

To: All Members of the EXECUTIVE

When calling please ask for:

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**Policy and Governance**

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Date: 12 November 2020

**Membership of the Executive**

Cllr John Ward (Chairman)  
Cllr Paul Follows (Vice Chairman)  
Cllr Peter Clark  
Cllr Andy MacLeod  
Cllr Michaela Martin

Cllr Mark Merryweather  
Cllr Nick Palmer  
Cllr Anne-Marie Rosoman  
Cllr Liz Townsend  
Cllr Steve Williams

Dear Councillors

A Special meeting of the EXECUTIVE will be held as follows:

DATE: FRIDAY, 20 NOVEMBER 2020

TIME: 12.00 PM

PLACE: ZOOM MEETING - VIRTUAL MEETING

The Agenda for the Meeting is set out below.

Yours sincerely

ROBIN TAYLOR  
Head of Policy and Governance

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## **NOTES FOR MEMBERS**

Contact Officers are shown at the end of each report and members are welcome to raise questions, make observations etc. in advance of the meeting with the appropriate officer.

### **AGENDA**

1. **APOLOGIES FOR ABSENCE**

To receive apologies for absence.

2. **DECLARATIONS OF INTERESTS**

To receive from members, declarations of interest in relation to any items included on the agenda for this meeting, in accordance with the Waverley Code of Local Government Conduct.

3. **QUESTIONS FROM MEMBERS OF THE COUNCIL**

The Chairman to respond to any questions received from Members in accordance with Procedure Rule 11.

4. **PROPERTY ACQUISITION FOR CONSIDERATION** (Pages 5 - 36)  
[Portfolio Holder: Councillor Mark Merryweather]

In line with the Property Investment Advisory Board (PIAB) Terms of Reference and PIAB minutes of 13 October 2020, the PIAB recommend to the Executive the purchase of the proposed property identified in Exempt Annexe 1.

#### **Recommendation**

The PIAB recommend the Executive approve the purchase of the property identified in Exempt Annexe 1 within its delegation limit of £10 million subject to:

- 1.1 A bid of up to £6,955, 000 to acquire the freehold, subject to satisfactory completion of the further evaluation work and due diligence referred to in this report.
- 1.2 To delegate to the Strategic Director (Sec 151) and the Chief Executive, in consultation with the Deputy Leader and Portfolio Holder for Finance, Assets and Commercial Services:

- i) The undertaking and signing off of the evaluation work and due diligence required as referred to in recommendation 1.1;
- ii) The decision not to submit a bid or to withdraw a bid if already submitted, in the event that the evaluation work and/or due diligence is not satisfactory;
- iii) The decision to accept a lower financial return (after internal borrowing costs) than required in Waverley's investment criteria, if justified after evaluating the wider strategic and long term benefits of acquiring this site;
- iv) To finance the acquisition as set out in this report;
- v) To delegate the completion of legal matters and signing of appropriate contracts to the Strategic Director (Sec 151) and the Chief Executive, in consultation with the Deputy Leader and Portfolio Holder for Finance, Assets and Commercial Services.

5. EXCLUSION OF PRESS AND PUBLIC

To consider the following recommendation on the motion of the Chairman:

Recommendation

That, pursuant to Procedure Rule 20, and in accordance with Section 100A(4) of the Local Government Act 1972, the press and public be excluded from the meeting during consideration of the following item(s) on the grounds that it is likely, in view of the nature of the business to be transacted or the nature of the proceedings, that if members of the public were present during these items, there would be disclosure to them of exempt information (as defined by Section 100I of the Act) of the description specified at the meeting in the revised Part 1 of Schedule 12A to the Local Government Act 1972.

