alone in pursuing this approach and there has been much comment in national press on the level of borrowing incurred by some local authorities. It is worth noting that no borrowing is being proposed for the investments outlined in this report.

Conclusion

51. The Corporate Asset Investment Fund Strategy is aimed at generating a long term and relatively stable source of income to offset the funding gap in the MTFS. The Strategy is not without risk and there is a possibility that in light of significant borrowing entered into by other councils to purchase property the government may impose restrictions on local authorities in the future. The County Council has not borrowed to fund these investments. Any future decisions regarding the financing of investments will be taken in line with the County Council's agreed Treasury Management Strategy and Annual Investment Strategy.

Equality and Human Rights Implications

52. There are no equality or human rights implications directly arising from this report.

Background Papers

Report to the Cabinet on 18th July 2016 – Corporate Asset Management Plan
<http://politics.leics.gov.uk/ieListDocuments.aspx?CId=135&MId=4604&Ver=4>

Medium Term Financial Strategy 2017/18 – 2020/21
<http://politics.leics.gov.uk/ieListDocuments.aspx?CId=134&MId=4433&Ver=4>

2016/17 Provisional Revenue and Capital Outturn
<http://politics.leics.gov.uk/ieListDocuments.aspx?CId=135&MId=5120&Ver=4>

Appendices

Appendix A - Draft Corporate Asset Investment Fund Strategy
Appendix B - Current Delegated Powers and proposed amendments

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