

Birmingham City Council

Report to Cabinet

27th July 2021



Subject: Property Strategy: Asset Review - Birmingham City Propco Limited (Propco)

Report of: Ian MacLeod Acting Director, Inclusive Growth

Relevant Cabinet Member: Councillor Ian Ward – Leader

Relevant O &S Chair: Councillor Tristan Chatfield – Finance and Resources

Report authors: Ian MacLeod, Acting Director, Inclusive Growth
Email Ian.MacLeod@birmingham.gov.uk
Julia Martin, Project Delivery Manager, Inclusive Growth
Email Julia.c.martin@birmingham.gov.uk

Are specific wards affected?	<input type="checkbox"/> No	<input checked="" type="checkbox"/> No – All wards affected
If yes, name(s) of ward(s):		
Is this a key decision?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
If relevant, add Forward Plan Reference: 008632/2021		
Is the decision eligible for call-in?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
Does the report contain confidential or exempt information?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No

1 Executive Summary

- 1.1 This report presents the details of a proposal to utilise the Council's existing wholly owned company, Birmingham City Propco Limited (Propco), to support the Council's Property Strategy 2018/19-23. The project is in response to the Council's broader Asset Review project that seeks to develop a range of solutions for the retention/disposal of Council assets; that balances short term returns and long-term benefits and is in line with the original Cabinet recommendations of 2017.

- 1.2 The report seeks approval to the strategy of investment in Propco through a combination of equity and loans over a five-year period to enable the company to acquire, enhance and dispose of land and property and to enter into agreements as required, to strengthen the company's existing governance and operation.
- 1.3 Expanding the operation of the existing wholly owned company provides the opportunity to support the Council's capital receipts programme. To invest in, hold, and develop assets for future disposal, and finally to gain best value from selected assets by their disposal to Propco as an alternative to selling them on the open market, thereby enabling value to be added to the assets pending their ultimate disposal.
- 1.4 Investment in the company may also generate long term dividends to the Council as the sole, shareholder.

2 Recommendations:

- 2.1 Approves the strategy for the development of Birmingham City Propco Ltd (Propco) through increasing the capacity of the company's operations, and its governance as set out in this report.
- 2.2 Approves a motion to Full Council to amend the General Delegations Part E3.2 of the Constitution to include a new delegation for the approval of disposals from, the Council Property portfolio into Birmingham City Propco Limited to the Leader and Cabinet Member for Finance and Resources, jointly with the Director - Inclusive Growth, Interim Director of Council Management and the City Solicitor (or their delegates) up to a limit of £25m in any one transaction. This delegation will enable the specified Member and Officers to approve Property transactions that exceed the generally 'property' delegation financial thresholds currently stated in the General Delegations Part E3.2 (xi).
- 2.3 Delegates to the Interim Director of Council Management, in consultation with the Leader of the Council, the authority to buy shares in and approve loans to, Propco up to an aggregate limit of £100m, on commercial terms and in compliance with HMRC rules on 'thin capitalisation', subject to a full business case for each investment being approved.
- 2.4 Approves a capital injection of up to £0.500m into Propco to provide a short-term working capital facility. This advance will be made on commercial terms, by the Council in its role as sole shareholder and will be used to facilitate a programme of acquisitions from the Council; to strengthen the governance of the company, and to develop a robust business plan.
- 2.5 Delegates the approval of the terms and details of the revised restructure of Propco governance to the designated shareholder representatives, these being the Chief Executive and Section 151 officer; in consultation with the Council's shareholder representative Group Company Governance Committee.

- 2.6 Authorises the City Solicitor to negotiate, execute and complete all necessary documentation to give effect to the above recommendations.

