NORWICH
City Council

MINUTES

SCRUTINY COMMITTEE
Call-in

15:30-17:55 **17 December 2019**

Present: Councillors Wright (chair), Ryan (vice chair), Button (substitute for Cllr Sands (S)),Giles, Grahame, McCartney-Gray, Maxwell (substitute for Cllr Manning), Oliver, Osborn, Schmierer (substitute for Cllr Carlo), Sarmezey and Thomas (Vi)

Apologies: Councillors Carlo, Fulton-McAlister (M), Manning and Sands (S)

1. Declarations of interest

There were no declarations of interest.

2. Exclusion of the Public

RESOLVED to exclude the public from the meeting during consideration of items *3 and *4 (below) on the grounds contained in the relevant paragraphs of Schedule 12A of the Local Government Act 1972 (as amended).

*4. Pre-scrutiny – Commercial Property Investment Strategy

(The chair took this item first)

(Don McCallum, commercial finance business partner and Mark Davies, commercial client asset manager attended the meeting for both items.)

The director of place introduced the report.

A budget had been set aside for acquisition and in the 2018-19 financial year, this budget was underspent. The remainder was carried forward to the 2019-20 budget which made the budget around £45 million. The current spend for the 2019-20 financial year was just under £20 million which would increase to £34 million if the acquisition of a property in Telford went forward. This would mean carrying forward around £11 million to the 2020-21 budget. The capital budgets were approved to create a sustainable revenue income to avoid cutting services.

The budget framework was already in place as was the Commercial Property Investment Strategy. There were some matters within the strategy which could inhibit future purchases and three changes were being proposed to mitigate this based on experience gained over the last year. These changes would allow the council to move more quickly with purchases and would give a wider pool of properties on which to place bids. The Norwich area was a relatively small geographical area with a limited number of large properties.

The report had been considered to be an exempt item as the potential purchase of a property in Telford would take the portfolio outside of the percentages within the Norwich area, as agreed in the current strategy. The council was seen as having a strong covenant therefore it would not be helpful if the vendor knew that the purchase would mean that the council was operating outside of the strategy.

The chair invited the cabinet member for resources to address the committee. Councillor Kendrick said that the strategy produced an income for the city and had protected frontline services at a time of cuts to local government funding. This approach to increasing revenue was one which had been taken by other local authorities throughout the country. The advantage of these investments meant that the council would retain buildings, even if there was a dip in income. Norwich City Council had been cautious with these investments and the asset and investment panel looked at each opportunity which was presented very carefully. The more investments were made, the more diverse the portfolio became and therefore the risk was lower. The portfolio was balanced and well managed. It was accepted that there could be an additional line in the council's corporate risk register for commercial property acquisitions.

(Councillor Oliver joined the meeting)

The chair said that he had concerns about this item being considered as exempt and thought that the item should be in the public domain.

It was noted that the legend describing the pie charts on pages 49 and 50 were missing the section showing 'alternative' properties which did not fit into the other categories such as gyms or hotels. This referred to the 19% section in the second chart on page 50 and the 17% section in the chart on page 49 of the agenda.

A member asked what other options for increasing flexibility within the portfolio had been considered, such as widening the area from the Norwich area to Norfolk or the East Anglia region. The commercial finance business partner said that there had been a decline in opportunities within those areas and the quality of the opportunities being presented had not been high enough quality to guarantee the revenue to support the budget. The limits within the strategy were self-imposed but there were not many investments arising which fit into the risk profile.

A member questioned whether the reference to Brexit at paragraph 14 of the report implied that the council would be buying properties after Brexit. The commercial finance business partner said that the paper had been written before the General election on 12 December and therefore a range of potential outcomes had been prepared by analysts. The council was looking for long term, sustainable income so prices dipping in the short term would increase over the long term. The commercial client asset manager added that reviews of assets were undertaken to sell properties and free up funds at opportune times.

In response to a member's question regarding the timescales of bidding for a property and changing the strategy to fit in with these, the commercial client asset manager said that buying commercial property was a competitive situation and the council had to respond quickly. The director of resources added that the report on changes to the strategy was scheduled to be considered by cabinet on 11 December 2019 but due to the General election, this had been postponed to 18 December 2019 which meant that the preferred sequence of events had been reversed by the pre-election period. By way of a follow up question, the member asked whether officers were aware that the purchase of the Telford property would bring the council close to the thresholds outlined in the strategy and therefore why have a threshold for local purchases which would tie the council's hands. The commercial finance business partner said that the council had been actively pursuing assets within the Norwich area to help to balance the portfolio but had not been successful in this. The vendor for the Telford property had also brought the bidding timetable forward twice. The commercial client asset manager said that in terms of thresholds, there was a lack of guidance for local authorities on proportions and balance within a commercial property portfolio and these were self-imposed to respect reasonable limits.

A member asked why a strategy was in place if changes were made to it each time a purchase needed to be made. The director of place said that there needed to be a degree of pragmatism regarding these purchases. The property market was dynamic and in practice, these were minor amendments to the strategy. If there were obstacle preventing objective being met, the council would look to amend the strategy. The interim section 151 and chief finance officer added that the strategy had only been in place for around a year so the updates reflected changes that needed to be made.

A member questioned whether using a single buyer's agent had been a mistake and if this was the reason that the council was moving towards using multiple agents. The commercial client asset manager said that there was a need to ensure that the council was in a position where it was an effective bidder on commercial properties. The use of a single buyer's agent was important at the beginning of that journey as it was important to understand the process and gain experience. A level of competence had been achieved which meant that the council could work in a more cost effective way with multiple agents to identify opportunities.

