

BY: Nick Chard, Cabinet Member for Finance
Elizabeth Walker, Interim Director of Property (joint)

TO: Corporate Policy Overview Committee 26 March 2009

DATE: 16 March 2009

SUBJECT: Property Enterprise Fund Terms of Reference

CLASSIFICATION: Unrestricted

FILE REFERENCE:

SUMMARY: FOR DECISION	This report advises Members of the relevance of the original Terms of Reference for the Property Enterprise Fund and recommends appropriate revisions. Members are asked to: <ul style="list-style-type: none">a. Recommend that no change is required to the original governance procedureb. Recommend the preparation of a detailed acquisition strategy.c. Note the position with regard to the non-operational property portfolio and disposal strategy.
----------------------------------	--

1. Background

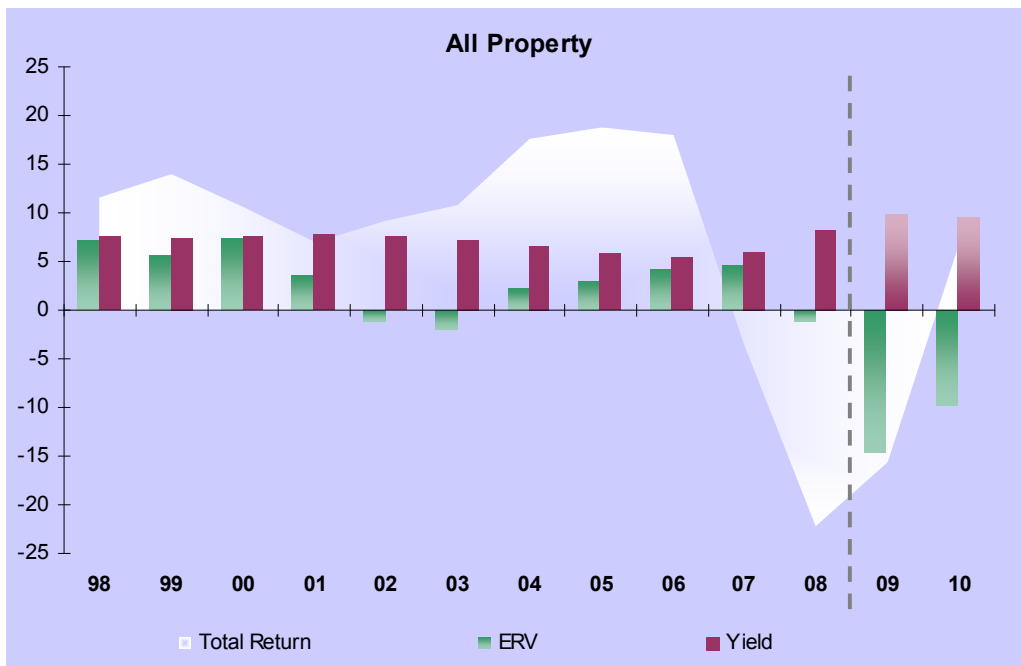
- 1.1 The Terms of Reference (TOR) for the Property Enterprise Fund (PEF) are contained within the Cabinet paper dated 10 July 2006 a copy of which is attached at appendix 1. Corporate POC have requested that these TOR be reconsidered to establish whether any changes are required.
- 1.2 PEF was established in 2006 in order to realise capital from the disposal of non-operational property, and to acquire property for future use, regeneration and income generation opportunities. Property Group has undertaken a vigorous disposal strategy for non-operational assets. 131 properties have been sold for a total receipt of £12,288,050.

2. The Property Market

- 2.1 Until the autumn of 2007, the property market had enjoyed successive years of growth in values and volumes, supported by a strong economy, pent-up demand

for new housing and relatively easy credit terms. A change in market sentiment was evident by the end of the 2007, but was generally assumed at that time to represent a market adjustment to values, which had become over-inflated. At this stage the adjustment was forecast to be between 5%-15% and all predictions indicated a relatively short dip in the market with recovery through the remainder of 2008.