3 Background

- 3.1 On 24th June 2017 Cabinet approved the Full Business Case (FBC) for the establishment of a company wholly owned by the Council that was to be utilised to provide a vehicle for commercial investment. Birmingham City Propco Ltd (Propco) was incorporated on 2nd October 2017. The Council is the sole shareholder, and the two directors are senior post holders within the Council.
- 3.2 Following a share issue, Propco entered into a loan agreement with the Council to enable the company to purchase the leasehold interests in two hotels that were previously held by the Council, as part of its commercial portfolio. This represented a total investment of circa £29m into the company. A service contract exists between the Council and Propco to ensure the prudent running of the company.
- 3.3 The establishment of Propco was the first phase of the development of a vehicle to enable the Council to operate successfully in commercial and investment property, and in doing so provide a sustainable net revenue return to the Council, as well as future dividends. These key aims also included the objective of the generation of capital receipt whilst retaining strategic land holdings to lever future growth benefits due to the development of HS2 and airport proximity etc. This first phase was set up to ensure the most appropriate investment vehicle, and terms of operation, that delivers the most advantageous financial terms to the Council, whilst also ensuring that Propco remains a viable business.
- 3.4 Whilst these aims remain the same, it was envisaged that phase 2 of this project would include the establishment of a full investment property strategy and plan that would include an agreed investment criterion, and capital financing arrangements for Propco, as well as establishing financial targets; delegations and performance management approach, and to formalise the relationship between the wholly owned company and the Council and purposes for appropriate usage.
- 3.5 The Council's Property Strategy was approved by Cabinet in November 2018, providing a long-term strategic approach to the management of the Council's real estate portfolio. The strategy also aims to maximise commercial and social returns by re-aligning the property assets, ensuring they act as a catalyst for development and inclusive economic growth. The strategy is the core real estate planning and performance document for the Council. The application of the Propco model is recommended for Council wide property activity and this approach is what is considered within this report.
- 3.6 The existing utilisation of Propco aligns with the Property Strategy and Capital Strategy contained within the Council's Financial Plan 2021-25; in that it aims to drive greater returns to the Council in the long term.

- 3.7 However, guidance issued by the HM Treasury in November 2020 prohibits local authorities from undertaking new investments for the primary purpose of attracting yield (while still making use of Public Works Loans Board (PWLB) financing) which, as noted in paragraph 3.3 above, was a key principle underpinning the original establishment of Propco.
- 3.8 The financial relationship between the Council and Propco must also be guided by HMRC rules on 'thin capitalisation'. These rules were established to prevent inter alia, contrived lending arrangements between organisations within the same company group structure being used to create unfavourable borrowing conditions that reduce corporation tax liability.
- 3.9 It is essential to ensure that the amended and standing financial guidance outlined above is taken full account of when considering how best to structure the development of Propco to utilise the Council's assets to unlock development and provide a catalyst for growth.
- 3.10 It would therefore be prudent for the Council to seek independent, expert advice on thin capitalisation thresholds to the extent that they would be applicable should Propco take advantage of the opportunities touched on in this report.
- 3.11 Following the report to Cabinet in November 2020 which set out the Council's Delivery Plan up to May 2022, and subsequent report in January that considered 'What Birmingham needs to do next', a refresh of the Property Strategy has been undertaken and has further considered the objective to increase the pace and scale and growth within the city. Propco has been identified to support these objectives. Coupled with this is the requirement to achieve additional capital receipts up to a value of £65m, to meet an anticipated shortfall in the Council's Medium-Term Financial Plan (MTFP) and generate the funds required to meet its transformation agenda.
- 3.12 The interim findings of the property asset review have identified a number of assets that could be recommended for disposal to Propco, whereby funding via the council loan facility could be used to enhance asset values to facilitate growth and development. For example, where a wider site assembly is required to deliver strategic regeneration proposals, or for investment purposes where the asset is required to deliver a financial income either through letting or disposal.
- 3.13 Once this review has concluded, these potential disposals will be subject to individual option appraisals to determine if disposal to Propco is the best course of action both strategically and commercially. Should disposal to Propco be the recommended course of action, property valuations for disposal and detailed loan and investment terms by the Council will be the subject of individual business cases and subsequent reports, in line with recommendations 2.2 and 2.3 of this report.
- 3.14 In order to expand the Propco portfolio and the operations of the company, it is vital that Propco develops a long-term business plan, which will need to be underpinned by amended articles of the company. This business plan will be

modelled on a proposed five-year investment period determined by the final recommended list of assets proposed by the Council for disposal to Propco.

