monmouthshire COUNTY COUNCIL sir fynwy

REPORT

SUBJECT:	**Investment Committee Performance Review**
MEETING:	**Governance and Audit Committee**
DATE:	**24th November 2022**
DIVISION/WARDS AFFECTED:	**All**

1. PURPOSE:

1.1 To provide members of Governance and Audit Committee with a performance review of the Investment Committee, with consideration of the recommendations of the Internal Audit Report Investment Property Acquisitions 21/22.

2. RECOMMENDATIONS:

2.1 For the Governance & Audit Committee to consider and scrutinize the performance review of the Investment Committee.

2.2 To review progress against the improvement proposals that were previously agreed by Governance & Audit Committee and resulting from recommendations arising from a previous internal audit report into investment property acquisitions.

2.3 To receive a verbal update at the meeting following consideration of the performance review by Investment Committee at its meeting on 7th November 2022.

2.4 For Governance & Audit Committee to consider proposed changes to the governance arrangements for the Council's commercial investment portfolio and any future investment considerations and to determine any further recommendations for improvement.

3. KEY ISSUES:

Project Background

3.1 In May 2018, Council approved a revised Asset Management Strategy, which included an Asset Investment Policy designed to optimize returns from the Councils investment portfolio, including the acquisition or development of new assets or other commercial opportunities.

3.2 The purpose of the policy was to help sustain Council services and enhance the asset base by providing a framework to enable the acquisition of commercial assets to increase net rental income streams and identify capital appreciation opportunities.

3.3 The Asset Investment Policy outlines the criteria for evaluation of properties, measured against income generation to satisfy the Council's Corporate Plan and ambition to be 'future focused'.

3.4 The policy sets out the need to seek out investment opportunities within Monmouthshire, the City Deal region and neighbouring areas of economic influence, which support our economic and regeneration priorities. The policy enables MCC to identify investment opportunities beyond our county boundary that meet our criteria as well as identifying different types of investment that enables us to minim risks by both sector and location.

3.5 Acquisitions are funded through approved prudential borrowing with a £50,000,000 fund established to acquired or investment over a three-year period. The cost of borrowing is serviced by the resulting rental streams, with a requirement that it should provide a net surplus over and above borrowing costs.

3.6 An Investment Committee was established to manage the investment portfolio, which has delegated authority to make investment utilised the approved prudential borrowing. The Investment Committee is made up of the Council Leader, Deputy Leader, Cabinet Member for Resources and Leaders of the two largest opposition parties. The Committee is advised by the Chief Officer for Resources and officers from Finance, Landlord Services and Legal Services. When considering acquisitions or investments, specialist advisors are used to supplement internal capacity and expertise as appropriate.

3.7 In July 2018, a Commercial Strategy was approved by Cabinet which reinforced the commercialisation of assets, and in February 2019, Council approved a wider definition of commercial investment. This gave authority to seek investments beyond land and buildings to include commercial loan facilities and equity or debenture interest.

The Asset Investment Policy

3.8 As discussed, the Asset Investment Policy sets out the framework and governance criteria for the management of the investment portfolio. The target returns for individual investments is that the returns must exceed borrowing costs by a minimum of 2%. The Asset Investment Policy enables individual investments to provide a lower return (i.e. below 2%) if investments can demonstrate economic development opportunities for Monmouthshire.

3.9 All business cases considered by Investment Committee consider the known risks at the time of the investment, together with the proposed mitigating action and potential exit strategies.

3.10 The Investment Committee is responsible for making the decisions on possible investments based on the business cases presented, ensuring that they meet the criteria as set out in the Asset Investment Policy. In addition, the Committee is responsible for ensuring that the assets are effectively managed, performance is monitored, and performance reviewed via an annual report in Governance and Audit Committee.