**For further information or assistance, please telephone  
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## WAVERLEY BOROUGH COUNCIL

### EXECUTIVE

17 NOVEMBER 2020

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**Title:**

**Investment Proposal**  
**Acquisition put forward for consideration**

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**Portfolio Holder:** Cllr Mark Merryweather, Portfolio Holder for Finance

**Head of Service:** Peter Vickers, Head of Finance and Property

**Key decision:** Yes

**Access:** Part Exempt

**Note pursuant to Section 100B(5) of the Local Government Act 1972**

Annexes to this report contain exempt information by virtue of which the public is likely to be excluded during the item to which the report relates, as specified in Paragraph 3 of Part I of Schedule 12A to the Local Government Act 1972, namely:

Information relating to the financial or business affairs of any particular person (including the authority holding that information).

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**1. Purpose and summary**

- 1.1 In line with the Property Investment Advisory Board (PIAB) Terms of Reference and PIAB minutes of 13 October 2020, the PIAB recommend to the Executive the purchase of the proposed property identified in Exempt Annexe 1.
- 1.2 The Property Investment Strategy (PIS) governance framework tasks officers with sourcing viable investment opportunities compliant with the strategy, appraising, completing due diligence and presenting the case to the PIAB to fulfil its governance function and if satisfied recommend the investment proposal to the Executive.
- 1.3 The PIAB governance role is to scrutinise and challenge the proposed investment to ensure it is in line with the PIS required governance, is in compliance with the strategic direction of the portfolio and agreed investment principles. This report includes the information provided to the PIAB to enable it to fulfil its governance function and recommend the proposed investment to the Executive.
- 1.4 The PIS's prescribed governance requires the PIAB to satisfy itself that prior to any investment recommendations it has first determined:
  1. The reason for the investment
  2. The powers under which the investment is made
  3. The extent to which the capital invested is placed at risk (exit strategy)
  4. The impact of any potential losses on financial sustainability (proportionality to

the General Fund net revenue budget and identified contingency)

- 1.5 This report provides the investment information and governance requirements in accordance with the PIS to support the PIAB investment recommendation to the Executive.

## **2. Recommendation**

The PIAB recommend the Executive approve the purchase of the property identified in Exempt Annexe 1 within its delegation limit of £10 million subject to:

- 2.1 A bid of up to £6,955,000 to acquire the freehold, subject to satisfactory completion of the further evaluation work and due diligence referred to in this report.
- 2.2 To delegate to the Strategic Director (Sec 151) and the Chief Executive, in consultation with the Deputy Leader and Portfolio Holder for Finance, Assets and Commercial Services:
- i) The undertaking and signing off of the evaluation work and due diligence required as referred to in recommendation 2.1;
  - ii) The decision not to submit a bid or to withdraw a bid if already submitted, in the event that the evaluation work and/or due diligence is not satisfactory;
  - iii) The decision to accept a lower financial return (after internal borrowing costs) than required in Waverley's investment criteria, if justified after evaluating the wider strategic and long term benefits of acquiring this site;
  - iv) To finance the acquisition as set out in this report;
  - v) To delegate the completion of legal matters and signing of appropriate contracts to the Strategic Director (Sec 151) and the Chief Executive, in consultation with the Deputy Leader and Portfolio Holder for Finance, Assets and Commercial Services.

## **3. Reason for the recommendation**

### **Objectives**

The Council's Corporate Plan (particularly housing, economic development and the financial sustainability of the Council) is supported by the Medium Term Financial Plan (MTFP) 2020-2024 which includes the generation of new cash and protecting the capital invested, and included as key objectives of the PIS. The MTFP has an investment property income target of £1.2m of new annual revenue in addition to the £1.3m currently being generated from the existing portfolio (see portfolio analysis below).

The new revenue will be achieved through regearing of existing assets, as well as

buying and building assets for inclusion in the investment property portfolio up to a potential total additional investment of £100m in value in compliance with the PIS, specifically with the objective of creating a risk balanced portfolio in respect of sector, geography, size of lot and length of lease etc. Protection of capital is equally as important as revenue and the PIS requires an adequate and acceptable exit strategy to be identified as part of the investment proposal.

