

RESIDENTIAL PROPERTY INVESTMENT STRATEGY

1. INTRODUCTION

- 1.1. This report seeks approval to implement a new strategy to invest in residential property, in particular to purchase privately owned residential properties either as existing private sector rental producing units or with vacant possession for letting to private sector tenants, and to develop sites that the Council owns or acquires to build dwellings to deliver a range of housing and tenures including private rental, sales and affordable housing offered under a range of different tenures.
- 1.2. The proposed Residential Property Asset Investment Strategy is attached to this report.

2. BACKGROUND

- 2.1. The Council's Corporate Plan 2016 – 2020 states that the Council continually reviews activities and services to identify opportunities for savings and opportunities to generate income to address significant reductions in government funding, whilst at the same time maintaining services that are important to our customers. The availability of suitable and more diverse housing is important to the viability of the local economy in the district. "More homes for local people" is one of the Council's key priorities as set out in its Corporate Plan.
- 2.2. The purpose of the Residential Property Asset Investment Strategy is to invest in residential property, in particular to purchase privately owned residential properties either as existing private sector rental producing units or with vacant possession for letting to private sector tenants, and to develop sites that the Council owns or acquires to build dwellings to deliver a range of housing and tenures including private rental, sales and affordable housing offered under a range of different tenures.
- 2.3. The October Medium Term Financial report covering the period to 2021/22 shows that, over that period, the Council has a projected cumulative budget shortfall of £1.399m (based, amongst other things, on a 1% pay award). It is considered that a meaningful contribution towards ensuring continued delivery of the Council's key services can be achieved through investment in good quality income producing residential property. The strategy is supplemental to other strategies being adopted by the Council that also aim to help close the Council's funding gap.
- 2.4. The Residential Property Asset Investment Strategy has a number of aims, including to introduce new income streams to the General Fund, to deliver a more diverse range of housing and tenures including market rented properties and sales, directly building, leasing or purchasing new residential property, to provide private sector rented properties as a reputable landlord with a proven track record in the provision and management of rented residential property in the district, to accelerate housing delivery and to act as an additional provider of affordable housing offered under a range of different tenures. The Council would retain the discretion to invest in residential property outside the district.

- 2.5. In order to fulfill the aims of the strategy, the Council will establish a Wholly Owned Company limited by shares to acquire, build, hold and manage the properties through a number of subsidiary companies (for the purpose of this report, such a company or group of companies will be referred to as the "WOC").
- 2.6. The WOC will operate through a Board of Directors. Members of the Council will be able to hold the WOC, through the Board of Directors, to account and also set operational parameters for the WOC, for example through a memorandum of understanding setting out a decision making protocol. Members, through the Corporate Overview and Scrutiny Panel and full Council, would oversee the business plan(s), checking on performance and deliverables via reports of the Board in accordance with agreed reporting deadlines.
- 2.7. The formation and membership of the WOC's board will need to be established. It is proposed initially to consist of 4 Directors, comprising 2 designated members of Cabinet and 2 senior officers. The WOC's Memorandum and Articles of Association, business plan and other legal documentation will set out the relationship between the Council and the WOC and determine the operational framework for the board to follow when running the WOC's affairs.
- 2.8. The Council has the capacity to invest approximately £10M in a residential property investment strategy utilising current reserve balances, although the Council will need to be mindful that this may have a bearing on the size and scope of the future capital programme before borrowing may be required, and may result in the need to utilize monies currently invested in higher yielding funds. This strategy should also be flexible enough to enable further investment, utilizing external borrowing if necessary, should the opportunity for larger developments arise.
- 2.9. As noted in the strategy, more than one third of local authorities indicated that they had or intended to establish a housing company to provide housing. Investments could be funded either from the Council's own resources or by taking advantage of its ability to borrow at relatively low rates of interest from the Public Works Loan Board (PWLB) compared to the return on property assets.
- 2.10. The Council is already the biggest provider of housing within the district, managing its own stock of approximately 5,000 properties in the social rented sector. The Council has implemented a housing strategy to acquire additional housing for social rent through the buyback of former council houses, the purchase of new affordable homes from developers and the development of its own land to build new homes for social rent. The Council has experience and skills in the acquisition, delivery and management of housing, which can be applied to the wider residential sector.
- 2.11. The Property Investment Task and Finish Group has reviewed the proposed Strategy and approved it.

3. FINANCIAL IMPLICATIONS

- 3.1. Full details of the financial implications are set out in the strategy.
- 3.2. The management of the Council's cash is dictated within the Council's Treasury Management Strategy and is held within a variety of investment types. The average yield achieved as at July 2017 from these investments was 0.99%. The investment portfolio at that date includes £8M in pooled property and equity funds which are higher earning (5.27% achieved), with the majority of other funds being held with less than 1 year to maturity.

