

Birmingham City Council

Report to Cabinet

30th July 2019



Subject: Property Investment Strategy
Report of: Director - Inclusive Growth
Relevant Cabinet Member: Councillor Ian Ward – Leader of the Council
Relevant O &S Chair(s): Councillor Tahir Ali - Economy and Skills
Councillor Sir Albert Bore – Resources

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Are specific wards affected?	<input type="checkbox"/> Yes	<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: 006350/2019		
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 In November 2018 Cabinet approved a new Property Strategy which clearly set out how the Council would manage its property assets.
- 1.2 It was agreed an annual Property Investment Strategy would be reported to Cabinet, setting out the basis on which new property acquisitions into the portfolio would be made.
- 1.3 This Property Investment Strategy sets out the current status of the existing portfolio and the steps needed to release underperforming assets and acquire new better quality assets to support this key income stream.

2 Recommendations

- 2.1 Approves the Property Investment Strategy attached at Appendix 1 thus enabling a more strategic management and operation of the Council's commercial property assets and property investment decisions.
- 2.2 Approves the motion to Full Council to amend the General Delegation Part B 13 of the Constitution to include a new delegation for the approval of acquisitions to, and disposals from, the Investment Property portfolio to the Leader and Cabinet Member for Finance and Resources, jointly with Director - Inclusive Growth, Chief Finance Officer 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 Investment Strategy transactions that exceed the general 'property' delegation financial thresholds currently stated in the General Delegations Part B Section 13 (vii).
- 2.3 Approves the commencement of any procurement activity for the provision of investment legal and property advice to support the strategy in accordance with paragraphs 7.4.1 and 7.5.2 and delegates the approval of the award of the subsequent contracts to the Director - Inclusive Growth in conjunction with the Assistant Director - Development and Commercial (or their delegate), the Chief Finance Officer (or their delegate) and the City Solicitor (or their delegate).
- 2.4 Authorises the City Solicitor to prepare, negotiate, execute and complete all necessary documents and agreements to give effect to the above recommendations

3 Background

- 3.1 The City Council is the single largest owner of property in Birmingham and holds the largest land estate of any UK local authority, extending to 26,000 acres. The Portfolio, excluding residential homes, infrastructure and schools has an asset value of over £2.4 billion. The commercial Income generating assets achieve approximately £26m in rental income per annum.
- 3.2 Due to historically reducing operating budgets, the City Council's investment Portfolio has been maintained as an existing wasting asset rather than that "used solely to earn rentals or for capital appreciation or both" as is the definition by the Chartered Institute Of Public Finance (CIPFA).
- 3.3 Following approval of the Corporate Property Strategy on 8th November 2018, the Property Investment Strategy has been developed to strategically manage the investment portfolio of assets to maximise revenue returns.
- 3.4 The Property Investment Strategy is the core real estate planning and performance document for the Council. The unique portfolio of assets provides an unrivalled resource base from which to drive forward the City's inclusive growth agenda and deliver a range of priorities for Birmingham and its residents. The city is experiencing a major revitalisation with its property market buoyant and growing across all sectors. The opportunities to utilise our property portfolio

to support the achievement of our ambitions for the City are significant. The Property Investment Strategy will enable us to progress and harness our assets to best effect.

- 3.5 The proposed Strategy will focus on a commercially sustainable asset management approach to better manage the portfolio value through a process of continual review, maximising returns from poorly performing properties via sales and pro-active deployment of receipts gained, driving greater returns from retained properties with targeted refurbishment investment and investment in new properties.
- 3.6 As part of the Strategy the City Council will further identify the objectives and strategic drivers described in the Property Strategy with improved analysis of the current cycle of the investment property market to highlight target markets and other investment opportunities, taking into consideration the City Council's objectives. The Council is not seeking to use long term borrowing to expand its investment property portfolio size but is reviewing and rationalising its existing portfolio to ensure it is invested in a suite of properties which provide an appropriate risk and return balance within a more targeted and streamlined portfolio.
- 3.7 At asset level, the Property Investment Strategy provides the ability to establish recognised investment and property criteria methods to identify opportunities through target lot sizes, geographies, sectors, tenant covenants and lease structures (see draft Investment Decision Guide produced in conjunction with our appointed agent at Appendix 3) as well as target portfolio weighting in order to ensure that the City retains a balanced and diverse portfolio that suits the needs of the citizens of Birmingham as well as the aims of the operational portfolio by providing greater returns in the face of further cost saving requirements thus providing a platform for greater financial stability. For clarity, the City Council would not invest in opportunities which were felt to bring our ethical and inclusive society views into question.
- 3.8 New investments will be funded from sales of existing portfolio assets. The Council's Financial Plan 2019-2023 has approved borrowing (to a maximum of £50m) as a short term bridging loan to cover any temporary gap between realising sales and reinvesting into new assets and to manage the financial risk of being out of the market for a period of time. Any borrowing will be settled by future capital receipts generated through disposals.
- 3.9 The portfolio will invest predominantly in property in Birmingham or the surrounding economic area, providing good commercial returns are expected. Birmingham is currently an attractive property market and has strong prospects for growth with the proposed completion of the HS2 rail link enhancing an already enviable transport network position and the drive for large companies/ Government bodies to reduce costs by relocating from London. The intention is that the investment of local taxpayers' money in property should also benefit the economy of Birmingham, where this does not damage its financial interests.