### **Legal Powers**

The PIS requires every proposal submitted to the PIAB to identify the legal powers under which the Council will invest by having regard to the legal opinion taken and to seek supplementary legal advice where appropriate.

The Council has taken legal Counsel advice regarding its ability to invest in property to support the Corporate Plan objectives, both in and outside of the borough and its powers to borrow to fund these investments. This legal advice is incorporated within section 6 of the PIS and summarised in Exempt Annexe 2 to this report.

The legal advice requires a business case and justification for the proposed investment and this is set out in this report. The Council will also seek specific legal advice on these proposals as part of the acquisition process.

The PIS also requires the legal checklist assessment to be completed for every proposed acquisition, this is set out in Annexe 3.

### **Return on investment**

The PIS objective is to develop a long term property investment portfolio that directly supports the Council's Corporate Plan objectives whilst securing a stable income for the Council's General Fund revenue budget representing yield at least in line with treasury management returns.

Treasury management returns are based upon fixed term, fixed rate deposits on the money markets within the agreed prudential parameters listed in the Treasury Management Strategy. The weighted average return achieved pre-Covid was 1.1%, this has reduced to 0.2% and is forecast to remain at this level for the duration of the MTFP.

The drop in the Bank of England base rate has also reduced the yield available on property returns in addition to economic factors. This makes investment decisions based upon yield more challenging after the cost of borrowing.

The Council will need to borrow externally to fund the full investment required to achieve the £1.2m additional income. The minimum cost of external borrowing to the Council is around 4%. Consisting of 2% statutory Minimum Revenue Provision (set on an annuity basis i.e. grows in line with the increase in rent stream) and around 2% borrowing interest rate, which depends on period of the loan, determined by the portfolio strategy (i.e. planned holding period for the investments).

The yield on property investment also depends upon the financing strategy,

consisting of a mix of capital receipts, internal cash diverted from treasury deposits and external borrowing. Internal borrowing to invest in property is assisted by the significant drop in the money market deposit returns.

Acceptable yield on property investment therefore comes down to an assessment of the risks of tenant default (and adequacy of a void provision) and capital loss weighed up against the amount of net cash being generated to contribute to the Council's General Fund revenue budget, an acceptable exit strategy to protect the capital invested and the impact on the overall portfolio financing strategy.

The Council will take portfolio financing advice from its external treasury management advisers as part of due diligence on investment proposals.

## **Risk**

Managing risk is a PIS key objective and lists the following criteria:

- Build a risk/return balanced property portfolio
- Diversify through class and location
- Protect capital invested in property acquisitions through predetermined holding periods and exit strategies
- Obtain stable inflation protected income growth

The PIS governance also requires risk to be minimised through the compliance with the investment criteria, completion of due diligence and having a management strategy and an exit strategy for each property. These risk criteria have been addressed in this report.

## **Property acquisition proposal**

An action plan was proposed at the PIAB meeting in September to phase the development of a balanced portfolio over three time periods, short, medium and longer term.

The short term would entail identification of investments that can be acquired within this financial year, generating immediate cash to support the MTFP whilst the medium and ultimately long term portfolio is constructed. These investments will comply with the PIS criteria of being within the area of economic influence, lot size, sector etc., however, they may not strategically fit the long term ambition of being in Borough or directly contribute to the Corporate Plan other than underpinning the MTFP. It is expected that these investments will most likely be open-market purchases of established assets at prevailing market yields and held for the duration of the MTFP or until they can be replaced with more strategically aligned investments.

The medium term investments will be those that will take some time to come on stream (one to two years) due to development time, rent holidays or regearing whilst also not necessarily fully fitting the desired characteristics of the balanced portfolio, such as lot size, sector, location and yield.

The longer term portfolio ambition is to be fully in Borough, diversified across commercial and residential, fully engaging the Corporate Plan ambitions. It is

expected that these investments will most likely be Council new-build developments which, if they are on existing Council land, should offer above-market yields.

