Portfolio:	Finance
Ward(s) Affected:	All

TITLE: Report of Task & Finish Group on the Council's Property Investments

Purpose

At its meeting on 9 September, P&F Scrutiny Committee considered a report on property investments for treasury management Since 2016.

The Committee agreed, *inter alia,* to set up a time limited 'Task and Finish Group' with a remit to examine the advice provided by professional agents to the Council regarding its property acquisitions and management, and to feed their findings into the Council's future Property Investment Strategy.

1. Executive Summary

1.1 At its meeting on 9 September, P&F Scrutiny Committee considered a report on property investments for treasury management since 2016.

1.2 The Committee agreed, *inter alia,* to set up a time limited 'Task and Finish Group' with a remit to examine the advice provided by professional agents to the Council regarding its property acquisitions and management, and to feed their findings into the Council's future Property Investment Strategy.

1.3 The remit and scope of the Group agreed at the Performance & Finance Scrutiny Committee was:

To examine the advice provided by professional agents to the Council regarding its property acquisitions and management to feed into the Council's future Property Investment Strategy.

1.4 The membership of the Group was:

- Cllr. Mylvaganam (substitute Cllr. Wrenn);
- Cllr. Garrett (substitute Cllr. Croke); and
- Cllr. Galliford

1.5 A projected budget of £110k was agreed for all stages of the work set out made up of a mix of external consultant costs and officer time, split £50k for officer time; £40k for external review of valuations; and £20k for any additional external advice required.

After the final evidence was taken, the Interim Head of Finance reported to the Group:

- That the total officer time spent on the review totalled £35k;

- That the £40k for external review of valuations had been largely spent (£38k);

- That there had been no need to seek any additional external advice;

- Therefore, total spend against budget was £73k, a saving of £37k against the budget agreed by the P&F Committee.

1.6 The Task & Finish Group has taken evidence from all the professional advisors involved:

- Arlingclose (Treasury advisors)
- Montagu Evans (Property consultants)
- Addleshaw Goddard (Legal advice)
- KPMG (External auditors)

1.7 The Group has also examined the papers that were put to Council at the time of the acquisitions in 2016, in particular the legal advice and risk management issues contained in the Chief Executive’s report to Council in July 2016 recommending the acquisition of the Mall Shopping Centre in Camberley and in the urgent action to acquire 45-51 Park Street in November 2016 signed by the Council’s Chief Executive and agreed by the Council Leader.

1.8 Avison Young UK Limited (AY) were instructed by the Task & Finish Group to carry out the “desktop” review of the 2016 acquisition of the Mall Shopping centre and ancillary properties. It was requested that their report should include a critical appraisal of the market in 2016, the purchase process and a review of the valuation and recommendations.

1.9 Their report was received by the Group on 19 November 2020 and has helped shape the findings of the final report from the Task & Finish Group. A subsequent piece of work relating to the acquisition of Park Street and Princess Way, Camberley was received by the Group on 26 January 2021 and the findings from have also informed the final report. Discussions have also been held with the Council’s auditors, BDO, regarding the Council’s approach to managing its current and future investments.

10.1 Attached to this report as an Annex is an Action Plan addressing issues raised during the review. Committee is asked to note that most or the recommendations have already been approved by The Corporate Management Team and implemented by the relevant officer(s).

1.10 Findings: Key Points

In acquiring the properties in 2016, the Council acted within the statutory framework and its own constitution.

1.11 The Avison Young Report

The findings of the AY report were accepted by the T&F Group. Items to note:

- The price(s) paid by the Council were at the top end of the valuations as validated by AY.
- The acquisition was primarily in support of the stated Council priority to redevelop Camberley Town Centre.
- The Council purchased the shopping centre by directly approaching the owner, thereby losing any competitive market tension. To be clear, the Council was only interested in viable investment opportunities within the borough boundary since these would also help deliver the Council priority to invest in and support the local economy, as well providing amenity to local residents. The Council was not interested in the purchase of alternative potential purchases outside the borough boundaries, since these would not deliver the Council's ambitions for Surrey Heath. As a result of this approach, competitive market tension (or 'leverage') could not be applied to the purchase of the town centre; the Council could not use the possibility of purchasing an alternative shopping centre elsewhere in the UK as a 'bargaining 'chip' in its discussions with Capital & Regional.
- The purchase of the properties allows the Council to undertake a wholesale redevelopment of the town centre that would not otherwise be possible.
- The properties require significant future investment to increase their market value over the long term.
- Prior to the purchase there had been no significant investment in the town centre by Capital & Regional and had the Council not made the purchase there was every possibility that the shopping area would continue to decline, with all the associated economic and social issues this would entail for the communities the Council serves.

2 Scope of the review

2.1 Members and local people have raised concerns about the Council's acquisitions of commercial property over the past five years. The issues that have been raised are broadly similar to more general criticism of local authorities taking on too much risk by engaging in commercial property speculation to generate income to fund services in the light of reducing financial support from Central Government. The COVID-19 pandemic and associated economic downturn has further exacerbated these concerns.