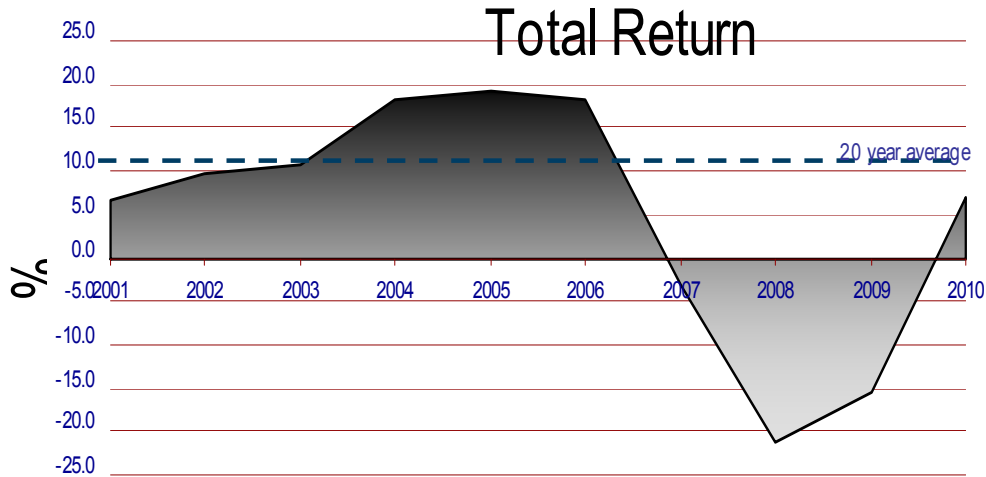
- 2.2 The collapse of Northern Rock, the well publicised difficulties of other financial institutions with major exposure to property lending and adverse press coverage regarding market sentiment, catalysed not only a further rapid fall in values, but a crisis of confidence across all sectors of the property market. A severe tightening of lending terms (the “Credit Crunch”) resulted in the number of transactions falling rapidly. Most residential developers have now withdrawn from acquisitions. It is generally felt that land values in Kent have fallen by 40-50%.
- 2.3 This year the UK economy is predicted to experience the largest contraction in Gross Domestic Product (GDP) since the Second World War. The forecasts are currently predicting a return to positive GDP in mid 2010. In 2009 total returns to property will be negative for the third year running. It is anticipated that transactional activity will pick up in 2010 sufficient to generate modest positive returns.



Source: Colliers CRE, IPF, Morgan Stanley

- 2.4 Even if lending terms to new borrowers are eased in a shorter timeframe, this will not of itself restore pre-2008 property values (or capital receipt expectations) given the prognosis for the health of the wider UK economy. Real prospects for the economy and property market improvement are predicted for 2011. The level of competition for properties and volume of transactions experienced between

2003 and 2007 is however not expected to return for at least the next five years and therefore a return to mid 2007 values is not likely for at least this period.



Source IPD/Colliers CRE

3. The KCC Non-Operational Property Portfolio

- 3.1 In 2006 the KCC non-operational property portfolio was valued at £74m (excluding investment properties). The value at 31 March 2008 for non operational properties (excluding investment properties) was £86m. To date 131 properties have been sold for a total receipt of £12,288,050.
- 3.2 When PEF was established in 2006 the targeted capital receipts were £45M. The fund was given a maximum permitted deficit of £10m, but was to be self-financing over a period of 10 years. The cost of any temporary borrowing is charged to the Fund to reflect the opportunity cost of the investment. Any temporary deficit is offset as disposal income from assets is realised. It was anticipated that the Fund will be in surplus at the end of the 10 year period.
- 3.3 Due to the effects of the Credit Crunch on the property market and the economic downturn, the rate at which properties are being sold has slowed dramatically. Property Group continues to add value by site assembly and through the planning process and will commence sales when the market shows significant signs of improvement.
- 3.4 The predicted capital receipts are risk adjusted to allow for prudent forecasting. High, medium and low risk factors are placed on each receipt to account for the unique risks inherent in achieving a receipt for each of the individual properties. The adjustment reflects for example, the risk of achieving planning, political

issues and title issues affecting value. The current forecast for capital receipts can be summarised as follows:

Projected capital receipts	£39.690m
High risk	£26.958m
Medium risk	£11.025m
Low risk	1.707m
Risk adjusted capital receipts	£13.305m

- 3.5 Given the down turn in the property market the projected capital receipts have been adjusted accordingly with the majority of disposals anticipated from mid 2010 onwards. The forecast receipts from 2009/10 to 2013/14, after adjustment for risk is therefore £13.305 M.
- 3.6 The properties within the portfolio fall into the following categories:
- 3.6.1 A small number of larger town centre redevelopment sites such as Wrens Cross in Maidstone and Swanton/Conyers in Ashford, of approximately 1 acre each. Typically these have a value of between £300,000 and £3m (assuming planning consent is obtained).
- 3.6.2 Parcels of land which currently do not have planning consent, but are being promoted by Property for development via the Local Development Framework process. These typically have values (once planning permission is granted) of between £500,000 and £8m.
- 3.6.3 Small bespoke properties which have no redevelopment potential with a value range of £100-£300,000.
- 3.6.4 Small plots of land with no current planning consent, but which would be sold for hope value in a buoyant market. These have a value range of £10,000-£100,000.

