SHDC Regeneration and Investment Strategy

1. Introduction

This strategy replaces the Council's Commercial Investment Strategy which was approved on December 2019. It reflects changes in the PWLB and the aspirations of the Council to support projects and investments that deliver regeneration, employment, the JLP and housing, strategic investments, climate change and our corporate strategy, within South Hams.

There are only limited occasions when this strategy and the scheme of delegation within it would need to be utilised, but having a scheme of delegation that provides for expedient, auditable decisions is an essential part of a regeneration toolkit. Opportunities that come to the market that align to corporate strategy priorities are often time bound, and the Council must be able to respond to those.

This Regeneration and Investment Strategy includes the following delegations in summary:

- To the Executive (via a formal meeting) for Regeneration and Investment on Council owned land, including debt finance within the approved borrowing limits.

- To the Head of Paid Service in consultation with the Executive and S151 Officer for acquisitions, including debt finance within the approved borrowing limits.

2. Overall Objectives:

The Council's Regeneration and Investment strategy has multiple objectives as stated below:

- Provide the financial toolkit and borrowing capacity for the Council to underpin its strategic priorities
- Enable investment in regeneration and therefore the economic activity of the District
- Allow the Council to have a streamlined decision making process in place should it be needed for time critical decisions
- Provide a framework to consider and provide for Security and Liquidity

3. Desired Outcomes:

The following outcomes are desired by the application of this strategy. Each opportunity will be assessed on its fit with meeting the objectives stated above and should deliver one or more of the following outcomes (benefits):

- ✓ Homes
- ✓ Job creation or safeguarding
- ✓ Health & Wellbeing
- ✓ Town centre regeneration
- ✓ Tourism / Increased footfall
- ✓ Business rate growth
- ✓ Improved asset utilisation
- ✓ Climate change mitigation
- ✓ Connectivity (Physical or Digital)
- ✓ Support the delivery of any other strategic priority of the Council
- ✓ A yield aligned to project risk and financial security – this will vary according to the project.

This strategy will be achieved through acquisitions and developments within the South Hams District. This may include the focussed acquisition of land, existing Regeneration and property assets and the development of new properties which are to be let to third parties. Furthermore it may include investments and acquisitions in infrastructure, homes and the renewable energy sector.

The following four types of investment are recognised in the Statutory Guidance on Local Government Investments (3rd Edition) (SGLGI):

1. Financial investments:

    a. Specified investments - generally short term investments (para 31 and 32)

    b. Loans - including to wholly owned companies (para 33 and 34)

    c. Non-specified investments (e.g. shares) - generally longer term investments (para 35 and 36)

2. Non-financial investments (e.g. property) - non-financial assets, held primarily or partially to generate a profit (para 37 to 40)

As described above, this strategy therefore relates primarily to non-financial investments i.e. Property. However, in the case of renewable investments it is possible that they may be classified as Financial Investments – Non specified investments. This strategy recognises that the purchase of Special Purpose Vehicles (SPVs) so as to own, operate or invest in renewable energy generation is a category of investment covered in this strategy.

4. Risk

- The risks of acquiring land, property and infrastructure may be mitigated through the acquisition of assets with secure, long term income streams, although this risk will be weighed up against the social and economic benefits of acquisitions to support commerce and trade in the District. Each opportunity's risk profile will be appraised individually and mitigated or accepted accordingly.
- Acquisitions are to be made in a careful and controlled manner, aligned to the corporate strategy, with specific analysis of risk criteria carried out in the 'due diligence' stage prior to the completion of each purchase.
- The Council's due diligence procedures are set out in detail in Section 5.3 of the Council's Investment Strategy. The Council's Investment Strategy also sets out Investment Indicators such as debt to net service expenditure ratio and regeneration and income to net service expenditure ratio.
- Each unique project will have its own set of risks and challenges, but where tenants are a feature those with strong financial standing and long unexpired lease terms will be preferred. It is recognised however that some regeneration projects are centred around poor tenant strength and typical highstreet issues. These criteria will be considered on a case by case basis and in order to meet the strategy objectives.
- Risk of loss (Para 41 SGLGI) shall be assessed on a case by case basis as part of the acquisition or investment due diligence and will be a criteria considered throughout the approval process. Risk of loss during the management phase of the investment shall be reported in accordance with the criteria below.
- In accordance with Para 23-25 of the Statutory Guidance on Local Government Investments (SGLGI), quantitative indicators or risk and portfolio performance will be reported to Audit Committee. The frequency of this reporting is anticipated to be every 6 months and will include the following indicators (as applicable):
    - Rental value by property (or land parcel)
    - Rental value by tenant
    - Sector split by purchase price

- Purchase price
- Rental income profile
- Tenant lease length
- Gross Yield
- Management, Maintenance and Risk Mitigation Reserve (MMRM) value
- Current value
- In the case of an SPV, relevant criteria shall be reported depending on the nature of the SPV.