2.2 At its meeting on 9 September 2020, the Performance & Finance Scrutiny Committee agreed to set up a Task & Finish Group to examine these matters.

2.3 Task and finish groups are informal, usually small and time-limited bodies comprised of Councillors and, often, co-optees brought in from outside the Council for their specific skills and experiences.

2.4 They are established by a parent Committee (in this case the Performance & Finance Scrutiny Committee) to undertake a discrete piece of scrutiny work, and report back to that Committee with their findings and recommendations. Decision-making in the Task & Finish Group (i.e., deciding on the wording of a final report and deciding on recommendations) is undertaken through consensus rather than through a vote, given the fact that the membership may not directly reflect political proportionality. To demonstrate transparency and accountability, Task & Finish Groups make published information, minutes and evidence-gathering sessions accessible to the public. The notes of these meetings are attached at Annex C.

2.5 The remit and scope of the Group agreed at the Performance & Finance Scrutiny Committee was:

> *To examine the advice provided by professional agents to the Council regarding its property acquisitions and management to feed into the Council's future Property Investment Strategy.*
>
> *The work to comprise:*
>
> - *Developing an agreed action plan on the key task at hand*
> - *Action the work programme in a timely fashion i.e. doing the work*
> - *Developing measures of evaluation*
> - *Reporting on the impact, learning, and outcomes*

2.6 The membership of the Group was:

- Cllr. Mylvaganam (substitute Cllr. Wrenn);
- Cllr. Garrett (substitute Cllr. Croke); and
- Cllr. Galliford

2.7 The Interim Executive Head of Finance was the lead officer within the Group, with additional support from Member Services.

3. Gathering Evidence

3.1 The evidence gathered by the Group was directed by the Scrutiny Committee. At its meeting on 9 September 2020, the Committee considered a report setting out a motion relating to the Council's property investments in Camberley Town Centre (which had been referred to the Committee by Full Council at their meeting on 22nd July 2020).

3.2 The motion:

- Expressed concern about articles in the national press regarding the Council's property investments;

- Sought information pertaining to the purchase costs of property investments since 2016; and

- Suggested further actions in the event that there had been a significant impairment of book value since the date of a property's purchase. The proposal was to use various levels of impairment to decide whether or not to cut the risk of further losses to the Council (and local taxpayers) by disposing of some or all of the Council's commercial property holdings.

3.3 It was acknowledged by the Committee that a number of those involved in the decision to pursue the purchase of the Mall Shopping Centre in 2016 were either no longer employed by the Council or were no longer elected members and there would therefore be little benefit in revisiting their actions at the time. Notwithstanding this, it was agreed that the concerns that there had been insufficient information available at the time for members to make a fully informed decision on the Mall's purchase did warrant further investigation and that the information provided in the relevant reports and workshops ought to be reviewed in order to inform future decision making.

3.4 The Task & Finish Group was established to review the information available at the time of the decision. A projected budget of £110k was agreed for all stages of the work set out made up of a mix of external consultant costs and officer time, split £50k for officer time; £40k for external review of valuations; and £20k for any additional external advice required. Subsequently, Council agreed the funding request for £40k to pay for the services of an external consultant to complete a desk-top review of the Council's property acquisitions. As reported in 1.5 above, of the total budget of £110k, £73k was spent, achieving a saving on the project of £37k against the agreed budget.

3.5 Concern was raised by the Committee that some documentation relating to the decision to purchase the Mall in 2016 remained exempt leading to a perception that the decision had not be subject to adequate scrutiny. It was agreed that the possibility of making the documentation public would be followed up with the Monitoring Officer as part of the work of the Task & Finish Group.

3.6 The starting point for the Group's work was to examine the decision-making surrounding the acquisition of the Mall Shopping Centre and ancillary properties in 2016. The Council's corporate plans included a commitment to acquire strategically important assets that:

- Promoted the delivery of key priorities;

- Were important in assisting the long-term economic wellbeing of the borough; or

- Were potential sites for housing.

3.7 In at its meeting in July 2016 the Council decided to purchase the Mall Shopping Centre in Camberley and all other property interests owned by Capital and Regional (C&R) in the town. The Council already owned a substantial freehold interest in much of the town centre.

3.8 In addition, in November 2016 under urgent action provisions the Council agreed to acquire other sites located in Park Street and Princess Way, GU1 3SP.

3.9 The properties purchased comprised a covered shopping centre with various street facing parades of retail property fronting Princess Way, Obelisk Way, Park Street, High Street and London Road.

3.10 The main anchor tenants were/are House of Fraser, Sainsbury's and Primark. The shopping centre is held freehold by Surrey Heath Borough Council and is subject to a long lease to Camberley Trustee NO 1 Ltd and Camberley Trustee NO 2 Ltd for a term of 150 years from 23 June 1988 (approximately 118 years unexpired) at a fixed head rent of £200,000 per annum.