Internal Audit Report and Recommendations 2021

3.11 The 2021 internal audit performance review of the Investment Property Acquisitions recommended a number of areas for improvement. The following tables outlines the recommendations of the 2021 performance review and progress made against each of those recommendations:

Asset	Issue identified	Progress	Status
All	Monitoring reports to Investment Committee excluded reference to the 7% annual return target included in the Asset Investment Policy.	Investment Committee will be asked to review the target annual return, in accordance with prevailing market conditions as required by Policy. No adjustment has been made as a short-term reaction to the pandemic however this target is subject to review.	Ongoing
	The Commercial Strategy has not been updated since 2018	A review and update of the Council's enabling strategies will be undertaken	Strategy to be reviewed by July 2023

		alongside and subsequent to the Council finalising its Community and Corporate Plan and which aims to be approved by Council in March 2023.	
Castlegate & Newport Leisure Park	Rental agreements with tenants and evidence of the review of these could not all be obtained.	A full reconciliation of leases held in respect of Castlegate BP and Newport Leisure Park has been undertaken	Completed
Broadway	A contract for the due diligence consultancy work was awarded without a tender or alternative quotations. No exemption from Contract Procedure Rules was sought.	Consultancy work will be appointed and undertaken in accordance with the Authority’s Contract Procedure Rules, and where required/appropriate CPR exemptions applied.	Completed. External tender subsequently undertaken via Sell to Wales.
	A contract was awarded to a supplier, who based their tender on significantly less working days than indicated in the project brief.	Future tender exercises will be undertaken on a fair and equitable basis. All tenderers will be afforded transparency in answer to any questions or clarifications sought during the tendering stage.	Completed as above. And ongoing for future tender exercises.
	Purchase Orders for the work completed by a contractor had been raised retrospectively.	A call-off order will be raised for future works. The contractor will deliver in accordance with the	Completed

		agreed scope of works, as limited by the tender and contract award.	

3.12 Overall, the audit report considered the process for investment property acquisitions has been assessed as providing ‘reasonable assurance’ which reflects that the financial and administrative systems reviewed were found to be adequately controlled, although risks identified (above) could compromise the overall control environment.

Investment Performance Update

3.13 The challenges of the pandemic, albeit unprecedented, have highlighted risks that naturally arise when undertaking commercial investments. The investment and property markets remain uncertain and, as a consequence of covid’s impact on the financial viability, no new investment activity has been undertaken in the 21/22 year.

3.14 Following the reinstatement of the Investment Committee post-election, the Investment Committee met November 2022 to discuss the performance of the investment assets. A summary below sets out the performance of Castlegate Business Park, Newport Leisure Park and Broadway investments.

	Castlegate Business Park	Newport Leisure Park
ROI at time of acquisition	3.76%	2.11%
ROI Aug 2022	-2.26%	1.62%
Occupancy at the time of acquisition	95%	100%
Occupancy August 2022	75.7%	97%

Castlegate Business Park

3.15 Castlegate Business Park was acquired in June 2018 for £7million together with a service charge loan of £900k and associated acquisition costs. The asset consists of mixed office and production/warehouse space amount to circa 217,000 sqft situated in 18 acres of land adjoining the Caldicot settlement.

3.16 As of March 2022, the anchor tenant was Mitel who had operated from the premises since its construction in 1984. At the time of the last performance update in February 2022, Mitel had served notice to surrender occupation of their office/warehouse space, reducing occupancy levels to 36.9%. The majority of the warehouse space has since been relet to an existing tenant, Wunda Group, reducing the vacant space from 138,000 sqft to 45,601 sq ft. This is the largest letting of industrial space in Wales this year.

3.17 The remaining space vacated by Mitel continues to be advertised and a marketing strategy has been implemented. Since the commencement of marketing, a number of viewings have occurred for smaller lettings (between 2,000 and 10,000 sqft) and there remains a reasonable prospect of securing new tenants.

3.18 Given that the asset currently performs below the 2% above borrowing criteria as set out in the asset investment strategy, Investment Committee is obliged to review the retention of the asset and consider its disposal. On balance, it is the recommendation of officers that Investment Committee continue to hold this asset to retain a strategic employment asset, on the understanding of having secured a letting to Wunda Group/DAQS and increased the rent roll and reduced MCC service charge liability. Whilst there still remains a forecast budget pressure for 22/23, the prospects for the site have significantly improved to increase the likelihood of returning the ROI to the required 2% above borrowing threshold.

Newport Leisure Park

3.19 Newport Leisure Park was acquired in March 2019 at a cost of £22.5million. It is situated on the Newport/Monmouthshire border and comprises of a mix of six restaurants, two retail units and three leisure units within an 11-acre site. At the time of acquisition, all of the units were let on the basis of long leaseholds with no rental or service charge arrears.