- 3.15 The scale of the proposed investment and potential income that may be generated for the Council as funder and shareholder over the next 5 years will result in additional resourcing requirements to service the company both in terms of servicing contracts; leadership and direction; and governance.
- 3.16 There are currently two board members, who are also the directors of the company. Both members/directors must be present for the Propco board to be quorate. The current governance arrangements are not sufficiently robust for the scale of investment proposed in the company, and additional resources are required to both ensure there are no conflicts of interests that prohibit the successful operation of the company and bring additional commercial expertise to guide the development and implementation of the company's business plan.
- 3.17 It is recommended that an independent chair and up to two further board members are recruited externally to enhance the governance structure of Propco. These costs will be met from within the Propco operational budget. The final proposed board structure and governance arrangements will be subject to further approvals as outlined in the recommendations of this report.
- 3.18 The existing service level agreement between the Council and Propco also requires amendment to reflect the increased level of resources required to support the company's operations. Any increase in the level of services provided by the Council to Propco will be reflected in an increased service charge payable by the company, and this will be reflected in individual business cases for disposals to Propco. Generic services provided by the Council such as the company secretary role will be charged by the Council at a commercial rate.

4 Options considered and Recommended Proposal

- 4.1 This report deals with the implementation of phase two of the recommendations contained with the 2017 Cabinet report of 2017 to establish Propco and as such the merits of working through a wholly owned company have already been established.
- 4.2 Options for the expansion of the company to support the Council's target capital receipts programme have been considered, and an evaluation matrix is being developed to support recommendations for the disposal of council assets into the company. The Council is in the process of carrying out an options appraisal in relation to proposed asset sales. The outcome of this work will inform the business cases of assets recommended for disposal to Propco.
- 4.3 The strategy to expand Propco to support the wider regeneration objectives of the Council's Delivery Plan has considered the following options:
- 4.4 **Business as Usual** – Propco maintains its current portfolio of leasehold interests, and the further acquisition and investment programme is not implemented. This

approach would not support the realisation of the capital receipts that could be generated within the 2021/22 financial year, and programme of change that is dependent on the financing of the capital strategy.

4.5 Undertake disposal programme to Propco

- 4.5.1 Propco has the ability to take ownership of assets which (whilst requiring a loan and hence, income to service the loan) enables the Council to take a capital receipt in the 2021/22 financial year. When used as an alternative to selling assets directly into the open market, this allows the Council as a shareholder to be in full control of the timing of the receipt.
- 4.5.2 The transfer of an asset into Propco will be at a value which will discharge the Council's duty to achieve best consideration under Section 123 of the Local Government Act 1972. Hence, Propco can continue to own the asset and maximise its value potential and most effective disposal strategy.
- 4.5.3 Secondly the disposal of assets into Propco provides the opportunity to capture the enhanced value of assets, where they can be utilised to unlock wider development opportunities over the longer term.

4.6 Disposal into an alternate wholly owned company

- 4.6.1 The Council is the sole shareholder of a number of wholly owned companies. InReach (Birmingham) Limited (InReach) is a similar company in structure to Propco and disposal of Council assets to InReach could be considered. However, InReach is currently set up solely to develop market rent housing and does not currently align with the objectives of Propco.
- 4.6.2 InReach may be considered where the proposed end use for a Council asset is market rent housing. As Propcos assets are intended to be used to support wider regeneration and development objectives, as well as to generate a sustainable commercial income to ensure the viability of Propco. Propco is viewed as the more appropriate vehicle to support the Council's property strategy at present.

5 Consultation

- 5.1 No external consultation is required in respect of this report
- 5.2 Relevant Member consultation has been undertaken in respect of the proposals to develop PropCo, and will continue as part of the development of the full business cases for the proposed disposal of assets.