In line with the short term action plan, Montagu Evans (the Council's appointed asset advisors) has identified a potential short term acquisition in the table below and detailed in Exempt Annexe 1.

Purchase cost	£6,955,000				
SDLT and fees	£452,075				
Total outlay	£7,407,075				
	2021/22	2022/23	2023/24	2024/25	Exit
	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
Rent net of management costs	378,300	378,300	379,246	379,246	379,246
Minimum Revenue Provision	82,230	83,875	85,553	87,264	89,009
<b>Net annual income to budget</b>	<b>£296,070</b>	<b>£294,425</b>	<b>£293,693</b>	<b>£291,982</b>	<b>£290,237</b>
Actual yeild	4.00%	3.97%	3.97%	3.94%	3.92%
Notional yeild (if debt financed)	2.12%	2.10%	2.09%	2.06%	2.04%

**Justification:** This purpose of this investment is to support the prudent management of the Council's affairs and is within the portfolio investment strategy. This investment will provide a net rental after MRP of £1,466,000 over the MTFP period.

**Risk:** Tenant specific risk analysis is covered in Exempt Annexe 1. The likelihood of a void within the remaining eight year lease is limited to the remote possibility of the default of a significant well established company. The tenant also has an option to a new 25 year lease from 2023. The exit strategy is to regear to a 25 year lease and sell in year 5. There is strong market competition for such leases from rival companies. The full year impact upon the revenue budget of a void period would be £550,000. This risk will be covered by the maintenance of an Investment Property Void Provision. A financial risk assessment is included on Exempt Annexe 5.

**Financing:** The purchase price of the investment will be financed from the use of internal cash within the Treasury Management Strategy. The opportunity cost for the use of this cash is 0.2% per year equating to £14,000. The fees and Stamp Duty Land Tax (SDLT) will be met from capital receipts.

**Portfolio strategy:** This asset will be purchased for a short term hold, (the period of the MTFP) to provide instant cash generation, it has an acceptable lot size at £7.4m and is in the supermarket sector of the portfolio. Whilst being out of the Borough boundary, it is within the area of economic influence.

**Portfolio analysis:** The make up of the Council's current portfolio is shown below, including the impact of the proposed acquisition. Whilst the proposed investment increases the supermarket holding, the existing investment is limited to a single ground rent on an out of town in Borough investment.

	FV £000		Annual	
<b>Current</b>			Rent £000	Yield
Office	11.09	43.4%	0.64	6%
Supermarket	7.63	29.8%	0.31	4%
Industrial	6.20	24.3%	0.30	5%
Retail	0.64	2.5%	0.07	11%
	<u>25.56</u>	<u>100.0%</u>	<u>1.32</u>	<u>5%</u>
<b>Proposed</b>				
Supermarket	7.4		0.29	4%
	<u>7.19</u>		<u>0.29</u>	
<b>Combined</b>				
Office	11.09	33.9%	0.64	6%
Supermarket	15.03	45.6%	0.60	4%
Industrial	6.20	18.9%	0.30	5%
Retail	0.64	2.0%	0.07	11%
	<u>32.96</u>	<u>100.0%</u>	<u>1.61</u>	<u>5%</u>

#### **4. Background**

4.1 Not required.

#### **5. Relationship to the Corporate Strategy and Service Plan**

5.1 Acquisition of investment property directly underpins the Corporate Plan.

#### **6. Implications of decision**

##### **6.1 Resource (Finance, procurement, staffing, IT)**

There are no resourcing implications from this report.

##### **6.2 Risk management**

Covered in detail within the report.

##### **6.3 Legal**

Legal implications – are covered within the body of the report, and Exempt Annexe 2.

##### **6.4 Equality, diversity and inclusion**

There are no direct equality, diversity or inclusion implications in this report. Equality impact assessments are carried out when necessary across the council to ensure service delivery meets the requirements of the Public Sector Equality Duty under the Equality Act 2010.