3.20 The investment has been disproportionately impacted by the pandemic due to the leisure and hospitality uses that occupy the site. This has resulted in tenants being unable to trade for substantial periods and seeking rental concessions. Two tenants, Pizza Hut and Frankie and Benny’s, entered CVA’s and have subsequently vacated.

3.21 Following relaxation of Covid restrictions, tenants have generally recovered well and have settled arrears. There are no arrears on Unit 3 (Wright Leisure), Unit 4 (Home Bargains), Unit 7 (McDonalds - service charge only), Unit 8 (Harvester), Unit 9a (Sally Sallon) and Unit 10 (Union Burger).

3.22 Covid hardship funding for the 21/22 financial year has been granted by Welsh Government to satisfy any rental shortfalls, allowing Newport Leisure Park to meet its £400,000 income target. Since the ending of the Covid hardship fund, two tenants have fallen into rental arrears and as a consequence a reduction in ROI below that of the 2% above borrowing criteria. A recent letting of Unit 5 to the Magic Bean Company (Starbucks) and planning approval for the creation of a drive through should positively impact the attractiveness of the estate and interest in this location. We are considering offers received in relation to Unit 4.

3.23 Unit 1 (Cineworld) have continued to satisfy their lease and rental obligations throughout pandemic. Cineworld continue to make monthly rental payments and are not in arrears, despite recently filing for bankruptcy in the United States. Recent publications and market information indicates that Cineworld have been granted funding to meet its daily obligations, and publicly they remain committed to meeting their ongoing obligations to their suppliers, vendors and staff. It is anticipated that Cineworld will emerge from bankruptcy in Q1 2023. MCC's investment management agent and Estates team continue to work to establish the short and medium term consequence to NLP, however it is evident this presents a risk both in capital value and annual return.

3.24 In common with the leisure sector and leisure parks generally, Newport Leisure Park has suffered with a reduction in rent-roll, ROI and therefore capital value. It is recognised that the ROI has fallen below that prescribed in the asset investment policy, and an options review is to be presented to the Investment Committee to review the structural impact of the pandemic and strategy with regarding to retention or exit strategy for the asset.

Broadway

3.25 In March 2020, on the basis of the completed due diligence and legal negotiations, to provide loan funding to:

Create a Special Purpose Vehicle, 'Monmouthshire Broadband Limited' for funding of £1.9 million for a 10-year term, secured against the network assets held and created by the investment made by the SPV

- Broadway Partners, for an unsecured revolving loan facility of £300,000 to assist the company in overcoming cash flow delays resulting from delays in UK Government gigabit voucher scheme payments.

3.26 The investment was to be used to build a mixed wireless and fibre-optic access network across Monmouthshire (covering 12,000 premises) that is capable of delivering broadband speeds between 50 Mbps and 1 Gbps. The planning assumption for the build out phase was 18 months in total. Despite disruption caused by the pandemic, by July 2021, Monmouthshire Broadband Limited had completed 34 of the planned 57 radio base station sites, covering circa 8,000 ‘white’ premises, and had circa 600 fixed-wireless and fibre customers.

3.27 In October 2021, Broadway Partners sought MCC’s consent to grant security to new investors – Downing LLP – who sought to invest £145 million in the company to enable it to deliver full-fibre broadband to 250,000 premises in rural communities. The MCC Investment Committee consented and MCC legal department agreed an intercreditor deed between MCC and the new funders.

3.28 To date, Monmouthshire Broadway Limited has drawn down two of the four tranche payments, total amount £1.15 million, of the £1.9 million total secured loan. Since the initial payment holiday of 12 months elapsed, MBL has repaid the loan plus SONIA-linked interest on a monthly basis, in accordance with the provisions of the Facility Agreement. In November 2021, Broadway Partners repaid in full and with the necessary interest the balance of the revolving loan facility and gave the requisite notice that they wished to close the facility. As such, this took place on 30 December 2021.

3.29 Significant contextual changes, along with the large inward investment secured by Broadway Partners since the MCC investment was made, have changed the focus of broadband infrastructure rollouts towards gigabit-capable fibre networks. As such, the original plan agreed with MBL appears anachronistic and so inappropriate to deliver. Officers continue to work with the contracted monitoring/project management consultancy to scope out the different ways forward and will present options to the Investment Committee in due course.