4. **Acquisition Strategy**

- 4.1 The Fund was established to "Aid enterprising property acquisition in a timely, efficient and cost effective manner" and to facilitate strategic acquisition of land and property to add value to the property portfolio, aid the achievement of economic and regeneration objectives and generate income to supplement the Council's reduced resources. Whilst this purpose is still valid today it has a wide interpretation and a more explicitly defined acquisition strategy would be helpful at this point in time.
- 4.1 To date two properties have been acquired, Manston Business Park which falls into the economic and regeneration category and a property in Upper Stone Street, Maidstone as part of a site assembly for Wrens Cross. This also falls into

the regeneration category. The total cost of these acquisitions is £5.3M, since the Upper Stone Street property was a direct land swap.

The Fund has also been earmarked to provide £1m for Ashford Library, £2m for Gateways over the MTP period and has made a £4m contribution to revenue budgets over 07/08 and 08/09 and £5.304m for the Eurokent Access Road in 07/08 and 08/09.

- 4.2 Taking all the above into consideration, the Fund is expected to be in a deficit position of £5.787m at the end of 2008-09.

Opening Balance – 01-04-08	-£0.828m
Planned Receipts (Risk adjusted)	£1.323m
Costs	-£0.592m
Acquisitions	-
Other Funding:	
- revenue budget support	-£0.700m
- Eurokent Access Road	-£4.194m
- Gateways	-£0.587m
Closing Balance – 31-03-09	-£5,787m

- 4.3 The TOR currently allow for expenditure on property acquisition up to a maximum borrowing level of £10 m and in exceptional cases this threshold can be exceeded to take advantage of investment opportunities which may arise. This requires the approval of the Section 151 Officer, Chief Executive, Cabinet Member for Finance and the Leader.

The down turn in the property market offers the opportunity over the next 12 – 18 months to take advantage of the depressed values and acquire on advantageous terms. The current cash flow shows a potential for £1 - £2m of further investment during 2009/10 without exceeding the £10m borrowing limit.

- 4.4 A clear and detailed acquisition strategy would be prepared to define the areas of investment and robust business cases for each acquisition would be prepared. In order to ensure that the fund invests in property with sufficient growth potential to generate a healthy return for the fund, it will be important to clearly define the hierarchy of priorities for acquisition. For example, in any one purchase, if regeneration was the most important aim, then a lower return would be acceptable, as opposed to income generation or capital appreciation.
- 4.5 The types of acquisition which are likely to be included are strategic land banking for medium and long term returns, town centre regeneration sites and site assembly acquiring land adjacent to existing KCC operational and non-operational holdings.

5. Governance

- 5.1 The authority to spend against the fund is delegated to jointly The Director of Property and the Director of Finance in consultation with and subject to the agreement of the Chief Executive, the Cabinet Member for Finance and the Leader. All acquisitions must be supported by a business case and signed off by the Chief Executive, Cabinet Member for Finance and the Leader.
- 5.2 The operation of the Fund is to be reported to the Cabinet Member for Finance monthly and a quarterly report submitted to Cabinet. In practice the actual reporting regime has been quarterly to PAG, Property Board and Cabinet, and detailed reporting on disposals has been undertaken by Property to the Leader, Cabinet Member for Finance.
- 5.3 Any decisions relating to acquisitions and disposals within the fund are taken in accordance with the Property Management Protocol (as set out in the Constitution) and are capable of being questioned by Members and called into scrutiny if necessary.
- 5.4 The governance procedure as set out in the original Terms of Reference remains valid and no change is therefore recommended.

6 Recommendations

Corporate Policy Overview Committee is asked to:

- 6.1 Note the existing Terms of Reference for PEF and recommend the preparation of a detailed acquisition strategy for the forthcoming financial year.
- 6.2 Recommend no change be made to the original governance procedure.
- 6.3 Note the position with regard to the non-operational property portfolio currently valued at £82m, the forecast receipts of £39.690 (£13.305 after adjustment for risk) and the strategy to significantly slow the pace of disposals until the market shows signs of improvement. This is currently forecast to be in mid 2010 onwards.

Elizabeth Walker
Interim Director of Property (joint)
Elizabeth.walker@kent.gov.uk
01622. 696956

Nick Chard
Cabinet Member for Finance
nick.chard@kent.gov.uk
01622 694434