Matthew Oakeshott, an investment manager at Olim Property, said councils were: "playing a gigantic game of Monopoly with taxpayers' cash".

Monopoly property purchases endanger councils

Property investments can be so risky they can potentially threaten the financial viability of councils.

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When Spelthorne Borough Council purchased BP's International Centre for Business and Technology campus in Sunbury-on-Thames in September 2016 for £358 million as a sale and leaseback transaction, a great many eyebrows were raised at the size of the purchase. It is reportedly the largest privately owned office park in the UK.

Until that point the Council had been entirely debt free and the acquisition was funded through prudential borrowing from the Public Works Loans Board (PWLB) on a 50 year fixed rate loan, so eyebrows were raised even further. Later it emerged that the Council had been in a bidding war against other interested parties, which pushed up the price from the initial asking price. It was also discovered that at the time of the purchase BP signed a lease-back deal for 20 years, which was 30 years shorter than the period of the loan to acquire the site. »

Spelthorne is of course not alone in buying commercial property investments, and was certainly not the first to enter this new arena. But it might be said that Spelthorne raised eyebrows sufficiently for articles about local authority commercial property investment to start appearing in the national press and even for questions to be asked in the House of Commons.

Instead of focusing on the specifics of the Spelthorne acquisition, I want to look at the common areas of risk around commercial property investments by local authorities. These are areas that increasingly council risk managers might find themselves involved with in the future.

In December 2017 CIPFA published updates to both the *Prudential Code*[1] and *Treasury Management Code*[2]. It is no coincidence that the two codes were updated at a time when questions were being asked about the scale of council commercial property investment.

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These two updated codes, especially the *Treasury Management Code*, provide a framework for commercial property acquisitions and a guide to those adopting an acquisition programme into how to do that sensibly, sustainably and with due regard to risk.

Councils pursuing this course should familiarise themselves with the requirements of the two codes, and adopt structures and processes to protect themselves and public money from such commercial risks. This is likely be a new area of activity for risk managers.

To help risk managers consider their potential new role in monitoring and evaluating risks associated with commercial property investment, below are some key areas councils should take into account.

Before purchasing property

Make sure the organisation has:

- Been through a robust business case development process, with alternatives to commercial property investment properly considered.
- Adopted a written investment strategy that sets out what it is trying to do and why, and has this been approved by full council.
- Developed clear investment criteria, so it knows what it will be looking to acquire, in what quantities or lot sizes, in which locations and in which market sectors.
- A clear and robust governance and decision process, so everyone knows what information will be relied on in investment decisions, how decisions get made and who makes those decisions.
- Established a target portfolio mix that provides a sensible, prudent, diversified and financially sustainable basket of investments.
- Set a target level of performance from its investments.
- Adopted protocols to ensure compliance with the *Treasury Management Code* in terms of security of capital.
- Considered the reputational risk associated by property investment activity and has a communication strategy in place to ensure that decisions are transparent for all relevant stakeholders.
- Sufficient relevant and appropriate knowledge and skills to safely undertake investment activity and manage the risks associated with it.

When looking at property

Once you have adopted your investment strategy, and want to buy property, you are going to have to consider risks associated with:

- Due diligence.
- Covenant strength of potential tenants.
- The type of asset being acquired - not just its market appeal and obsolescence, but also the nature of construction.
- Failure of Plan A and whether there is a Plan B.
- Opportunities to undertake early capital investment into the asset to bring added capital value or increase return.
- Not committing to future investment intervention to maintain asset value and income flow.

Spelthorne Borough Council purchased the BP campus in Sunbury-on-Thames in September 2016 for £358m. A further 145,500 sq ft was bought by the Council in December 2016 for £28m completing ownership of the site.

Once you have purchased property

Risk management does not end once an asset has been acquired. Questions an organisation should be ask may include:

- What arrangements are there to manage exposure to risk ahead of the anticipated portfolio mix being established?
- What are the arrangements for monitoring and managing portfolio performance in terms of income, yield and rental debt? How does performance compare with industry benchmarks?
- Is the organisation undertaking regular re-valuations of investments, actively managing investments (and obsolescence) and keeping on top of management costs?
- Does the organisation monitor changes in the business and performance of its tenants, and in changes to the economy that could affect the ability of tenants to keep paying the rent?
- Does the organisation use market insight to review the portfolio mix of investments to reflect changes in risk across different locations or market sectors?
- Does the organisation keep abreast of legislative changes that could impact on the rental levels from its investments, the ability of tenants to pay rent or the ability to continue to find tenants for its investments, for example, the *Energy Act 2010*?

This is nothing more than a summary of some of the issues risk managers might in future have to consider. I have only scratched the surface. The risk management community is going to have to get up to speed very quickly if they are going to know what questions to ask and, more importantly, what answers to those questions they should want to hear.

In a Guardian article in April 2017 Liberal Democrat Leader Vince Cable voiced his concerns about councils' property investments: "local authorities have a long and inglorious history of gambling in financial and property markets." He was also reported as saying: "in some cases they may succeed, but there is a very high risk of bankrupting their local authorities."

References

[1] CIPFA *Prudential Code 2017*
cipfa.org/policy-and-guidance/publications/t/the-prudential-code-for-capital-finance-in-local-authorities-2017-edition-book

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