5. Location:

- Wherever opportunities or need is identified within the District, in order to acquire or develop good properties or deliver projects of infrastructure which achieve some or all of the Council's multiple objectives and desired outcomes as stated above and are deemed as an acceptable risk.

6. Tenant mix (where applicable):

- Where possible, a mix of tenants will be sought to create a balanced portfolio
- The final decision over the appropriateness of any tenant would be reviewed at the time of acquisition
- SHDC owns a significant number of regeneration and business units already within the District, mainly smaller units and tenants with relatively low credit ratings. This reflects the historic policy of supporting small start-ups which has proved successful and continues to be.

7. Lease length (where applicable):

- A minimum 4 years unexpired (mean unexpired term for multi-let properties) is preferable, however this is flexible if it helps achieve the strategy objectives
- For multi-let properties, a mix of lease expiry dates are preferred, thereby limiting void risk (unless the property is purchased with a view to re-development)
- Properties would preferably be let to sound tenants on leases with a preference for 'Full Repairing and Insuring' leases for single occupiers and through internal repair obligations and a service charge for multi-let properties.
- There may be overriding community benefit and/or economic reasons to move away from these criterion and these will be considered on a case by case basis.

For all of the above:

The final decision over the definition of "good", "secure", "strong", "long", "careful", "controlled", "acceptable", "balanced" and "risk-averse" will be agreed between the property acquisition advisers (including legal due diligence) and the Officers delegated with the responsibility to conclude the acquisition of the properties. This discretion will be based on both the risk to the capital value of the asset and its fit with the strategy objectives.

8. Yield:

- The Council will only acquire properties and make investment decisions where the running cost does not require Council subsidy, (unless otherwise agreed by the Executive to further a strategic priority with a clear funding plan in place). Per acquisition, no minimum target will be set, but the yield must be balanced against the financial risk of the project holistically.

- Where projects deliver key strategic priorities, or where the community benefits of job creation or safeguarding, tourism, town centre regeneration, business rate growth or effective asset utilisation are significant a very low or zero net yield may be acceptable.

9. Value & Cost:

- Acquisitions: Larger lot sizes are favoured - smaller size properties have disproportionately higher management costs and expose the Council to greater property void risks, but the economic and trade benefits of buying smaller units may outweigh this.
- Acquisition costs of properties, land and buildings are forecast not to exceed 7% (Stamp Duty Land Tax (SDLT) / Legal / Agents / Due Diligence). These costs are to be contained within the overall strategy budget.

10. Funding:

- Following the PWLB Consultation the rules for PWLB investment have changed. The following criteria are the only criteria in which the Council can use PWLB funding as supported by this strategy.

A. **Housing** - activity normally captured in the HRA (SHDC does not have a HRA) and General Fund housing, or housing delivered through an LA housing company including access to the PWLB for land release, housing delivery, or subsidising affordable housing.

B. **Regeneration** projects typically with one or more of the following characteristics:

I. the project is addressing an economic or social market failure by providing services, facilities, or other amenities that are of value to local people and would not otherwise be provided by the private sector

II. the project prevents a negative outcome, including through buying and conserving assets of community value that would otherwise fall into disrepair

III. the Council is making a significant investment in the asset beyond the purchase price: developing the assets to improve them and/or change their use, or otherwise making a significant financial investment

IV. the project involves or generates significant additional activity that would not otherwise happen without the LA's intervention, creating jobs and/or social or economic value e. while some parts of the project may generate rental income, these rents are recycled within the project or applied to related projects with similar objectives, rather than being applied to wider services

C. **Refinancing** would cover restructuring or extending existing debt from any source. The government proposes that refinancing should be a stand-alone category separate from the others on the basis that it is not always possible or meaningful to attempt to trace the link between some debt coming due and the spending that the debt originally supported.

D. **Service delivery** to undertake borrowing to deliver a primary or other service function of the Council.

The S151 officer will determine if the project being considered meets the criteria set out above and define which of the criteria it meets. Further to that:

- Acquisitions and development initiatives will be funded using predominantly borrowing or any other unallocated or available Council reserve or capital receipt. The Council shall not borrow more than or in advance of need as part of the funding for investments of developments so as to benefit from the investment of the extra sums borrowed (para 46 & 47 SGLGI).