3.11 Camberley Trustee NO1 Limited and Camberley Trustee NO2 Limited also acquired the freehold interests in the following:

- 45-51 Park Street
- Land and buildings lying on the south side of London Road, Frimley; Land lying to the south of 129 & 131 London Road, Camberley including 10 High Street and 127 London Road (former Allders development site)
- 30-54 High Street (even) including 1A-D, 2, 2A, 4 & 4A Grace Reynolds Walk
- 5-21 Park Street (odd) and 48-54 (even)
- 145-153 (odd), 161-171 (odd) & 181-183 (odd) London Road

3.12 The total purchase price of the acquisitions was £103.6 million, calculated as follows:

	£'000
1. July 2016 Acquisitions:	
Shopping Centre Valuation	77,850
London Road Valuation	1,950
Allders Site Valuation	2,500
TOTAL VALUATION	82,300
Marriage Value	1,700
Stamp Duty Savings	2,000
SUB-TOTAL	**86,000**
2. November 2016 Acquisitions:	
Park Street and Princess Way Valuation	17,600
TOTAL	**103,600**

3.13 The Marriage Value was the added value arrived at by combining the freehold (already owned by Surrey Heath Borough Council) and the leasehold interest. The Stamp Duty Savings were calculated as a 50/50 split between buyer and seller based on savings of £4 million SDLT because the purchase was made within a Jersey Property Unit Trust (JPUT) to which Stamp Duty did not apply.

3.14 The decisions by the Council in 2016 were informed by:

- Input from senior Council officers involved in the acquisition, management and disposal of commercial property assets; and

- Input from professional advisors to the Council on commercial property acquisition, management and disposal.

3.15 The Task & Finish Group took evidence from all of the professional advisors involved:

- Arlingclose (Treasury advisors)
- Montagu Evans (Property consultants)
- Addleshaw Goddard (Legal advice)
- KPMG (External auditors)

3.16 It should be noted that in the case of the Council's external auditors, KPMG were replaced by BDO with effect from the audit of the 2018/19 accounts, and that information relating to the audit view of the 2016 acquisitions was largely based on guidance from the new auditors. BDO have continued to review and advise the Council on the treatment of property acquisitions since their appointment and this has provided the Council with a fresh perspective in the management of its property portfolio.

3.17 In addition, the Task & Finish Group appointed Avison Young (property advisors) to carry out the desk-top review and advise the Group more generally on property matters.

4. Key Findings from the Task & Finish Group

4.1 Decision-making by the Council

4.1.1 Report to Full Council July 2016

4.1.2 The decision to proceed with the purchase of the Town Centre, London Road and Allders Site was made by Full Council in 2016 on the basis of a report from the Chief Executive of the Council.

(i) Legal advice contained in the Chief Executive's report

The Council sought Queen Counsel's opinion as to whether the Council had the necessary powers to acquire and manage the assets including the power to borrow to invest in the proposal.

The advice confirmed that there was sufficient power to make the acquisition as a Council and indeed there were a number of powers which could be exercised to purchase the assets, either under the Local Government Act 2003, the Local Government and Housing Act 1989 as well as the 1972 Act.

Whilst there were many ways in which the Council could have chosen to structure the acquisition, it relied particularly on the relevant power contained in s120 of the Local Government Act 1972, whereby a Council has the power to acquire property for the purposes of either its statutory functions or for the benefit, improvement or development of the area. Economic Development is a statutory function of a Local Authority and there are also powers within the planning legislation to acquire land by agreement for planning and public purposes. As the majority of the sites that were purchased formed either part of redevelopment proposals, refurbishment plans or preserving economic development of Camberley Town Centre, the Council was satisfied that it had the necessary powers to make the acquisition.

In terms of investment powers, section 12 of the Local Government Act 2003 provides a power to invest "for any purpose relevant to [a Local Authority's] functions under any enactment". The Council also has power under section 1 of the same Act to borrow money for such a purpose.

Therefore, the Council carried out the acquisition, and financed the purchase price from the Public Works Loan Board, for a purpose relevant to its statutory functions.

In addition, it should be noted that the Council has statutory functions both in relation to the economic well-being of its area, and in relation to its planning and development. It also has more specific powers under the Local Government Act 1972 and the Town and Country Planning Act 1990 to acquire land for the benefit, improvement or development of its area (1972 Act) or in the interests of proper planning, or to facilitate development which will promote the economic development of the area (1990 Act).

The Counsel's opinion provided in relation to the acquisition of the Shopping Centre has informed subsequent acquisitions of commercial property.

(ii) Risk Management issues contained in the Chief Executive's report

The report drew the attention of members to potential risks associated with the proposed acquisition, both at the point of acquisition and in the longer term. As regards the purchase risks, the report highlighted the need to justify the initial price agreed using financial assessments to confirm the forecast rental income, the structural and running costs of the centre, and other aspects of the valuation.

The point was also made that PWLB loan rates could not be fixed in advance and that the assumptions about the costs of borrowing contained in the report were therefore provisional: an increase in interest rates would increase borrowing costs. In the event, the advice and costings provided by Arlingclose (the Council's retained financial advisors) proved correct and were not subject to variation between the date of the Full Council meeting and the date of completion of the purchase.