Risk Management

3.30 Whilst each investment will have its own unique characteristics and associated risks, as is the case with any investment, the key risks associated with commercial and property investment activity are:

- That all decisions to incur expenditure are backed be effective legal powers and a resultant risk arises if decisions are subsequently invalidated by changes in statutory provisions or developments in case law, albeit that the retrospective application is unlikely.
- The authorities returns are at risk, while, once incurred borrowing costs are unavoidable. A reduction in returns could put pressure on the authority’s revenue account.
- Capital gains are at risk and in relation to fair value of the property on the balance sheet, for example, where the commercial property fair value is less than the value of the debt liability.

- A risk of proportionality in terms of the extent that the authority's revenue budget is reliant on income from commercial investments.
- A lack of expertise with council staff and those undertaking review and making decisions leading to poor acquisition decisions.
- A downturn in the property market or the market within which the investment is made.
- The long-term structural impact of covid on property sectors and consumers/ workforce behaviours and their resulting capital and revenue values

3.31 Separate Legal counsel advice has been received and that confirmed that the Council can operate within existing legal powers and guidance and in making the commercial investments as intended. Legal advice is sought separately for each commercial investment being considered.

3.32 Business cases that are developed and considered by Investment Committee undertake a full and proper assessment of risk and associated risk management and mitigation strategies. Business cases are supported by detailed commercial, financial and legal due diligence, with external advisors appointed as required to supplement the experienced staff within Legal, Finance and Estates.

3.33 Proposals presented to Investment Committee seek to describe the opportunity being considered from the perspective of the cash flows anticipated, and net returns quantified, any qualitative benefits evaluated, reasonableness of assumptions made, any risks/volatility anticipated against those assumptions, and provides the risk mitigation action proposed should those risks crystallise. There is a skewed emphasis towards the risk mitigation aspect of any proposal, not because highly speculative opportunities are being presented to Investment Committee, but instead recognising that any investment has a degree of speculation and despite commercial investment being an increasingly common aspect for local authorities to address declining central government resourcing, the stewardship of public funds and security of investment remains a key consideration to any local authority decision-making.

3.34 Prudential indicators monitor and contain local authority borrowing levels and commercial investment activity is separately shown and further supported by the additional reporting requirements necessitated by Welsh Government Investment guidance.

The Wider Local and National Context

3.35 Local authorities have a range of powers to acquire commercial property and make investments. In some instances, authorities also have powers to finance these investments through borrowing. Local authority borrowing and investment takes place within the prudential framework, made up of powers and duties and a set of statutory codes and guidance to which authorities must have regard.

3.36 Following moves by UK Treasury and the Debt Management Office (DMO), and a strengthening of the Prudential Code, if a local authority is planning to acquire investment assets bought primarily for yield in any of the following three financial years, the authority will be unable to borrow from the PWLB to finance any expenditure in its capital plan.

3.37 Investment assets bought primarily for yield are assets that serve no direct policy purpose but are held primarily to generate an income. An 'investment asset' could be a capital or property asset, or interest or right that generates a balance sheet asset (such as, but not limited to a loan, sale and leaseback agreement).

3.38 If such an asset had been bought 'primarily for yield', the investment asset would serve no direct policy purpose linked to the authority's core functions, but would have been acquired primarily because it would generate an income stream for the authority, which would most often (but not exclusively) be used to support wider service spending.

3.39 These investment assets bought primarily for yield would usually have one or more of the following characteristics:

- buying land or existing buildings to let out at market rate
- buying land or buildings which were previously operated on a commercial basis which is then continued by the local authority without any additional investment or modification
- buying land or existing buildings other than housing which generate income and are intended to be held indefinitely, rather than until the achievement of some meaningful trigger such as the completion of land assembly
- buying a speculative investment asset (including both financial and non-financial assets) that generates yield without a direct policy purpose

3.40 Local authorities cannot use the receipts from selling existing primarily for yield assets to acquire new primarily for yield assets. Local authorities can use the receipts from selling existing primarily for yield assets to finance other capital expenditure in service delivery, regeneration, housing and preventative action.

3.41 It is important to note that the Council paused any further active consideration of commercial investments activity as a consequence of the pandemic and the resultant uncertainty in property and investment markets. No investments have been made subsequent to the strengthening of the Prudential code and confirmation has been provided on an annual basis to the DMO that no PWLB borrowing is intended for the purpose of acquiring investment assets primarily for the purposes of yield.