- There are no circumstances in which the Council would seek to disregard the prohibition on borrowing ahead of need, purely for profit. Any investment in renewable energy generation, as set out in the corporate strategy, would be classified as service delivery and would be made with a view to reducing the Council's carbon emissions.
- Liquidity – Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the Authority will spread its liquidity profile across its portfolio and also have a spread of the sector in which the Council invests. The Council also documents potential exit strategies as part of its due diligence checks.
- Borrowing is to be secured on a case by case basis on the most advantageous terms available predominantly through borrowing or any other unallocated or available Council reserve or capital receipt.
- Currently borrowing levels are capped at £60m.
- The borrowing term will not exceed the expected remaining life of the property, but the Council wishes to secure borrowing over a maximum 50 year term. Liquidity will be a factor in determining the amount of rent set aside in the Maintenance Management and Risk Mitigation reserve for each investment. This will be reviewed with the same frequency as the risk reporting procedure set out in this strategy.
- Capital repayments will repay all of the capital value (through MRP) of any acquired property or borrowing for property development.
- For non specific financial investments the period of the loans shall be linked to either the viable business case of the investment or the asset life whichever is the shortest as determined at the time of acquisition or investment.

11. Tax Implications:

- Due to the Council holding acquired or developed assets, it is not anticipated that there will be any corporation tax or income tax implications from this strategy
- Some properties may be VAT elected, meaning VAT must be charged to tenants. This will be dealt with on a case by case basis and will be covered by the due diligence connected with that acquisition. The Council is able to charge and recover VAT
- Capital Gains Tax would not apply to assets sold from Council ownership
- Where investments in companies (such as SPVs) are made in line with this strategy, all tax liabilities will remain with the SPV.

12. Exit Strategy:

- The Council is not looking to actively trade Regeneration and property within the first 5 years of ownership of any acquired property, however this is flexible if required to meet this strategy's objectives.
- If it is determined that the most prudent action is to sell an individual asset, this will be considered on a case by case basis and will be acted upon in consultation with Executive Members, the S151 officer and the Head of Paid Service
- It is proposed that the majority of investments shall be non – financial investments (properties) and as such will be held as Council Assets. Investments such as SPVs shall be owned through the purchase of shares. It is important to note that there would be early repayment charges if borrowing used to acquire or develop a Regeneration and property was to be repaid before the end of the loan term. However, Public Works Loan Board (PWLB) lending is not secured against

property, so would not inhibit the asset being traded during the loan period. An alternative asset could be purchased (& held) with any sale receipt.

13. Governance Arrangements - general:

- Acquisitions and developments must conform to the adopted Regeneration and Investment strategy. Any deviation from the agreed strategy will require Council approval.
- The Council's Senior Leadership Team will initially consider each proposal as an initial step and recommend that the proposal proceeds in principle to the Executive.
- When any decision to proceed with a development or acquisition is being considered, local Ward Members (where applicable) will be briefed at the earliest opportunity and be able to share their views with Executive Members and be consulted before the final decision is made. Executive Members, along with the Head of Paid Service and S151 officer, will consider each and every proposal on its own merits and specifically how each proposal meets the Council's multiple objectives and desired outcomes.
- The Head of Paid Service in consultation with the Executive Members and S151 officer will consider debt proportionality (the amount borrowed to date against the net service expenditure ratio) on a case by case basis for each acquisition as part of the decision making process, with information provided to them and the s151 officer, the Head of Paid Service and the Leader of the Council. Investment Indicators are set out within the Council's Investment Strategy. Table 2 of the Council's Investment Strategy shows the aggregate of Regeneration and property income and treasury income as a percentage of the Council's gross service expenditure.
- The Council undertakes sensitivity analysis of the interest repayments on its borrowing requirements as a percentage of its available reserves to ensure there is sufficient coverage in the event that income is below that forecasted. The Council also put 10% annually of all rental income and income from energy prices into a Maintenance, Management and Risk Mitigation (MMRM) Reserve. This is part of the Council's contingency arrangements.
- Officers, working with their specialist advisors in the market will sift opportunities and only present to Executive Members, opportunities that closely meet the Strategy. They will then lead the Executive Members into debate over the specific benefits and risks of each opportunity before the Executive Members make a decision. In this way, risk will be transparent through the process.
- Projects and their outcomes will be kept under constant review by officers and reports to Executive and Audit Committee.

14. Governance: Development on Council Owned Land

- The Council will delegate the authority and decision making function relating to 'Development on Council Owned Land', including debt finance, to the Executive, assuming that the proposed expenditure complies with the Council approved total borrowing limits.
- This delegation is to include the granting of associated leases in excess of 15 years as and when required, as recommended by the Head of Assets, on a project by project basis.
- Any project will be subject to Due Diligence and Legal Searches and occasionally other data as need arises.
- Specialists will be commissioned to act on behalf of the Council to source suitable development and tenant opportunities and manage the due diligence process.
- Officers will provide Members of the Executive with a set of data and an indicative cash flow for each project under investigation. These will aid decision making on whether to proceed or not.