- 3.10 Whilst it is proposed that the primary focus will be on Birmingham and the immediate surrounding economic area this does not rule out investment across the UK generally, subject to legal powers, and it will be important to consider and engage in acquisitions where advantageous and the opportunity can be justified by our investment criteria and taking into account the level of risks/returns.
- 3.11 Strategic property/site purchases will also be analysed and considered with a view to land assembly opportunities enabling a greater marriage value to being unlocked and delivering a driver for development and regeneration.
- 3.12 Opportunities to gain a secure income from debt financing will also be considered as part of the strategy in order to reduce risk by utilising an alternative investment and releasing financial barriers to development prospects.
- 3.13 Where a specific opportunity has been identified, a two stage process will be utilised consisting of an initial high level due diligence procedure which will lead to the production of a recommendation report. Following receipt of a positive narrative, a non-binding offer would be made to adhere to standard market timescales before moving forward to obtain the necessary governance approval if an offer was provisionally accepted. This process maximises the speed to market whilst still allowing the City Council to retain control of the decision making process.
- 3.14 The Property Investment Strategy will provide a structure for benchmarking and performance of an asset management approach and will be reviewed and revised on an annual basis.
- 3.15 Property market demands fluctuate which makes it imperative the Property Investment Strategy is implemented promptly, otherwise opportunities to secure investment may be missed.
- 3.16 Agile decision making is required in order to be able to respond at short notice to good property investment opportunities, and to protect existing investments. However, strong governance and financial controls will be necessary. Controls will be modelled in part on Council Treasury Management principles. It is proposed that:-
- Investment purchases and sales will be approved by the Leader and Cabinet Member for Finance and Resources jointly with the Director, Inclusive Growth, Chief Finance Officer – Finance and Governance and the City Solicitor (or their delegates).
 - The Property Investment Board, comprising officers from Property Services, Treasury Management and the Finance Business Partner, will keep the portfolio and its budget under review and develop purchase and sale proposals for executive decision. The Board will take appropriate professional advice on an ongoing basis from investment and property professionals.

- Executive decisions will be reported quarterly to Cabinet as part of regular financial monitoring. The Property Investment Strategy and policy will be brought annually to Cabinet for approval.
- Any potential purchase or refurbishment transaction would be limited to a maximum outlay of £25m in order to minimise risk to the portfolio structure and ensure that funds remain to take advantage of multiple opportunities simultaneously should they appear.
- Investment Management Practices will be maintained in accordance with CIPFA's Treasury Management Code to ensure that robust processes are in place to manage the portfolio. This will include training plans to ensure that officers and members involved in administration and decision making have appropriate skills and training.
- Other controls on investment activity are set out in the Investment Strategy and Investment Tactics Sections at 6 and 7 of the Property Investment Strategy document (attached as appendix 1) and include parameters for hurdle rates lot size (including an absolute purchase of £25m in a single transaction) and loan to value and maturity period (for loans). These will be reviewed annually by Cabinet in the Annual Strategy Report.

3.17 Market yields for different types of property are a key indicator of risk and return. The next stage for the Council is to evaluate the yields on the portfolio properties to help identify under/over performance as a means of determining investment or disposal decisions. This will be reported to the Property Investment Board in due course. Currently, an indication is that 20% of the rental income is generated from 0.31% of the assets.

4 Options considered and Recommended Proposal

4.1 Do nothing.

4.1.1 The City Council would not be able to realise the aims of the Property Investment Strategy previously agreed by Cabinet.

4.1.2 The ability to garner greater returns from the commercial portfolio would be severely restricted and possibly lost.

