London Borough of Barnet Asset Acquisition Strategy

1.0 Background & Introduction

1.1 This paper sets out the strategy for the acquisition of real estate assets by LBB. The purpose of this document, therefore, is to set out the strategy of LBB for how these assets will be acquired, how risk will be identified and managed, how both current and future income generating assets will be managed and how overarching governance arrangements will be deployed. It covers the following:

- Objectives and Strategic Priorities
- Risk
- Portfolio mix
- Governance and performance reporting arrangements
- Management of the portfolio
- Funding and financial performance of the portfolio
- Returns & Investment evaluation criteria
- Performance indicators & monitoring of the portfolio
- Acquisition procedure

1.2 The London Borough of Barnet (LBB) will, from time to time, have the opportunity to secure strategically important and / or distressed assets, which require long-term public-sector interventions. On occasion, these may be income producing or marginally profitable investments.

1.3 On occasion, as Local Authority and existing landowner, LBB can use its position in the Borough to acquire assets for regeneration, which may create synergies with the Council's existing estate and assets.

1.4 Such assets have been purchased in the past, such as land ownerships at Brent Cross - most recently the Council's offer for the Brent Cross South retail park.

1.5 This strategy sets out the rationale for the acquisition of real estate assets by LBB. Matters to be taken into account include, but are not limited to:

- Strategic Acquisitions that align to our Growth Strategy and Barnet Plan 2025
- Assets which facilitate regeneration projects, whilst providing no detriment to the general fund.
- Sites that are considered distressed and require long-term public-sector intervention

1.6 Acquisitions that principally fulfil housing need requirements are not covered by this strategy.

1.7 The Strategy set out by the Council will be compliant with the Prudential Code for Capital Accounting[1] ("the Code"). The strategy will also be compliant with the MHCLG Statutory Guidance on Local Government Investments[2] ("MHCLG Guidance"). Officers will provide relevant internal guidance documents.

1.8 Recognising that the economic climate can change quickly, which could influence the property market, this policy will be regularly reviewed in the light of this.

2.0 The Wider Landscape

2.1 The Council has had to deliver substantial levels of savings in response to diminished resources available following the economic downturn and subsequent rebalancing of public finances from 2010/11. The Council has approved savings proposals of circa £174m to 2019/20 whilst the population in the borough has increased by 9.5% in the same period.

2.2 LBB's ability to acquire assets depends on interest rates, and in particular PWLB interest rates, which in recent times have been volatile as a result of general interest rate movements and policy changes. When interest rates move significantly the target measures in the policy will need to be reviewed.

2.3 The COVID-19 pandemic response has changed habits for individuals and business alike. As the long-term impact of recovery and renewal arising from the pandemic becomes clearer this will influence the type of asset the Council chooses to invest in.

2.4 The Council has significant aspirations in the Barnet Plan 2025 around growth and regeneration. To facilitate this, there needs to be a sound decision-making framework and clarity of governance. This will ensure that when making acquisition and / or disposals the council is not over-exposed to particular asset classes and risks – financial, commercial and reputational.

2.5 The Council already holds a significant portfolio of assets in its own right. As part of any asset acquisition, the Council will consider the impact on its own portfolio of the acquisition or, where relevant, a disposal.

2.6 The Council's Asset Acquisition Strategy can both support regeneration commitments and support Medium Term Financial Strategy (MTFS) outcomes.

3.0 Links to the Barnet Plan and Other Strategies

3.1 This Strategy supports the vision and objectives as set out in Barnet 2025:

- A well maintained and pleasant borough that we protect and invest in
- Safe and strong communities where people get along well
- Our residents live happy, healthy, independent lives with the most vulnerable protected

This Strategy links to the key themes of:

- Thriving
- Clean, Safe and Well Run

3.2 Any proposals that further emerge from the Barnet 2025 plan will be reviewed and reflected in the asset acquisition strategy as it is revised going forwards.

3.3 The Strategy has links to other Council documents:

- Capital Strategy
- Medium Term Financial Strategy
- Treasury Management Strategy
- Growth Strategy
- Asset Management Plan
- Infrastructure Development Plan
- Economic and town centre development plans

4.0 The Existing Portfolio

4.1 The Council owns a variety of commercial and residential properties. The commercial property can be divided into operational property and commercial property. The commercial properties currently held by the Council are made up of predominantly traditional council holdings such as shops, sports clubs and community centres.