##### **6.5 Climate emergency declaration**

Investment decisions, whether for treasury management or property acquisition

must be undertaken in accordance with investment guidance, both statutory and from the Chartered Institute of Public Finance and Accountancy (CIPFA), which states that investing must adopt security, liquidity, yield principles in that order.

These acquisitions' are proposed on their contribution to Council's financial sustainability and positive impact on the Medium Term Financial Plan which in turn supports the Council's Corporate Objectives with regard to the Climate emergency declaration.

## **7. Consultation and engagement**

- 7.1 The details of the proposed acquisition have been shared informally with the Chairmen and Vice-Chairman of the Value for Money Overview & Scrutiny Committee, and the Audit Committee; and with the Leader of the Principal Opposition Group. The details have also been shared with the Council's External Auditor, Grant Thornton.

## **8. Other options considered**

- 8.1 None

## **9. Governance journey**

- 9.1 Report goes to the PIAB before Executive, the value of the proposed bid is within the authority of the Executive to approve.

## **Annexes:**

Exempt Annexe 1 – Investment proposal  
Exempt Annexe 2 – Legal opinion  
Annexe 3 – Legal checklist  
Exempt Annexe 4 – Property prospectus  
Exempt Annexe 5 – Financial risk analysis

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## **Background Papers**

There are no background papers, as defined by Section 100D(5) of the Local Government Act 1972).

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## **CONTACT OFFICER:**

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### Investment Checklist

The following check list will be used to determine the decision on whether the proposed investment can be undertaken.

<ul style="list-style-type: none"> <li>▪ <b>Can we acquire commercial and residential property?</b></li> </ul>	
<ul style="list-style-type: none"> <li>– What are the legal powers to support the acquisition and, crucially, are they powers specifically to acquire property or to make investments?</li> </ul>	Annexe two sets out the legal powers. These specifically enable the acquisition of a property out of borough for investment in line with the PIS.
<ul style="list-style-type: none"> <li>– Where borrowing is required, what are the powers available to support the taking out of loans?</li> </ul>	Internal treasury funding will be utilised. Para 46 referenced in Annexe two covers the requirements for borrowing (including internal borrowing)
<ul style="list-style-type: none"> <li>▪ <b>Should we acquire commercial and residential property?</b></li> </ul>	
<ul style="list-style-type: none"> <li>– Can the Council justify the exercise of the legal powers in the way proposed?</li> </ul>	Justification is fully covered in the report.
<ul style="list-style-type: none"> <li>– Does the Council's decisions have proper regard for the statutory guidance?</li> </ul>	Yes, fully regarded and justification is provided in the report.
<ul style="list-style-type: none"> <li>– Does the Council's decisions have proper regard for the Prudential Code in terms of affordability, prudence and proportionality?</li> </ul>	Yes, fully regarded and justification is provided in the report.
<ul style="list-style-type: none"> <li>– Is the acquisition defensible under the best value duty?</li> </ul>	Yes, yield has been considered and external valuation provided
<ul style="list-style-type: none"> <li>▪ <b>Will we acquire commercial and residential property?</b></li> </ul>	
<ul style="list-style-type: none"> <li>– Is the proposal consistent with the Council's Corporate Strategy and Medium Term Financial Plan?</li> </ul>	Fully compliant, explained in the report.
<ul style="list-style-type: none"> <li>– Can the proposal be accommodated within the Council's Treasury Management Strategy and Property Investment Strategy?</li> </ul>	Sufficient funding is available for the duration of the investment. PIS governance requirements are fully complied with.
<ul style="list-style-type: none"> <li>– Does the Council have the necessary competence to take the proposed decision?</li> </ul>	Yes, expert external advice has been sought for legal, financial and investment advice. Officers are qualified and experienced.
<ul style="list-style-type: none"> <li>– Does the Council have appropriate skills to manage the asset?</li> </ul>	Yes, Investment manager is suitably qualified, experienced and has sufficient capacity.

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