4.1.3 The opportunity to drive growth and development would be hampered.

4.1.4 The ability for the City Council's Property Services to enhance operational efficiencies would not be realised.

4.2 To do nothing and continue to manage the City Council's real estate without a formal investment strategy would result in both a reducing and deteriorating standard of portfolio and would mean that lost/reducing returns would not be able to be addressed. The City Council's income from the portfolio would fall and

would continue to fall as well as encountering increasing costs due to the lack of investment. A piecemeal approach such as this would miss the opportunity to maximise commercial and social returns and fail to ensure development and inclusive economic growth which will underpin the social fabric of communities across the city.

- 4.3 An alternative would be for the Council to sell the portfolio and use the proceeds to enhance its capital programme or repay borrowing. However, this would result in the loss of a significant long-term income stream yielding around 5% net of costs, and growing each year due to rent reviews, whereas repaying debt would save interest and MRP of only 3.6% for a limited period.
- 4.4 In order to maximise benefit to the region, investments will be primarily concentrated on the wider Midlands area.

5 Consultation

- 5.1 Ward Members for the relevant areas will need to be consulted for the individual transactions as and when they arise.
- 5.2 Officers from within Property Services have worked in conjunction with CBRE to prepare the Property Investment Strategy (attached as Appendix 1) and are supportive of its structure and intentions and therefore recommend approval to its findings and proposals.

6 Risk Management

- 6.1 Reputational risk: There is a reputational risk the City Council is seen to be purchasing large assets or numbers of properties for tactical and profit-making purposes rather than recognising the transactions as part of an overall strategy to use the City Council's property assets to full advantage. Similarly the rationalisation of Operational Property could be seen to adversely affect service provision. Press releases will be utilised to explain the balanced approach of the Property Strategy 2018, and staff and members will be fully engaged and briefed accordingly
- 6.2 Inability to meet property market timelines: Non-delivery or delay in delivery of rationalisation may occur as a result of the impact of the existing governance process and speed of the market could prevent us from realising strategic opportunities.
- 6.3 The unpredictable nature of the property market and the impact of Brexit upon the economy are as yet unknown. Regular reviews of projects and performance will be maintained and associated delivery plans will include mitigation options in order to avoid over-reliance on specific property sectors. It is intended that the strategy is reviewed annually as a minimum but also upon significant political or financial events.
- 6.4 All investment carries financial risk. A financial objective of the portfolio is to achieve a relatively steady and growing net income stream, whilst recognising

that the capital value of the portfolio will fluctuate under the influence of market conditions. By applying the Property Investment Strategy the City Council's investment portfolio will be better positioned to reduce risk of fluctuating property markets as well as having the ability to alter the view of particular property holdings to a long term strategy to benefit from the long term capital and rental growth that property has been evidenced to provide over a 15 to 20 year economic cycle.

- 6.5 The Property Investment Strategy work carried out by our appointed agent (CBRE) has highlighted the current property portfolio is subject to an imbalance in holding numbers within certain property sectors and this poses a risk to the health of the overall income stream during the property cycle. This imbalance needs to be addressed to protect the income from unsustainable fluctuations and reductions.

7 Compliance Issues:

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

7.1.1 The proposal contributes towards the Vision and Forward Plan (2019/20) and Property Strategy 2018. The Property Strategy 2018 is aligned with the strategic outcomes outlined in the Council Plan 2018-2022 – to create a city of inclusive growth where every child, citizen and place matters. The Property Strategy 2018 will help make Birmingham: a great city to learn, work and invest in; a great city to grow up in; a great city to age well in; a great city to live in; and for residents to gain maximum benefit from hosting the Commonwealth Games.

7.1.2 It supports the Council Plan and Budget 2019-2023 by generating resources and thus helping the Council to achieve a balanced budget.

7.1.3 Birmingham Business Charter for Social Responsibility (BBC4SR)

Compliance with the BBC4SR is a mandatory requirement that will form part of the conditions of any tender over the threshold for the policy. Tenderers will be required to submit an action plan with their tender that will be evaluated in accordance with the stated criteria and the action plan of the successful tenderer(s) will be implemented and monitored during the contract periods.

7.2 Legal Implications

7.2.1 The power to acquire, dispose and manage assets in land and property is contained in Sections 120 and 123 of the Local Government Act 1972.

7.2.2 Section 1 of the Localism Act 2011 contains the City Council's general power of competence and Section 111 of the Local Government Act 1972 contains the Council's ancillary financial and expenditure powers in

relation to the discharge of its functions including the disposal and acquisition of property.