- 3.3. Local authorities are seeking to become more self-sufficient and not reliant on grant funding. An important issue when implementing the Residential Property Asset Investment Strategy is the value of the property portfolio and the expected target net yield. It is recommended that a target for investment return aims to make a significant contribution towards the current forecast budget deficit mentioned in 2.3.
- 3.4. An initial capitalization of the WOC in the order of £10m would be funded up to 33% as equity from usable General Fund reserves, with the remaining WOC finance being debt issued by the Council to the WOC, repayable on commercial terms, provided by the Council through internal borrowing or external loan lent onto the WOC. The actual amount of General Fund reserves used will depend on the overall balance available and the debt interest charges will be designed to strike an appropriate balance between keeping the WOC solvent, and maximizing the return to the Council. The decision as to whether the Council will borrow externally and at what point in time is a treasury management decision and not directly linked to the purchase of the asset or this strategy.
- 3.5. The financial return to the Council comes via the interest charges levied on the debt finance issued to the WOC, plus dividend payments, when the availability of funds allow. The rate of interest charge levied will be set on commercial terms. The Council will also charge a management fee per property to the WOC and will levy commercial charges to the WOC for legal and professional services. Interest rates and charges should not be excessive however as this may affect the potential solvency of the WOC.
- 3.6. The summary financial information provided in the strategy provides reasonable assurance that investment in Residential Property is worthwhile, and that development opportunities should be of particular interest, due to the higher returns, and the use of land value to act as equity for the WOC, rather than cash.
- 3.7. Although the Council's cash balances averaged at £74.7m in the 12 months to July 2017, they are forecast to decrease over the next few years. The level of usable General Fund reserves is currently around £19m. It is envisaged that an internal borrowing arrangement would take place to finance the debt element of the initial £10m investment, although the Council's Responsible Financial Officer will ensure the most efficient use of internal funds in relation to current and forecast external borrowing rates to ensure the strategy is financially sound over the long term
- 3.8. Officers believe that the Council could currently potentially borrow funds with the Public Works Loan Board (PWLB) at a rate of around 2.5% - 3.00%. The PWLB fixed interest rates are based on gilt yields and are published twice a day. The PWLB needs to be satisfied the Council is acting lawfully when borrowing funds.
- 3.9. This Council already has substantial loans of c£144M following the Housing Revenue Account resettlement. The Council's prudential indicators, which are agreed as part of the Treasury Management Strategy and Annual Budget 2017/18, include for example, a limit on external debt. The agreed size, funding mix and anticipated timing of the acquisitions of the property portfolio would need to be taken into account in the prudential indicators, to include an increase in the overall external debt limit.
- 3.10. It is necessary for the Council to take a prudent approach to the management of its financial affairs. When assessing investments taking a prudent approach, the Council will need to consider such factors as the security against loss, the liquidity of the investment, the yield, affordability of the loan repayments, change in interest rates and property values.

- 3.11. An initial investment portfolio totaling £10m is deemed as reasonable in the balance of risk versus reward, and is sought as a supplementary estimate to the Council's budget. The indicative eventual level of revenue to be generated is estimated in excess of £350k PA. Expenditure and income budgets will be added to the budget at the appropriate time, when properties are identified and purchased and developments undertaken.
- 3.12. There are a number of risks the Council should consider, all of which could have an impact on the net return to the Council as set out in section 4 of the strategy.
- 3.13. The internal reserves that will be available to invest in the WOC's equity should total no more than 33% of any prospective purchase / overall cost of development. Any expansion of the portfolio beyond the point whereby internal reserves can no longer be utilized will require on-lent prudential borrowing. The cost of any borrowing will form an integral part of the financial evaluation of any purchase / development, and will only proceed if the level of financial return over the long term is appropriate.

4. ONGOING PERFORMANCE REVIEW

- 4.1. The WOC will be responsible for providing regular reports on management issues and the performance of the WOC to the Council.
- 4.2. It is proposed that six monthly reports are to be provided to the Corporate Overview and Scrutiny Panel and annual reports provided to full Council in respect of progress against the Strategy.

5. HUMAN RESOURCE IMPLICATIONS

- 5.1. Acquiring, managing and developing the Council's residential property investment portfolio will have an impact on Council workloads, including within the Estates and Valuation and Housing Strategy and Development teams. There may be additional staffing requirements required to fulfill the Strategy. Such additions will form part of the additional expenditure budgets referred to in paragraph 3.11 when properties are identified and purchased and developments undertaken.

6. PORTFOLIO HOLDERS COMMENTS

- 6.1. I am pleased to see the Council has developed a residential property asset investment strategy. By a carefully considered investment in residential property the Council will be able to generate income to support the delivery of services as well as deliver much needed greater diversity in housing

7. CORPORATE OVERVIEW AND SCRUTINY PANEL

- 7.1 The draft Residential Property Investment Strategy was discussed by the Property Investment Task & Finish Group and the Corporate Overview and Scrutiny Panel recommended to the Cabinet that the Residential Property Investment Strategy be approved.

8. ENVIRONMENTAL, EQUALITY AND DIVERSITY AND CRIME AND DISORDER IMPLICATIONS

8.1. There are none.

9. RECOMMENDATION

9.1. That the Council:

9.1.1. Approves the Residential Property Asset Investment Strategy attached to this report.

9.1.2. Approves the proposed level of initial investment as set out in this report.

9.1.3. Authorises the Chief Executive, the Executive Head Governance & Regulation, and the S151 Officer, in consultation with 2 Portfolio Holders determined by the Leader of the Council, to take all decisions, including entering into all necessary contracts and agreements, including the setting up of the WOC (and subsidiaries) and related costs, to implement the Residential Property Asset Investment Strategy as set out in this report;

9.1.4. Approves the appointment of 2 Cabinet Members and 2 senior officers to the board of directors of the WOC following its incorporation, such individuals to be agreed by the Chief Executive in consultation with the Leader of the Council.

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Background Papers:

Asset Investment Strategy