In response to a member's question about the 2% net return on investments, the commercial finance business partner said that the 2% hurdle rate was agreed as part of the delegated authority to purchase properties. The loans were taken out over a fifty year timespan with a fixed interest rate. The modelling included exploration of different scenarios such as changes to rents and landlords and tenant breaking leases. This was all part of the due diligence. The interim section 151 and chief finance officer said that there was an earmarked reserve set up at the beginning of the process and the council had benefited from transferring additional net income above the budget into the reserve, this stood at £1m in March 2019. Going forward, twenty percent of the net income would be put into the earmarked reserve until it was considered that an appropriate limit had been reached.

A member asked what the process was for changing the strategy as opportunities arose. The director of place said that there was a member and officer board which discussed changes to the strategy at its meetings. These changes would be brought to cabinet for approval and would be made to the strategy document.

A member referred to item c on page 53 of the agenda papers and said that other council's experienced success when they invested in their own retail areas whilst taking advantage of low interest rates. If the council was investing outside of its own boundaries, other local authorities would be benefiting from the business rates. The interim section 151 and chief finance officer said that the council's commercial strategy allowed for investment in the council's existing portfolio of investment assets, and that a number of locally-owned properties had been recently improved.

The committee considered a number of other recommendations which on being put to the vote were not agreed to be carried forward and were as follows:

- To include financial evidence and analysis of financial decisions on commercial property acquisitions as an appendix to relevant cabinet papers with 4 in favour, 7 against and 1 abstention.

- To place the revised Commercial Property Acquisition Strategy in the public domain at the earliest opportunity with 4 in favour, 6 against and 2 abstentions.

- To not have a percentage of properties to be bought within the greater Norwich area specified in the Commercial Property Acquisition Strategy with 4 in favour and 8 against.

- To invest to improve existing stock in Norwich and ensure this is prioritised over stock out of borough with 4 in favour, 7 against and 1 abstention.

RESOLVED to ask cabinet to consider adding a line on commercial property acquisitions to the corporate risk register.

(Councillor Vivien Thomas left the meeting at this point.)

3. Call in – Commercial property acquisition

The chair invited Councillor Price to address the committee and to set out his reasons for instigating the call-in.

Councillor Price said that as a non-cabinet councillor, he was only privy to the initial report form the agent with the key decision notice. There was only a short period of time to call in a purchase and councillors did not have the in depth training and expertise to scrutinise these decisions. He would recommend that another independent voice be added to the debate such as an internal audit officer to give members reassurance around risk. The papers considered by the asset board should be made available to all councillors. There was a potential financial downturn approaching and he considered that the council was not being streamlined and dynamic in relation to this.
No officer reassurance had been given to non-cabinet councillors so he felt that he had no option but to call in the decision.

The director of resources said that it was not the role of internal audit to be property specialists but instead to ensure that the policy had been applied correctly to a decision. The Commercial Property Investment Strategy could be added to the next year's internal audit plan. In terms of decision making, matters were reserved for cabinet, council or delegated to officers. The asset and investment board included officers with appropriate experience and qualifications in that area. Key decision notices were published to all members and included the risk analysis and officer reports.

The director of place said that the process for acquiring the commercial property was in accordance with the Commercial Property Investment Strategy. Cabinet members had the same papers that were circulated to all members along with the key decisions notice but some would attend the asset and investment board meetings and have the opportunity to ask further questions. Officers would ask for the views of these cabinet members on acquisitions but the decision would be made by officers.

A member questioned whether as the current tenant was manufacturing single use plastics, had the changing market been taken into account with the purchase. The director of place said that there was guidance around what the council would not invest in and that particular area was not included in that guidance. The council was purchasing a building and not a company and void periods without a tenant were included in the financial modelling.

A member asked why leases were being accepted of around five years when in the past, leases with over ten years were being sought. The report also indicated that works needed to be undertaken at the property such as double glazing and window replacements. There were also several points which were still showing as to be confirmed in the report which was concerning. The commercial client asset manager said that the average lease was around 7.5 years now which was indicative of the market. There was only a short amount of time to prepare the due diligence report and if the bid was accepted, more detailed work would be undertaken and these points completed before exchange. There was a dilapidation liability which gave the ability to recover costs of repairs to the building. A commercial building without double glazing was not a bad commercial opportunity as other factors were more important for that type of building such as yard space and eave height. A site visit had been undertaken and there were good accommodations for workers.

Members discussed Energy Performance Certificates which seemed to be low at a D rating. The commercial client asset manager said that a D rating was deemed as satisfactory for these types of buildings and the tenant has the responsibility to undertake repairs and maintenance to the building but there would need to be processes in place to monitor this. A member questioned whether upgrades to reach a C rating for the building and repair liability had been included in the modelling. The commercial client asset manager said that the council would react to this at the appropriate time. The commercial finance business partner said that as part of the financial modelling, many variables which were beyond the control of the council had been included, such as changes to legislation. This included negative assumptions around tenancies and what work would be needed to be done to attract new tenants. Interest rates were monitored and expert advice was followed.

(Councillor Price left the meeting at this point).

The committee considered a recommendation to use a proportion of the members training budget to allow members to develop their skills to effectively scrutinise purchase decisions but on being put to a vote, it was agreed not to take this recommendation forward.

RESOLVED to not refer the matter back to cabinet and the decision would stand.

CHAIR