15. Governance: Regeneration and Investment Acquisitions within the South Hams

The Council will delegate the authority and decision making functions, including debt finance, relating to 'Regeneration and Investment Acquisitions in the South Hams' to the Head of Paid Service in consultation with the Section 151 Officer and Members of the Executive, assuming that the proposed expenditure complies with the Council approved total borrowing limits.

- Any project will be subject to Due Diligence and Legal Searches and occasionally other data as need arises.
- Assuming the bid remains as per that authorised at the time of sign off, the final sign off prior to exchange and payment of deposit (typically 10%) is made by the Head of Paid Service in consultation with the S151 officer and Leader of the Council. If anything material has changed, the Executive Members will be re-consulted.
- This process of delegated authority is required because there is often very little time (a number of days) to secure a bid on an opportunity of strategic interest, especially if it is off market. Off market bids avoid price inflation caused by competing bidders.
- The Executive Members have been made aware that they will be required to process and respond in a very quick timeframe so as to provide their view.
- When South Hams District Council acquire a Regeneration and Investment in line with this strategy, a report will be presented (for noting purposes) to the subsequent meeting of the Executive.

16. Running / Review

- If the management of acquired or developed assets cannot be managed in-house by existing resources, it will be outsourced to property professionals.
- The cost of this management is to be deducted before calculating the net yield.
- The Executive will receive regular reporting to confirm portfolio composition and performance. Regular portfolio performance reporting will be presented to Audit Committee as required.

17. Disposal

- Once acquired, decisions relating to the ownership and disposal of any acquired or developed properties will be dealt with in-line with the Council's constituted scheme of delegation.

18. Resources:

- Project resources will be reviewed on a project specific basis, but will be resourced from the Place and Enterprise Directorate, with additional legal support. This will be supplemented by specific consultant advice as required and associated costs built into the business case for each project.

19. Risk assessment and due diligence

The Authority assesses the risk of loss before entering into and whilst holding property investments/property opportunities by carrying out appropriate due diligence checks and implementing mitigation measures in managing risk:

A. The tenants need to be of good financial standing (this is assessed using Dun & Bradstreet credit rating reports and annual accounts). The number of tenants e.g. sole tenant or multi tenanted will be assessed.

B. The property condition such as date of construction and any imminent or significant refurbishment or modernisation requirements (forecast capital expenditure).

C. How the property investment or financial, non specified investment meets the Council's multiple objectives as set out in the Council's strategy e.g. Liquidity, renewable energy, economic regeneration, business growth.

D. The lease must meet certain standards, such as being in a regeneration and popular location and have a number of years left on the lease providing a certain and contractually secure rental income stream into the future. Any break clauses will be assessed along with the number of unexpired years, bank guarantees and rent reviews.

E. The location will be within the South Hams District Council's boundary as set out in the Regeneration and Investment Strategy (apart from renewable energy investment which may have a wider geographic spread). The population of the catchment area, the economic vibrancy and known or anticipated market demand as well as proximity to travel infrastructure and other similar properties will be assessed.

F. Rental income paid by the tenant must exceed the cost of repaying the borrowed money from the Public Works Loan Board (which is itself funded by the Government). The surplus is then an ancillary benefit which supports the Council's budget position and enables the Council to continue to provide services for local people.

G. The gross and net yield are assessed against the Council's criteria.

H. The prevailing interest rates for borrowing at the time.

I. Debt proportionality considerations.

J. The life and condition of the property is assessed by a value r and the borrowing is taken out over the life of the asset. The amount of management and maintenance charges are assessed as well as the ease of in-house management. 10% of all rental income (or an amount as deemed prudent) is put into a Maintenance Management and Risk Mitigation Reserve to cover any longer-term maintenance issues.

K. The potential for property growth in terms of both revenue and capital growth will be assessed.

L. The risks are determined by the property sector e.g. office, retail, industrial, associated with specific properties and the mix of sectors within the Council's portfolio.

M. Details of acquisition costs e.g. stamp duty land tax, legal costs

N. The documented exit strategy for a purchase/new build.

O. The legal and technical due diligence checks will also identify any specific problems such as anomalies in the title deed, restrictive use classes, indemnities, local competition, construction or refurbishment requirements.

P. The Council engages the use of external advisors to assist in undertaking e lements of the due diligence checks such as technical, legal, accounting, property and taxation advice.

Q. The Council undertakes sensitivity analysis of the interest repayments on its borrowing requirements as a percentage of its available reserves to ensure there is sufficient coverage in the event that rental income is below that forecasted. This ensures that the Council has the available reserves to enable service delivery to be maintained in the short to medium term, whilst alternative solutions are implemented.