6 Risk Management

- 6.1 The Project is managed through the Propco Development Project Board chaired by the Assistant Director for Property. A project assurance role is undertaken by the Inclusive Growth Delivery Board
- 6.2 The following are identified as the key project risks:

- i. Propco ability to service debt will impact on the extent of lending by the Council, and associated ability to dispose of assets to Propco and meet capital receipts targets. Mitigated by a blend of equity and debt to be considered as part of individual business cases for each disposal /acquisition.
- ii. The Council may not approve disposal into Propco due to adverse impact on revenue loss. Mitigated by financial modelling to consider revenue impacts prior to disposal.
- iii. Propco may choose not to buy Council property based on its own due diligence advice.
- iv. Property market conditions may impact the level of capital receipts that are generated. This will be mitigated by Propco releasing assets at the optimum phase in the property cycle.
- v. HM Treasury have committed to continually review the November 2020 update on accessing PWLB and so further restrictions on the acquisition of property by the Council or its subsidiaries cannot be ruled out.

6.3 A Risk Management schedule will support each full business case.

7 **Compliance Issues:**

7.1 How are the recommended decisions consistent with the City Council's priorities, plans and strategies?

7.1.1 The proposals contained within the report are consistent with the priorities, plans and strategies in the City Council's Plan 2018-2022 (2019 update) to achieve existing six outcomes for Birmingham to be:

- An entrepreneurial city to learn, work and invest in
- An aspirational city to grow up in
- A fulfilling city to age well in
- A great city to live in
- A city whose residents gain the most from hosting the 2022 Commonwealth Games
- A city that takes a leading role in tackling climate change, as follows:

7.1.2 Council Property Strategy. The utilisation of Propco supports the Council's property strategy intaking a medium to long term strategic approach to the Council's unique asset base and ensuring a balanced delivery of maximised commercial and social returns. Delivery of the Property Strategy objectives will include reference to other Council policies in line with the Policy Framework – including financial, planning, infrastructure, housing, jobs and skills, sports, culture, social cohesion and neighbourhoods.

- 7.1.3 Council Financial Plan 2021-25. The utilisation of Propco and support for the achievement of the capital receipts target is a key plank in the capital strategy within the Council's financial plan. This plan also sets out how Council will leverage its real estate assets to generate social benefits and financial returns through disposal, development and investment.
- 7.1.4 The long-term aim will be to generate returns for the Council that can be used to support front line services alongside achieving improvements in skills, jobs and other social objectives. The implementation of the proposal outlined in this report will also support the commercialism approach that seeks to improve the financial return of assets that the Council holds, including seeking to generate new revenue for the Council.

7.2 Legal Implications

- 7.2.1 The power to acquire, dispose of and manage assets in land and property is principally contained in Sections 120 and 123 of the Local Government Act 1972.
- 7.2.2 Under Section 1 of the Localism Act 2011, the Council has the power to enter into the arrangements set out in this report, which are within the remit and limits of the general power of competence and Sections 2 and 4 of the Localism Act 2011.
- 7.2.3 The Council's interest in companies is regulated by Part V of the Local Government and Housing Act 1989.
- 7.2.4 Sections 93 and 95 of the Local Government Act 2003 and the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009 empowers the Council to trade commercially through a Council owned trading company but before deciding whether to trade commercially the Council must be satisfied that it has the statutory power to engage in the particular activity. Further, the power to trade is subject to a number of requirements which the Council must consider including the development of a full business case and risk assessment prior to trading.
- 7.2.5 The Council's power to dispose of land held for housing purposes traditionally known as HRA or Part 2 land is contained with Sections 32-34 Housing Act 1985 and power to dispose of land held in the General Fund and public open space is contained in Section 123 Local Government Act 1972.
- 7.2.6 Using its investment powers at section 12 Local Government Act 2003, loan funding may be provided to Propco. This must be on commercial terms to ensure compliance with public subsidy rules. Trading between the Council and Propco is permissible, and in compliance with Section 95 of the Local Government Act 2003. Section 95 requires a company to be created in order to trade.

- 7.2.7 The Council has already entered into a service contract with Propco to provide asset management, and legal services. The additional costs of facilitating the future acquisitions, investments and management will be charged to Propco and the contract will be varied by agreement with Propco to reflect these increased costs. The details of each of the project costs will be recovered through each development and included in its FBC.
- 7.2.8 In view of the Council as the sole shareholder of Propco, full transparency is required in respect of the determination of best consideration being achieved for future land disposals into Propco to demonstrate probity, independent joint valuations are to be commissioned by the Council and Propco.