4.2 Good asset management requires that the performance of the portfolio should be continually monitored, both as to the composition of the portfolio and its financial performance. An exercise is being undertaken to review the past and current performance of the commercial assets to inform sell, retain or manage decisions.

4.3 The Council's existing portfolio is considered to be low risk, with returns broadly in line with comparable market properties. It is a portfolio that tends to be weighted towards smaller scale investments. Some assets may not fit with this strategy. Once the review has been completed, further recommendations will be submitted to the Housing and Growth Committee (H&G).

5.0 Other Objectives

5.1 The Council aims to create or support jobs and/or add social or economic value in line with its Social Value Policy and through Section 106 obligations.

5.2 The Council will support, as a priority, the Borough's town centres where market failure and / or economic and market conditions may render local authority intervention desirable, in order to sustain and revitalise those locations.

6.0 Risk Management

6.1 The following risk categories have been identified as a framework for managing risk:

1. Political
2. Economic
3. Social
4. Technological
5. Legal
6. Environmental
7. Property-related
8. Financial
9. Corporate & Governance

6.2 Political Risks

6.2.1 A change in political leadership and/or direction, at either national or local level, may require the organisation to change its approach.

6.2.2 Concerns expressed by local residents may result in objections to acquisitions or other post-acquisition pressure that is misaligned with objectives.

6.3 Macro Economic Risks

6.3.1 The Council is exposed to inflation risk when acquiring assets, with associated costs or liabilities. This can be mitigated through appropriate leasing contracts. In addition, the use of PWLB will allow for fixing of rates, which at the current very low levels may create greater benefits if rents are indexed through CPI or RPI. This risk mitigation, of course, depends on general market conditions and the willingness of lessees to accept such clauses. The Council will need to have exit strategies in place where it can no longer mitigate inflation pressures.

6.4 Social Risks

6.4.1 Barnet residents and/or people looking to move into the area may not want the assets supplied

6.4.2 Outcomes attached to the acquisitions may not align to social outcomes desired in the future

6.4.3 Where a proposed regeneration is envisaged or acquisition made, an Equalities Assessment will be undertaken. This will ensure alignment with the Council's policies in this regard

6.5 Technological Risks

6.5.1 Additions to the portfolio are at risk of possible poor financial performance due to technological changes e.g. online shopping vs high street shopping

6.6 Legal Risks

6.6.1 Further legislation may be introduced to deliberately constrain local authority acquisitions, under certain circumstances.

6.6.2 Legislation / case law may affect the implementation of governance structures under which assets are managed i.e. LLPs etc.

6.7 Environmental Risks

6.7.1 Assets may be distressed as a direct result of environmental contamination etc. so LBB must quantify all such risks carefully. Thorough due diligence will therefore be carried out prior to purchase.

6.8 Property related risks

6.8.1 Location

It is anticipated that all property acquisitions will take place in-Borough as that is where the maximum regeneration and operational benefits can be achieved for Barnet residents. We recognise that too much weighting in one geographical area can add risk but it is considered that the potential operational, regeneration, economic and social benefits that will drive the decision to acquire in-borough acquisitions will almost always justify investment in the Borough. However, as property prices in London are higher than some other areas it is recognised that affordability may be challenging.

6.8.2 Condition

Properties in a poor condition, structurally and cosmetically, will restrict the prospect of future rental growth, without significant investment. However, where regeneration is the desired outcome these issues may become of a lower priority compared with the potential additional benefits of regeneration. Full condition surveys will be prepared prior to purchase to mitigate this risk, to ensure that the price paid properly reflects the condition of the property.

6.8.3 Tenant & Leasing Risk

The quality of current and future tenants is crucial to the longevity of property investments. There may be opportunities to improve this by capital investment in the property, asset management and regeneration schemes. This will determine the quantum of rent able to be charged, the likelihood that the tenant will pay the rent for the length of the lease, and financial stability of the asset.

6.8.4 Lease Risk

The terms of the lease on an asset are important as they govern, amongst other things, lease length, rental growth prospects, repair liabilities etc. Specialist advice will be obtained from leasing agents when negotiating new leases.

6.8.5 Sectoral Risk

A diversified portfolio, by sector, will be maintained, as far as is practicable so that there is less financial exposure to each sector. It is considered that regeneration benefits could often outweigh this desire, but each case will be taken on its merits.

6.8.6 Liquidity Risk

Property as a sector cannot be liquidated quickly, however, once assets are improved by financial investment, they should take on greater liquidity.