As regards longer term risks, the report noted that as with all property investments there would be an on-going level of financial risk in relation to empty properties, rent reductions, non-payment etc. The report suggested that these risks were mitigated to some extent by:

- The large number of properties being purchased.
- The fact that for the purposes of the acquisition valuation units currently empty in the centre had been valued at nil.
- The Council's PWLB borrowing costs being a fixed and known quantity.

The report contained a calculation to the effect that annual rents would need to reduce by 26% for the Council to suffer a financial loss. Of course, in the event, rents have indeed fallen by more than 26% over the period 2016 to 2021 most dramatically during the Covid-19 Pandemic:

Rent Income	£000
2016/17	5,750
2020/21 (unaudited)	3,600
Percentage reduction	37.6%

At the time of acquisition a fall in rental income of 37.6% was not considered to be within the parameters of reasonably foreseeable risk.

The other point made in the report about on-going financial risks is more telling: that the financial viability of the purchase would be jeopardised if further borrowing were required, such as for centre refurbishment. In fact, the long-term success of the town centre, its transformation, would require significant further funding and associated borrowing in order to be achieved.

4.1.3 Urgent Action agreed 31 October 2016

4.1.4 The Urgent Action to acquire 45-51 Park Street in November 2016 was signed by the Council's Chief Executive and agreed by the Council Leader. The reasons for urgency were that the Council was aware of other potential buyers and that the Council would be required to exchange quickly.

4.1.5 The Urgent Action authorised the Chief Executive to acquire the freehold for the sum of £17.6 million, subject to due diligence and after consultation with the Council's Land & Property Board. The Chief Executive was also authorised to spend up to £275k on professional fees related to the purchase.

4.1.6 The Urgent Action confirmed that the Council had the legal powers to acquire the properties and that borrowing from the PWLB would be required to finance the deal. It was noted that the acquisition meant that the Council would now own all the property within the covered shopping mall except for Primark.

4.1.7 Although the specific powers to purchase and fund the acquisition of 45-51 Park Street were not included in the Urgent Action signed by the Leader, it is clear that they were the same as relied upon in the earlier transactions relating to the Town Centre, London Road and Allders Site.

5 The Avison Young Report

5.1 Avison Young UK Limited (AY) were instructed by the Task & Finish Group to carry out a “desktop” review of the 2016 acquisition of the Mall Shopping centre and ancillary properties (“The Mall”). It was requested that their report should include a critical appraisal of the market in 2016, the purchase process and a review of the valuation and recommendations.

5.2 Their report, received by the Group on 19 November 2020, has helped shape the findings of the final report from the Task & Finish Group, particularly in examining the advice provided by professional agents to the Council regarding its property acquisitions and management.

5.3 In addition, their report addressed various comments made at the Performance & Finance Scrutiny Committee of July 2020.

5.4 A subsequent piece of work relating to the acquisition of Park Street and Princess Way, Camberley was received by the Group on 26 January 2021and the findings from this are also set out below.

5.5 The AY report included a review of the valuation(s) provided to the Council by Montagu Evans (ME), the Council’s property consultants, who provided AY with an electronic version of their 2016 valuation which was undertaken in Argus Enterprise (a profession-standard valuation software) and with their valuation report which was undertaken in accordance with the RICS Valuation – Professional Standards January 2014 (‘the Red Book’). AY confirmed that the ME valuation of £82,300k for the Mall was in accordance with ‘the Red Book’.

5.6 Their report also concluded that the valuation was at the top end of the range they would have expected to have seen in 2016. They noted that the town centre is/was ‘Town Dominant’ and that an adjustment in estimated yield from rental income of minus 0.5% against comparable ‘Town Dominant’ shopping centres given within the ME report reduced the valuation of the core property (the shopping centre) from £77,850k to £71,600k. The valuation was carried out in the correct technical manner and contained all the items AY would have expected to see. The valuation of £77,850k was at the top end of the range AY would have expected to have see at the date of purchase.

5.7 Looking forward from 2016, the AY report notes that actual income has not kept up with the income projected within the ME valuation. At the valuation date the gross passing rent was £5,451k per annum. In the third month of the Pandemic and associated lockdown, the June 2020 tenancy schedule shows a gross passing rent of £5,102k per annum, a decrease of -6.39%. The cashflow within the valuation predicted a gross rent of £6,270k per annum a fall of -18.61% as at June 2020. AY’s report emphasises that a valuation is only a snapshot of the property at a fixed date and the income profile within the report is not guaranteed and is subject to economic changes, which have gone against the shopping centre sector since the date of the Council's purchase.

5.8 The findings of the AY analysis are consistent with the evidence gathered by the Task & Finish Group from Montagu Evans.

5.9 Acquisition of The Mall: Findings from Avison Young (AY)

5.9.1 AY's recommendations are based on a limited scope review of the report "Strategic Acquisition of Property Holdings in Surrey Heath" that went to Full Council in July 2016, recommending the acquisition of Camberley Town Centre.

5.9.2 The desk-top review was undertaken in the week-ending 20 November 2020.

5.9.3 AY did not review the Counsel's opinion which considered the vires of the Council to make the investment (this has been dealt with in Section 3 above). Their review focussed on making recommendations for the process and documentation that should accompany future investment decisions.