7.3 Financial Implications

- 7.3.1 The business case for the establishment of Propco established the precedent for utilising the company to support the achievement of capital receipts required to meet the Council's financial plan.
- 7.3.2 As with all property disposals the net proceeds from the future disposal of the assets are subject to market forces. Propco will seek to maximise values to contribute to the generation of capital receipts to support the delivery of the Council's Financial Plan 2021-2025. This report is not asking for approval to transfer any specific assets into Propco at this time, but to put in place the structure to enable the disposal of assets at a future date.
- 7.3.3 The Council will continue to maintain a commercial relationship with Propco. The commercial relationship will include the disposal of assets at market rate and the provision of a loan secured against property and assets, under commercial terms. In addition, services provided by the Council to Propco will be charged on a full cost recovery basis. Propco will make payments to the Council, comprising both payments in relation to loan finance and services provided and as a further distribution of net operating surpluses generated. The financial implications of any changes to the service contract between the Council and Propco will be addressed within the Propco business plan and will generate a future increased revenue stream to the Council.
- 7.3.4 This report seeks approval to the principle of a loan and equity facility to Propco up to £100m. This figure is based on estimated values of a number of Council assets that are to be considered for disposal by the Council as part of its Property Strategy. The details of the actual loan and equity requirements will be subject to individual full business cases in accordance with recommendation 2.3 of this report.
- 7.3.5 In addition to property acquisitions, PropCo will also use the £100m facility to finance activities necessary to maximise sales receipts generated when

PropCo disposes of properties. Such activities could include for example, site remediation/clearance or obtaining planning permission.

- 7.3.6 Any loan facility from the Council to Propco will be secured on the property and assets of Propco, with interest calculated at a commercial rate to be determined at the point of the investment and subject to final negotiation between the Council and Propco. Interest and principal repayments will commence from the date the assets are acquired by the company, although the final terms will be agreed as part of the full business cases.
- 7.3.7 The future investments made by the Council of either debt or equity, will be met from prudential borrowing. New guidance from the Government states that local authorities cannot access public works loan board (PWLB) resources while making capital investments principally for yield (whether funded directly from borrowing or other sources). Due regard will be given to this guidance (noting risks in paragraph 6.2 above) with justification in the annual Treasury strategy of how the Council continues to comply with HM Treasury regulations.
- 7.3.8 The details of the indicative acquisition programme and value of the loans and how they will impact on existing debt profile of Propco will be considered in the full business cases for investment.
- 7.3.9 As sole shareholder the Council wishes to provide investment to Propco to develop its business plan and for Propco to restructure its governance and operational structure to support the acquisition and potential development of future investments. These costs are estimated to be up to £0.500m
- 7.3.10 This investment will be made by a capital injection to the company of £0.500m, to provide a short-term working capital facility, and the terms of the investment will be subject to approval by the Propco board. This advance will be made on commercial terms, by the Council in its role as sole shareholder.

7.4 Procurement Implications (if required)

- 7.4.1 There are no procurement implications with the recommendations of this report

7.5 Human Resources Implications (if required)

- 7.5.1 The project is resourced by existing employees, supported by existing commissioned services.

7.6 Public Sector Equality Duty

- 7.6.1 An Equalities Assessment was undertaken in 2017 ref number EA001951 in respect of the establishment of Propco, which concluded that the assessment at this stage is that there was no need to proceed to a full equality analysis. This decision was reviewed as part of the establishment

and approval of the Full Investment Property Strategy and Plan. Within the scope of the project there is no potential to adversely affect any protected group and by generating additional levels of income to subsidise Council services the project will contribute to equality of opportunity.

- 7.6.2 Decisions on how best to use any income generated will be made as part of the normal Council budgeting process, which will be subject to its own equality analysis.

8 Appendices

- 8.1 Appendix 1 Equalities Analysis EA001951

9 Background Documents

- 9.1 Cabinet Report 27th June 2017: Development of an investment vehicle for commercial property and the disposal of surplus properties to the vehicle – Full Business Case

- 9.2 Property Strategy Report to Cabinet November 2018