It is considered that many of these risks can be mitigated via due diligence. Due diligence commences with LBB's evaluation criteria for property purchases; due diligence on the specific property, tenant, lease etc; the acquisition approval process, and accountability for

implementation. Processes to govern these aspects will be established to mitigate any potential risks arising.

6.9 Financial Risk

6.9.1 The main financial risks relate to borrowing, interest rate movements, the ability to service debt, the property market, and its commensurate impact on rent levels, as well as the level of investment in assets that may required. Mitigation of these risks will include maintaining a commercial and risk-averse loan-to-value ratio (i.e. LBB borrows as little as possible to fund commercial acquisitions), the adoption of financing criteria, and a business case approach that ensures net revenue & capital receipts can reasonably be expected to fund the acquisitions.

6.9.2 The following criteria will be used to evaluate acquisitions, unless in special cases other factors reduce the required return.

1. A 'hurdle rate' of 5% net yield will be required on commercial assets. Acquisitions with development potential will be required to deliver a blended profit of over 15%. However, regeneration requirements and social need may contribute to a business case that will justify a lower hurdle rate. For the avoidance of doubt, from a Council perspective, net yield is considered to be:

$$\frac{\text{Gross Rent Receivable – Operating and Maintenance Costs (excluding costs of borrowing)}}{\text{Asset Purchase Price}}$$

   This will allow the Council to compare the net return % with the cost of borrowing %. Any acquisitions that effectively represent an investment, held within the General Fund, will be required to service the costs of borrowing – interests payable and minimum revenue provision – and ensure no detriment to the General Fund of the Council.

2. The General Fund impact from any asset classed as an investment (short or medium-term) must, as a minimum, break-even during the early years with a net positive impact over the life of the asset acquisition.

3. Investments must comply with the spirit of the Prudential Code whilst generating returns for the General Fund and deliver other socio-economic benefits for the Borough. Where a beneficial investment is outlined on a purely commercial basis and does not align easily with the Prudential Code, the decision to invest will lie with Policy & Resources Committee following recommendations from the Section 151 Officer.

4. An investment should not imbalance the portfolio to any extreme towards a particular investment class over a medium-term period. This will incorporate impacts on both non-current asset class and balance sheet long-term liabilities.

5. Assets will be held at fair value and subject to regular, periodic valuations. Adjustments to asset values will be reflected in the statement of accounts in the year they occur.

6. There exists a requirement within the Statutory Guidance on Local Authority Investments for the council to set limits on commercial income as a percentage of net service income.

This will be set, approved and reviewed annually as part of the annual Treasury Management Strategy.

6.11 Corporate risks

6.11.1 The corporate risks will include whether the Council has access to the skills and expertise to: identify appropriate properties for acquisition, to commercially manage the portfolio, to provide the development and regeneration expertise necessary (ensuring that there are good tenant / landlord relationships) and legal and environmental compliance. The Growth team has been resourced to have these skills, with assistance from external agents. The risk will be mitigated by our commercial management of the portfolio, including the management of tenants. Accountability will be through an internal officer board that reports into Housing and Growth and / or Policy and Resources Committees, with ongoing management through a combination of the Council's Property Services and external specialists.

6.12 A comprehensive risk register will be maintained and reported as part of the governance arrangements.

7.0 Governance, Management and Performance Reporting

7.1 An internal acquisition and management governance board will be established to oversee the acquisition and management of assets (where they represent a short to medium-term investment), once approved by relevant committee / delegated officers. It is envisaged that reports will be produced to be submitted to Housing & Growth and Policy & Resources Committees, as appropriate.

7.2 The internal governance board will be made up of senior officers and will review valuations, business cases and performance reports (including KPIs) from Property Services and external agents, all of which will be collated and presented to the Board by the Asset Portfolio Manager. The internal governance board will make recommendations to relevant committees (Housing & Growth in most cases) for formal approval. These recommendations will include acquisitions, disposals and any significant through-life investment in the property.

7.3 Delegated powers for new acquisitions and asset disposals will be in accordance with Article 10 of the constitution and the scheme of delegation. It is envisaged this could form part of an Acquisition Forward Plan.

7.4 The performance of the Council's investment assets will be reported twice per annum to the Financial Performance and Contracts Committee. Reporting is to contain, at a minimum:

- Actual performance of existing assets against planned
- Actual doubtful debts and voids performance against planned
- Actual investments delivered against the Investment Forward Plan, where there is a Forward Plan
- Actual financial returns from assets against budget
- Poor performing assets and actions to address performance
- Risk management, appetite and updates to the risk register

7.5 Management of the commercial portfolio is equally as important as the acquisition process for each asset. It is therefore recommended, subject to affordability, that an Asset Portfolio Manager is appointed, together with an Estates Project Officer, and that they in turn appoint specialist managing agents and development / construction partners to properly manage each property.