5.9.4 AY have set out their conclusions from their investigations. The following comments are extracted from their report to the Task & Finish Group:

I. We (viz. Avison Young) consider that the information provided to the Council in 2016 was light on systematic analysis. The acquisition of Camberley Town Centre was a significant one for the Council and it appears that the information and supporting narrative was not proportionate to the size of the investment decision. The internal paper lacked sufficient detail on options, benefits and risks;

II. The Councillors do not appear to have been provided with detailed decision-support documentation showing the case for public investment purpose, desired outcomes, rationale and objectives are explicit and their fit with the Council's strategic aims are clear. It is clear to us (viz. Avison Young) that the purpose of the acquisition was primarily in support of the stated Council priority to redevelop Camberley Town Centre. It was a public investment in the sense that it allocates funding to an initiative that the market cannot successfully or may not wish to deliver on its own;

III. Investment decisions should be based on a business case that is fit for purpose and proportionate to the scale of the decision being made. We (viz. Avison Young) would draw your attention to HM Treasury Five Case Model provides a leading practice methodology. This should be adopted because it would enable the Council to consider value for money taking into account. The Five Case Model considers 1) Strategic Case, 2) Economic Case 3) Financial Case, 4) Commercial Case and 5) Management Case. Adoption of this model would have given the Council greater confidence regarding the investment case;

IV. A valuation report is a snapshot of a property's valuation at a specific date. it does not necessarily provide forward looking advice which the Council would have been best to seek. An acquisition report should have been commissioned from ME showing a clear plan for the future of The Mall together with a forward looking ten-year cashflow together with development proposals. This would have given greater clarity on the future potential of the investments to the Councillors and highlighted income risks;

V. The valuation was of an income generating asset which would receive some refurbishment but would continue to operate broadly "as is"; but as stated in 11 above the Council's objective was primarily as an investment not as an operational asset.

VI. The Council purchased the shopping centre by directly approaching the owner, therefore lost any competitive market tension (see 1.11 above), but the Council avoided having to bid against other potential purchasers. This meant that re-negotiation of an agreed price following a valuation would be very difficult;

VII. The property was purchased at a time of market uncertainty due to the June 2016 Brexit vote. Generally, Brexit had a negative impact on the commercial investment market during the mid-part of 2016 and forced many listed funds to block immediate redemptions. However, in 2016 the subsequent difficulties faced by retailers were not readily apparent although the sector weakness was gradually become apparent. Since the purchase, the retail occupational market has been dominated by tenant failures and Company Voluntary Arrangements many relating to tenants that were perceived to have excellent covenant strength in 2016.

VIII. If the Council had not purchased The Mall there may not have been any further capital investment in the centre and this would have a detrimental impact on the Camberley town centre which may have been difficult to reverse in the short-term. The purchase of the property allows the Council to undertake the wholesale redevelopment of the town centre providing a mixed-use development;

IX. At the date of purchase, the direction of travel for town centre shopping centres was to see income and capital values falling. The fundamental challenges faced by physical stores of the relentless move on-line was not addressed at the time of your purchase. A pure valuation report is not the most suitable report to address these issues.

X. The market has some uncertainty following the Brexit referendum which slowed the number investment transactions;

XI. It is best practice for a Public Sector body to obtain an independent valuation by an external valuer that is not part of the procurement process, although this is not universally followed;

XII. In our opinion the use of ME to facilitate the purchase and to manage the shopping centre is not a conflict of interest;

XIII. We would regard an annual valuation by ME as creating a conflict and would not be best practice. The property is now independently valued by BNP Paribas;

XIV. The property will need significant future investment although this should increase the Market Value over the long term. In order for Councillors to fully understand the asset decisions should be accompanied by detailed financial modelling demonstrating projected income and expenditure over the life of the investment rather than a valuation report which tend not to address such matters. Long-term impact on cashflows and balance sheet should also be a fundamental part of such a long-term decisions. There should also be a quantification where possible of the economic and undoubted social benefits which would flow from a wholesale redevelopment of the property.

5.10 Acquisition of Park Street and Princess Way, Camberley, Surrey GU15 3SP: Findings from Avison Young (AY)

5.10.1 The conclusions from this piece of work were as follows:

I. We (viz. Avison Young) consider that the information provided to the Council in 2016 was light on systematic analysis. The acquisition of the property was another significant one for the Council and it appears that the information and supporting narrative was not proportionate to the size of the investment decision. The internal paper lacked sufficient detail on options, benefits and risks.

II. The Councillors do not appear to have been provided with detailed decision-support documentation showing the case for public investment purpose, desired outcomes, rationale and objectives are explicit and their fit with the Council’s strategic aims are clear.

III. The sale of the Southampton property at nearly 25% under its asking price is a good example of astute negotiation and waiting for the right time to purchase a property rather than “rushing into” a sale because the Vendor’s wishes and aspirations. [NB: This was an example cited in the main body of the AY report examining comparable acquisitions at the time of the purchase(s) in 2016 and is attached at Annex B.]

IV. Investment decisions should be based on a business case that is fit for purpose and proportionate to the scale of the decision being made. We (viz. Avison Young) would draw your attention to HM Treasury Five Case Model provides a leading practice methodology. This should be adopted because it would enable the Council to consider value for money taking into account.