7.2.3 Section 12 of the Local Government Act 2003 gives the City Council power to invest for the purpose of any of its functions or for the prudent management of its financial affairs. In using this power the Council will have regard to the Government Investment Guidance and CIPFA's Treasury Management Code. This is described more fully in the Strategy appendix section 1e.

7.2.4 Section 1 Part 1 of the Local Government Act 2003 gives the City Council power to borrow for the purpose of any of its functions or for the prudent management of its financial affairs.

The Investment Property Strategy contains further information in relation to the exercise of the City Council's statutory powers as set out in 7.2.1-7.2.4 above.

7.3 Financial Implications

7.3.1 The Property Investment Strategy is a framework designed to secure long term and sustainable income streams for the City Council and to increase its financial resilience over time so that it is less reliant on declining funding from Central Government.

7.3.2 The proposals will reinvest the proceeds from the disposal of under-performing assets, in order to maintain a growing property income stream. This does not assume any borrowing in the long term. However, in the short term a 'bridging loan' facility is proposed to cover any temporary gap between realising sales and reinvesting into new assets. The reinvestment principle will be reviewed annually in the financial planning process and in this Property Investment Strategy. The table below shows the Council's gross commercial rent income budget for the next five years:

	2019/20	2020/21	2021/22	2022/23	2023/24
	£m	£m	£m	£m	£m
Rent income:	25.776	26.276	28.556	29.906	31.256
Cumulative Increase:	-	0.500	2.780	4.140	5.480
%		1.9%	10.8%	16.1%	21.3%

7.3.3 In order to provide a balanced budgetary position on an annual basis, replacement assets will need to be purchased that grow the City Council's income over and above the rental level loss. With targeted purchasing of assets in a number of sectors our aim is to achieve a growth in net income equating to 21% by 2024.

- 7.3.4 The appointment of agents for related opportunity analysis and property identification is based upon the criteria set out in the Crown Commercial Services Framework document and is based upon a reducing percentage linked to actual purchase price of the asset.
- 7.3.5 Revenue expenditure incurred in delivering the Property Investment Strategy and managing the investment portfolio will be funded as part of the net revenue budget for the investment portfolio, (2019/20 £18.218m).
- 7.3.6 To ensure prudent financial monitoring as part of the annual Property Investment Strategy an update report will be included in respect of the prior years activity. Any completed transactions are to be reported on a quarterly basis to Cabinet through the Treasury Management reporting process.
- 7.3.7 Where the City Council is treating any acquisition as an 'investment' the City Council must adhere to the Local Government Act 2003 and will be recorded on the City Council's balance sheet as an identifiable Investment asset.
- 7.3.8 The V.A.T implications of all property acquisitions, including specifically V.A.T. Partial Exemption, will be discussed with the City Council's V.A.T team to ensure that any adverse VAT implications may be mitigated. This is described more fully in the Strategy appendix section 5e.

7.4 Procurement Implications (if required)

- 7.4.1 There is a requirement for the provision of investment legal and property advice to support the Property Investment Route where there is not the availability or specialism for the services to be delivered in-house. The proposed procurement strategy is to carry out a further competition exercise using either the Crown Commercial Services Estate Professional Services or the Homes England Property Professional Services Framework agreements. In the event that these framework agreements not being considered suitable, an open procurement process will be undertaken with a strategy approved by the Director - Inclusive Growth in conjunction with the Director Commissioning and Procurement (or their delegate), the Chief Finance Officer (or their delegate) and the City Solicitor (or their delegate), in accordance with the Procurement Governance Arrangements and advertised on OJEU, Contracts Finder and www.finditinbirmingham.com. The cost of advice will be met within the portfolio's budgets.

7.5 Human Resources Implications (if required)

- 7.5.1 Internal professional property and legal resources will be utilised in the progression of the individual transactions.

- 7.5.2 Subject to recommendation 2.3 external professional property agents and legal staff may be required for certain specialist and urgent investments and will be commissioned when necessary, given the specialist nature of investment acquisitions.

7.6 Public Sector Equality Duty

- 7.6.1 The approval of this Property Investment Strategy does not raise any equality issues, at this stage, as referenced in EA report number EQUA313 attached at Appendix 2. Any impacts raised upon acquisition or sale will be reviewed as part of any further initial Equality Assessments requested.

8 Appendices

- 8.1 1. Property Investment Strategy
- 8.2 2. Equality Assessment Report – EQUA313
- 8.3 3. Investment Decision Guide

9 Background Documents

- 9.1 15 November 2018 Cabinet report, Property Strategy 2018/19 – 2023/24 including First Phase Projects