8.0 Portfolio Mix

8.1 Poor performing properties (financially, operationally or sustainably) held in the existing portfolio with no regeneration benefits will be considered for sale, (or managed should there be deemed to be potential to uplift their value). Capital from disposals will be available to be reinvested in properties with prospects of better-quality yields and growth potential. This will be decided on a case by case basis.

8.2 It is recommended that portfolio and property purchases are monitored carefully to ensure there is enough diversification in the portfolio in order to mitigate risk, as far as is practical.

8.3 Further, the regeneration opportunities on all properties will be reviewed regularly.

9.0 Funding risk and financial performance of the portfolio

9.1 Acquisitions will normally be funded using external borrowing and / or capital receipts. The exact funding mechanism will be reflected in the assumptions of the Business Case that supports the decision to acquire the asset.

9.2 The sources of capital will be investigated, and the most appropriate funding source will be recommended through the business case approach adopted. Appropriateness will be determined on a case-by-case basis with due reflection on risks, resourcing and affordability. Secondary considerations will be needed around accounting treatment for assets and financing. Examples will include changes required under IFRS16 – Accounting for Leases in 2021/22.

9.3 Consideration will be provided to private sector finance to aid regeneration. Whilst not typically as advantageous as PWLB in terms of interest payable, they do allow the Council to forward fund key developments without calling on its own resources. Typically, forward fund arrangements will be considered where there are scarce capital resources and a need to drive a long-term revenue stream from the assets to the benefit of the local taxpayer. The Council's exposure to these types of deal will be limited on the basis that the Council will, at all times, maintain a balanced portfolio of investments and financing that generates the most optimal outcomes for the Borough.

9.4 Capital receipts from disposals may be reinvested in the portfolio, where accounting standards, rules and regulations and statute allow. Decisions on this will be made on a case-by-case basis, having considered the impact on the whole capital programme. This will ensure the ongoing development of investments do not draw overly on the main capital strategy resourcing needs. Business case development for acquisitions will be prepared on the basis of long-term borrowing being required to finance the acquisitions, based on the principle that the finances its capital programme in line with the capital financing requirement overall, as oppose to an individual project by project basis

9.5 A separate revenue budget for the management of the investment property portfolio will be established and maintained, as part of the overall Estates Managed Budgets.

9.6 The Council's Treasury Management Strategy (TMSS) and Capital Strategy underpin prudent, responsible levels of borrowing the Council can maintain. This Asset Acquisition strategy must align with both documents.

9.7 The performance of the investment properties in the portfolio is to be benchmarked annually by reference to the Investment Property Database (IPD), and subject to a mid-year review in line with the TMSS.

10.0 Asset Evaluation Criteria

10.1 The criteria to be used in making decisions on acquiring properties will be split into two groups:

Non-discretionary:

10.1.1 Compliance with the regulatory framework

10.1.2 Confirmation that the acquisitions have regeneration or operational justifications

10.1.3 Justifiable (business case) on its own merits and its relativity to the weighting and performance in the overall portfolio

10.1.4 Legal & agency advice obtained, and due diligence conducted

10.1.5 Strategic context clearly identified and understood

10.1.6 Resource implications fully understood

10.1.7 Investment in the property confirmed to be compliant with LBB Corporate Objectives

10.1.8 Market factors will be taken into consideration when purchasing, and at which phase of the property cycle the market is in at that time.

10.1.9 Protection of the General Fund

Discretionary

10.1.10 Satisfactory quality of property

10.1.11 LBB will benefit from direct returns from the portfolio

10.1.12 Potential future capital growth

10.1.13 Improving the local economy

10.1.14 Local job creation

10.1.15 Increase in Council Tax/Business Rates, etc

10.1.16 Strategic site assembly

10.1.17 New housing

11.0 Acquisition Process

Examples of timetables for acquisitions, investment review and disposal processes are attached in Appendix 1