V. Adoption of this model would have given the Council greater confidence regarding the investment case.

VI. The valuation was of an income generating asset which would receive some refurbishment but would continue to operate broadly “as is”.

VII. The property was purchased at a time of market uncertainty due to the June 2016 Brexit vote. Generally, Brexit had a negative impact on the commercial investment market during the mid-part of 2016 and forced many listed funds to block immediate redemptions. However, in 2016 the subsequent difficulties faced by retailers were not readily apparent although the sector weakness was gradually become apparent. Since the purchase, the retail occupational market has been dominated by tenant failures and Company Voluntary Arrangements many relating to tenants that were perceived to have excellent covenant strength in 2016.

VIII. The market has some uncertainty following the Brexit referendum which slowed the number investment transactions.

IX. It is best practice for a Public Sector body to obtain an independent valuation by an external valuer that is not part of the procurement process, although this is not universally followed.

X. The valuation was carried out in the correct technical manner and has all the items we would expect to see. The valuation was at the very top end of the range we would expect to have seen at the date of purchase.

5.11 AY Recommendations to the Task & Finish Group

5.11.1 The AY report contained six recommendations, and these are set out below, with observations and comments.

Recommendation 1

Future decision-support documentation should ensure that the public investment purpose, desired outcomes, rationale and objectives are explicit and their fit with the Council's strategic aims are clear. It should be made clear whether the acquisition of property is for financial investment or for an economic, social or public service delivery purpose. The likely achievement of the objectives should be tracked throughout the investment decision-making process and documentation.

Observations:

It is clear that the purpose of the acquisition was primarily in support of the stated Council priority to redevelop Camberley Town Centre. It was a public investment in the sense that it allocates funding to an initiative that the market cannot successfully deliver on its own (although little supporting evidence of the market failure was provided). The report did not present the primary rationale for the acquisition as being a financial investment.

The key priorities were expressed in fairly generic terms – e.g. "to increase our strategic influence", "to assist long term economic wellbeing", and "to allow the Council a more direct and longer-term control in the future management and direction of Camberley Town Centre". There was not a clear, detailed explanation of the desired outcome(s), acquisition rationale and how the outcome(s) will be achieved. The consequences of not making the acquisition (i.e., the 'counterfactual') was not described.

Recommendation 2

Investment decisions should be based on a business case that is fit for purpose and proportionate to the scale of the decision being made. The HM Treasury Five Case Model provides a leading practice methodology, and its adoption will enable the Council to consider value for money taking into account:

1. Strategic Case
2. Economic Case
3. Financial Case
4. Commercial Case
5. Management Case

Observations:

The information provided to the Council in 2016 was light on detail and systematic analysis. The acquisition of Camberley Town Centre was a material and significant one for the Council and it appears that the information and supporting narrative was not proportionate to the size of the investment decision. It lacked sufficient detail on options, benefits and risks.

Recommendation 3

The Council should consider preparing a programme-level business case for the redevelopment of Camberley Town Centre. This would provide the economic, social and financial rationale for future expenditure and an economic framework for future investment decisions.

Observations:

The investment had many characteristics of a programme and should have been appraised us such: e.g., the objective of the initiative was the delivery of a social and economic outcome; to secure that outcome involves a set of projects and activities over the life of the investment, there were significant complexity and interdependencies.

Recommendation 4

A range of options should be tested financially and non-financially to achieve an option that provides the best value for money in achieving the strategic aims. The non-financial criteria should include fit with project objectives, strategic alignment, affordability, deliverability. The financial cashflows should cover the economic life of the asset.

Observations:

Two options were described for this transaction – to buy or not to buy. Other options, such as seeking a partner, joint ventures and alternative routes for town centre revitalisation were not explored. A robust business case should cover a range of options. In this case a rationale for only two to be taken forward for detailed consideration would need to have been provided based on supporting analysis.

Recommendation 5

Future investment decisions should be accompanied by detailed financial modelling demonstrating projected income and expenditure over the life of the investment. Long-term impact on cashflows and balance sheet should also be a fundamental part of such a long-term decision. There should also be a quantification where possible of the economic and social benefits.

Observations:

The section of Annex A [to the report to Council in July 2016] which refers to the financial model provides very little by way of detail or information. We would have expected to see far more financial information to support an acquisition of this size. It is implied in the report that the opportunity to purchase was because refurbishment and redevelopment of the centre was sub-commercial for the vendor, which emphasises the need for robust financial analysis. We would expect the capital costs of lifecycle replacement, refurbishment and redevelopment to have been examined, along with quantification of the value of the social and economic benefits, using established benefit cost ratio techniques.

Recommendation 6

The Council should undertake a robust risk assessment on future investments that is proportionate to the size of the investment. The assessment should consider scenarios and quantify the key risks through considering impact and the likelihood of the risks materialising. Mitigation strategies should be set out and there should be clarity on the unmitigated risk that the Council will be exposed to as a result of the potential transaction and management and commercial arrangements put in place.