Proposed Changes to Governance Arrangements

3.42 An Investment Committee was established in 2018 to manage the investment portfolio, and which had delegated authority to acquire or invest over a three-year period against a £50,000,000 fund established through approved prudential borrowing.

3.43 All three investments made by the Investment Committee to date have been made within the three-year period, the last of these in March 2020.

3.44 The three-year period approved by Council in May 2018 has now lapsed. Furthermore, there remains a pause on further commercial investment activity and that has continued due to the ongoing market instability since the start of the pandemic.

3.45 The ability for the Council to entertain any future commercial investment primarily for yield through PWLB borrowing is now restricted. Any future investment would need to be seen to be delivering against a direct policy objective of the Council and arguably where market failure requires the Council to act.

3.46 If any future investment considerations are intended to deliver against direct policy objectives of the Council then it naturally prompts for the current governance arrangements to be reviewed. It is therefore proposed that recommendation is made to Council:

a) To Dissolve the Investment Committee;

b) To pass responsibility to the Performance and Overview Scrutiny Committee for scrutinising the performance of the investment portfolio;

c) That the Governance and Audit Committee continues to assure itself that the controls in place to maintain and monitor the investment portfolio remain robust and appropriate.

d) That any future investment activity is subject to the appropriate decision making body as laid out in the Constitution.

4. OPTIONS APPRAISAL:

4.1 The report is not a decision-making report. The report represents a performance review of the Investment Committee and update on the recommended actions from the 21/22 Audit Report. Therefore, no option appraisal is required.

5. REASONS:

5.1 The Asset Investment Policy requires an annual performance review of the Investment Committee to be undertaken and in order to ensure that the governance arrangements, policy documentation and legislation are being reviewed and adhered to.

5.2 To allow for a timely review of the governance arrangements in place and in overseeing commercial investment activity and the investment portfolio that is managed and maintained.

6. RESOURCE IMPLICATIONS:

6.1 The three investments to date are Castlegate Business Park, Newport Leisure Park and Broadway.

6.2 £30.7m of the £50,000,000 prudential borrowing fund has been spent to date on the three investment acquisitions. Any costs of due diligence and advice incurred exploring other commercial investment opportunities have been met from existing revenue budgets.

6.3 As a result of the acquisitions, budget savings have been introduced. The budgeted level of savings for Castlegate Business Park and Newport Leisure Park are £209,000 and £400,000 respectively. As a consequence of the surrender of Mitel at Castlegate Business Park and ending of the Welsh Government Covid hardship fund, the ROI's for both investments have dropped to -2.26% and 1.62%. This is considered a temporary decline due to the successful lettings to Wunda Group and the Magic Bean Company. The performance of the wider investment portfolio and investment reserve will support the income targets.

6.4 The capital values of both assets have decreased in the last year reflecting the impact of the pandemic and reduction in rent rolls/occupancy levels. It is anticipated NLP will continue to see a reduction in its capital value until the final unit has been let.

6.5 There are no significant arrears at Castlegate Business Park. Two occupiers of Newport Leisure Park are in arrears and discussions are ongoing with the tenants to establish recovery plans. Cineworld continues to be monitored regularly.

7. EQUALITY AND FUTURE GENERATIONS EVALUATION (INCLUDES SOCIAL JUSTICE, SAFEGUARDING AND CORPORATE PARENTING)

There are no equality or Future Generations implications arising from the purpose of this report. This report is seeking to provide a review of performance of the Investment Committee, and any implications arising from it.

8. CONSULTEES:

Stacey Jones – Finance and Resources Manager
Joanne Chase – Head of Commercial Law

9. BACKGROUND PAPERS:

Appendix A – Asset Investment Policy December 2020
Appendix B – Capital Strategy and Treasury Management Strategy 2022/23
Appendix C – Investment Committee Terms of Reference

10. AUTHOR(S):

Peter Davies – Deputy Chief Executive (S151 Officer)
Nicholas Keyse – Estates Development Manager

11. CONTACT DETAILS:

Tel: 07398 954828
Email: peterdavies@monmouthshire.gov.uk

Tel: 01633 644773
Email: nicholaskeyse@monmouthshire.gov.uk