Appendix 1

Example Acquisition Process

1.	Property Identified as a potential acquisition by Property team / Introduction from Investment Agent	INITIAL OPPORTUNITY STAGE
2.	Property assessed against investment & regeneration criteria & inspected	
3.	If fits criteria, Asset Acquisition Lead / Assistant Director - Estates notify Director of Growth & Regeneration and Director of Resources & internal governance boards of a potentially suitable property.	
4.	Introduction from Agent recognised & procurement rule compliance confirmed (if appropriate).	
	Socialise with Leader, Chair of H&G Committee, Chair of FPC Committee and other key members	
5.	Obtain cashflow from agents, run own financial model (ideally ARGUS) and confirm compliance with CIPFA Prudential Code	BUSINESS CASE 1-3 WEEKS
6.	Undertake initial appraisal of tenants to ensure it complies with LBB Corporate Objectives and tenants are of suitable financial standing.	
7.	Undertake appraisal and recommend funding source	
8.	Development appraisal run; Obtain valuation and run sensitivities	
9.	Brief report prepared & presented to internal governance boards to consider business case	
10.	Agreement of Boards to recommend to either key decision makers under Article 10 of the constitution (Officers or Committee). If the decision is not within the financial and regulatory delegation given to the Chief Officer – any recommendation will have to be approved by Committee (usually Housing and Growth Committee)	
11.	Make offer with conditions (offer to be signed off by internal governance boards)	UNDER OFFER STAGE 3-4 WEEKS
12.	Conditions to the offer could include (but not exclusively): searches, receipt and analysis of leases, title and other legal DD, structural, electrical and mechanical surveys, inspection, EPC, DDA compliance, environmental desktop survey (or more intrusive surveys should this be highlighted), any TUPE implications, VAT and tax issues, insurance requirements	
13.	Instruct lawyers; determine arrangements for future asset management & appoint agents to help with DD.	
14.	Undertake surveys in order of importance	
15.	Prepare report (full DPR or committee papers) on property for final sign off	EXCHANGE STAGE 1-2 WEEKS

16.	Ensure surveys etc are satisfactory and put in place DD on issues above in no 11.	
17.	Determine date for exchange of contracts, including arrangements for transfer of funds	
18.	Complete Purchase. Management handover to Agents. Ensure insurance activated.	COMPLETION 1 DAY

12.0 Through-life investment process

1.	Property Identified as needing capital investment	INITIAL SCOPING STAGE
2.	Level of investment assessed and priced up	
3.	Internal governance board notified of a potential capital project requirement.	
4.	Impact on cashflow to be assessed by reviewing the financial model	BUSINESS CASE 1-3 WEEKS
5.	If financial model indicates that investing in and retaining the asset is viable, a business justification case is to be drafted.	
6.	Brief report prepared & presented to internal governance Boards, to consider business case	
7.	Agreement of Boards to allocate capital funding for the works	
8.	Project(s) to be implemented in accordance with LBB project management toolkit	IMPLEMENTATION

13.0 Disposal process

1.	Property identified as a potential disposal by Property Services team / Asset Portfolio Manager as a result of deterioration in the original business case, to the point the retaining the asset is no longer viable.	REVIEW STAGE
2.	Financial model reviewed to confirm initial assessment	
3.	Asset Acquisition Lead / Assistant Director - Estates (Chris Smith) notifies Director of Growth & Regeneration and Director of Finance & internal governance boards of a potential disposal.	
4.	Socialise with Leader, Chair of H&G Committee, Chair of FPC Committee and other key members	
5.	Develop Business Justification Case for the disposal	BUSINESS CASE 1-3 WEEKS
6.	Brief report prepared & presented to internal governance boards, to consider business case	
7.	Agreement of Boards to recommend to either key decision makers under Article 10 of the constitution (Officers or Committee)	
8.	Market the property and invite expressions of interest; Process to comply with S123 of the LGA (best consideration) and obtain or comply with any other statutory consents or requirements	INITIATE DISPOSAL
9.	Assess bids and select purchaser	

10.	Brief disposal report prepared & presented to internal acquisition boards, for approval	
11.	Accept offer, with conditions, if necessary	UNDER OFFER STAGE 3-4 WEEKS
12.	Facilitate purchaser's searches, receipt and analysis of leases, title and other legal DD, structural, electrical and mechanical surveys, inspection, EPC, DDA compliance, environmental desktop survey (or more intrusive surveys should this be highlighted), any TUPE implications, VAT and tax issues, insurance requirements	
13.	Instruct lawyers & appoint agents to conduct DD.	
14.	Undertake surveys in order of importance	
15.	Prepare report (full DPR or committee papers) on property disposal, for final sign off	EXCHANGE STAGE 1-2 WEEKS
16.	Determine date for exchange of contracts, including arrangements for transfer of funds	
17.	Complete sale. Management handover to Agents.	COMPLETION 1 DAY