Observations:

There was reference to potential risks associated with the acquisition, but there was inadequate quantification of the potential risks and their likelihood. We would have expected a range of scenarios covered, including but not limited to interest rate changes and income reductions. There was generally little consideration of mitigation or exit strategies.

6 Public Works Loans Board Borrowing to Fund Investments

6.1 The Task & Finish Group took evidence from Arlingclose, the Council's retained financial advisors, who provided support and guidance of the funding of the 2016 acquisitions. Arlingclose have confirmed that the borrowing undertaken by the Council since 2016 to fund its commercial property acquisitions has been in accordance with its statutory powers and treasury guidance. BDO, the Council's external auditors, have also confirmed that Council borrowing is in accordance with both statutory powers and the Council's agreed treasury management strategy.

6.2 However, Committee should note that in 2019 The Public Accounts Committee raised concern about whether the Ministry of Housing, Communities and Local Government had sufficiently robust mechanisms to monitor borrowing by Councils from the Public Works Loan Board (PWLB) to fund commercial development portfolios.

6.3 Consultation was carried out as part of the provisional financial settlement for 2021/22 and the final settlement confirmed the government's commitment to reform the PWLB lending terms, ending the use of the PWLB for investment property bought primarily for yield, which the Chancellor stated was a risk for both national and local taxpayers.

6.4 In November 2020, the government cut PWLB lending rates to gilts + 100bps for Standard Rate and gilts + 80bps for Certainty Rate and at the same time introduced new borrowing terms.

6.5 In future, Councils must ensure that their proposed borrowing complies with the revised lending terms of the PWLB:

- The PWLB will no longer lend to local authorities that plan to buy commercial assets primarily for yield. The PWLB will still be available to all local authorities for refinancing.

- In order to borrow from the PWLB, local authorities will now be required to submit a summary of their planned capital spending and PWLB borrowing for the following three years.

- These plans must be included in the commentary section of the Certainty Rate return. This is an annual return submitted to PWLB in advance of the start of the financial year. The Council's Certainty Rate return for 2021/22 was submitted on 26 February 2021.

- Councils that have said in their Certainty Rate returns for previous years (e.g., 2020/21) they plan to buy commercial property in the coming years have had to review these plans to ensure that they comply with the new PWLB lending terms.

6.6 Taken together, the reduction in the costs of borrowing and the controls on the types of schemes for which borrowing is permitted will have a significant impact on future commercial property acquisitions.

6.7 The Council's Property Investment Working Group (which reviews all potential commercial property acquisitions) has been made aware of these changes and since November 2020 all reports on potential purchases have included a clear statement of the intended reason for acquisition: economic development; land assembly; strategic policy; yield; etc. It should be noted that at the time of writing (June 2021) the Council has no plans to borrow to acquire property primarily for yield.

6.8 Within the Council's financial management systems there are safeguards already in place to act in accordance with the Prudential Code of Financial Management to prepare investment strategies annually as part of Surrey Heath's Treasury management requirements. The strategy explains how investments (including commercial property portfolios) relate to the Council's core purposes.

7. The Jersey Property Unit Trust (JPUT)

7.1 The Council bought the town centre assets as a JPUT since that was the way the previous owner (Capital & Regional) held the Retail Assets. As pointed out above, the agreed price included a 50/50 share of the £4 million saving in Stamp Duty achieved by continuing to hold the underlying assets in a JPUT. Addleshaw Goddard (the Council's legal advisors for the purchases) have confirmed that the share of SDLT savings in these proportions is standard practice in these types of acquisition.

7.2 However, Committee should note that there are no additional tax advantages in continuing to hold the assets as a JPUT. In any event, the London Road properties will need to be moved out of the JPUT in order to progress the London Road Development. It has been agreed, therefore, these commercial property holdings will move under the direct ownership of the Council and the JPUT will be wound up. It is expected that the assets held in the JPUT will be 'on-shored' early in financial year 2021.

7.3 In the meantime, the Council's auditors, BDO, have provided additional assurances regarding the Council's approach to managing its current and future investments:

> As part of the additional assurance that the Council has requested, in the Audit Plan for the coming year BDO have agreed the following:
>
> In undertaking their audit of the Council, they plan to place reliance on BDO Jersey's work. In placing reliance on the work of BDO Jersey, they will undertake the following procedures:
>
> • Assess the competence and independence of the BDO Jersey Team;
>
> • Participate in planning meetings with the BDO Jersey Team and communicate the work they require them to perform for the purposes of the audit of the Council. In doing so, they will communicate details of the financial reporting framework applicable to the Council, their timetable, the significant risks of material misstatement relevant to the audit of the Council, and the materiality levels applicable to the audit. They will also undertake a review of

the BDO Jersey team's key audit working papers, and key outputs from their audit including reports to Those Charged with Governance.

In addition to the reliance the Council's auditors place on the work of the BDO Jersey team, as part of their audit of the Council they will:

• Review the inclusion of the Trust's financial statements into the Council's financial statements;

• Undertake testing of transactions and balances arising in the Trust between January and March 2020;

• Obtain direct confirmation of the cash balances held by the Trust at 31 March;

• Review updated valuations of the investment property held by the Trust; and

• Confirm that any adjustments required to convert transactions and balance from an FRS102 basis IFRS basis.

8. Officers Comments & Conclusions

8.1 Having considered the work carried out by the Task & Finish Group, officers comments are as follows:

8.2 Acquisition

8.2.1 The Council acted within the statutory framework and its own constitution. It took counsel's opinion and ensured sufficient professional advise from legal, financial and property experts. As well as the legal guidance provided at the time of acquisition, other legislation provides the Council with both flexibility and safeguards for commercial activity. Section 4 of the Localism Act requires anything done for a purely commercial purpose to be carried out by a limited company. However, if a local authority is using powers related to (say) regeneration or economic development to buy a local shopping centre, for example, it is not acting purely in a commercial purpose and can own it direct. The general power of competence, introduced in the Localism Act, permits a local authority exercising it with:

- The power to do it anywhere in the United Kingdom or elsewhere;
- The power to do it for a commercial purpose or otherwise for a charge or without charge; and
- The power to do it for the benefit of the authority, its area, or persons resident or present in its area.

8.2.2 Again, as the Council manages its commercial property as an adjunct to other functions rather than purely for financial gain a company structure is not required.

8.3 The Avison Young Report

8.3.1 The findings of the AY report are accepted. Items to note:

- The price(s) paid by the Council were at the top end of the valuations as validated by AY.

- The information provided to the Council in 2016 was light on systematic analysis. The internal paper lacked sufficient detail on options, benefits and risks.

- Members were not provided with detailed decision-support documentation showing the case for public investment purpose, desired outcomes, rationale and objectives.

- The acquisition was primarily in support of the stated Council priority to redevelop Camberley Town Centre. It was a public investment in the sense that it allocates funding to an initiative that the market cannot successfully or may not wish to deliver on its own.

- Future investment decisions should be based on a business case that is fit for purpose and proportionate to the scale of the decision being made.

- An acquisition report should have been commissioned from ME showing a clear plan for the future of The Mall together with a forward looking ten-year cashflow together with development proposals. This would have given greater clarity on the future potential of the investments to the Councillors and highlighted income risks.

- The Council purchased the shopping centre by directly approaching the owner, therefore losing any competitive market tension.

- There were market uncertainties during 2016, some of which were not factored into the valuations. Since the purchases, the retail occupational market has been dominated by tenant failures and Company Voluntary Arrangements many relating to tenants that were perceived to have excellent covenant strength in 2016.

- If the Council had not purchased The Mall there may not have been any further capital investment in the centre and this would have a detrimental impact on the Camberley town centre which would have been difficult to reverse in the short-term. The purchase of the property allowed the Council to undertake the wholesale redevelopment of the town centre.

- It would have been best practice for the Council to obtain independent valuations by an external valuer that was not part of the procurement process however the use of ME to facilitate the purchase and to manage the shopping centre was not a conflict of interest.

- The ongoing annual valuation by ME would have created a conflict and would not be best practice. The properties are now independently valued by BNP Paribas.

- The properties require significant future investment to increase their market value over the long term. In order for Councillors to fully understand the consequences of future investment the asset decisions should be accompanied by detailed financial modelling.

8.3.2 An action plan to address any outstanding issues arising from the AY report will be presented to the next meeting of the Performance & Finance Scrutiny Committee.

8.4 Funding for future investments

8.4.1 The new rules relating to borrowing from the PWLB to fund future investments has been noted and included in the agreed treasury management strategies for financial year 2021/22 presented to Full Council on 24 February 2021.

8.5 The Jersey Property Unit Trust

8.5.1 As noted above, the Task & Finish Group were satisfied that the acquisitions via the JPUT were correct and legitimate. The Group also noted that the JPUT is to be wound up in early financial year 2021/22 and all assets transferred 'on-shore' to the Council's balance sheet. This task was completed in April 2021. Overall management of tenant relationships and lease negotiations have passed to the Council and the 2020/21 budget agreed by Council in February 2020 anticipates savings of £125k from the new arrangements. The Council has recently employed a new Head of Investment & Development, and he has begun a review of tenancies to reflect the findings of the Performance & Finance Task & Finish Group and the recommendations arising from the Avison Young report.

Annex A: Action Plan to deliver recommendations.
Annex B: Avison Young Report
Annex C: Minutes of T&F Group

BACKGROUND PAPERS	**Minutes and notes of the Task & Finish Group Evidence taken from:** • **Arlingclose (Treasury advisors)** • **Montagu Evans (Property consultants)** • **Addleshaw Goddard (Legal advice)** • **KPMG (External auditors)** • **BDO (External auditors)**
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CONSULTATIONS, IMPLICATIONS, AND ISSUES ADDRESSED

	Required	Consulted	Date
Resources			
Revenue			
Capital			
Human Resources			
Asset Management			
IT			
Other Issues			
Corporate Objectives & Key Priorities			
Policy Framework			
Legal			
Governance			
Sustainability			
Risk Management			
Equalities Impact Assessment			
Community Safety			
Human Rights			
Consultation			
P R & Marketing			