November 2021

Property investment FAQs

How can the Council invest in properties? I thought councils were short of cash.

The Council did make a number of investment asset acquisitions up to Autumn 2018 as part of a Capital Strategy to generate sufficient long term income to offset the impact of disappearance of Government grants. Since then the Council have focused on in-Borough housing and regeneration and the Council is not now making acquisitions for income generating purposes.

Yes, councils are short of cash as government funding has been removed in recent years. The Council started its investment policy to make up this shortfall and avoid cutting services and to help it to be able to generate affordable housing across the Borough which meets the needs of residents.

We were taking advantage of low cost government finance in order to buy high quality investment assets which will generate an income stream. The income generated is more than the financing costs and we are using this surplus to maintain Council services and build housing.

What has been the impact on the Council's income from property of the economic impacts of COVID-19 pandemic? Are Council services at risk?

Prior to any formal announcement of support from government, Spelthorne Borough Council held an emergency council meeting in May 2020 and agreed to commit £2m from the reserves accumulated via our prudent treatment of asset to support businesses and residents in the Borough.

The Council's investment assets have continued to perform extremely well despite the economic downturn (the worst for more than 300 years) caused by the COVID-19 lockdowns. For 2020-21 financial year the Council has collected 99% of the rental income invoiced and the collection rate is expected to rise to 99.2% as most of the outstanding balance is paid by tenants under rent deferral agreements.

During the pandemic the Council has continued to set aside funds from part of the rental income stream into sinking funds to ensure it has contingency funds to cover future potential dips in rental income. At the end of 2021-22 the funds in the sinking funds reserves will total more than £30m.

Is the Council risking council taxpayer cash on commercial properties?

No. The Council is not risking council taxpayers' cash to buy commercial properties; the low cost government funding for this strategy comes from the financial markets.

The Council has also been very focused on identifying and managing risk. It has only acquired high quality assets after extensive due diligence both on the assets and the tenants. The Council's assets team proactively engaged with tenants during the COVID-19 pandemic to ensure tenants continued to pay rent. The Council has modelled the future risk of their being dips in rental income when existing leases have break clauses exercised or end potentially resulting in dips of income when space becomes vacant and then rent free incentives need to be offered. The Council is setting aside sufficient funds in its sinking funds reserves to ensure that it can cover such dips in income without any impact on the Council's budget or council taxpayers. The sinking funds also cover cost of future refurbishments of the assets.

Why is the Council investing in areas outside Spelthorne? Shouldn't we be putting money into our own area?

The Council is no longer acquiring investment assets - whether inside or outside the Borough. Historically, there were very limited opportunitities to purchase assets in Spelthorne which meet our "best-in-class" criteria. Where we have invested in the past beyond our boundaries, we have only done so in the Heathrow Economic Area to purchase those best-in-class assets which would provide a profit. The furthest distance any investment has been from the Borough is 30 miles.

The Council is putting money into its own area. We have a range of projects planned and underway which are delivering housing across the Borough (in 2021 - one 25 affordable rent scheme; one 55 unit mixed affordable, keyworker and private rental scheme, a single person homeless hostel and a 20 unit family emergency accommodation scheme) and regenerating Staines-upon-Thames town centre and in Ashford.

Doesn't the government have guidelines in place to stop councils doing this?

The government has guidance on council borrowing - the Council abides by this at all times and we have taken legal advice to ensure that we stay within the law.

Why can't the money for investment properties be used instead for services to residents?

Councils are not allowed to borrow to directly fund services. Indirectly, we can borrow money which when invested yields a surplus which goes into protecting services and building houses.

Why can't the money be used to build council houses?

The money is being used to provide more housing, with a number of schemes under development. We are buying sites within the Borough for housing as well as investment assets which will give us the income to be able to develop these sites and cover some of the upfront costs of planning, procurement and construction.

Why can't the money be used to repair potholes?

Spelthorne Borough Council is not responsible for highways; that is the job of Surrey County Council.

What sort of assets is the Council buying?

The Council strategy was to buy best-in-class investments in sought-after locations with excellent transport links and blue chip tenants.

Why does the Council have £1bn of debt if its annual budget is around £22m?

The Council has this amount of debt because it has purchased assets of equivalent value. We will be steadily paying off that debt over the loan periods. The assets generate an income stream which goes into the annual budget. The net income stream (after allowing for things like interest payments and management costs) is nearly £10m. If we did not have this income we would be forced to cut half of the Council's services and put up charges to make up the difference.

Can the Council afford the repayments?

Yes. Each acquisition is affordable in its own right. We make allowance for things like interest repayments, loan repayments, management costs and sinking funds for longer-term refurbishments before we take any surplus into the Council spending plans. We are very prudent in our approach.

What will happen if the property market crashes?

If the values of the properties decrease then the Council will still have a number of tenants in situ who will be paying rent (for example BP paying rent until 2036). We aim to have tenants signed up on leases for around 10 years. We are investing on a long-term basis and we fully expect to hold these assets through a number of economic cycles. We have made allowances for costs such as refurbishment and void periods when there are no tenants, and we are building up sinking funds to ensure the money is there when we need it. We currently have £11m set aside and by April 2023 this will rise to £35m.

The assets value on the Council's blanace sheet has reduced in 2020-21 by £50m is this a threat to the council taxpayer?

No. The COuncil is looking to hold the assets for the long term and short-term fluctiations in asset value do not impact on the Revenue Budget bottom line. As a result of the worst economic recession for more than 300 years assets values across the county were reduced and the Council's independent valuers reduced the value of the investment assets by 5.4%. However, what is important is the assets have continued to provide the same level of income as before (and in case of BP site the annual rental is rising from September 2021(. We anticipate the values will recover over time.

What's a 'sinking fund' and how big is it?

A sinking fund is a sum of money set aside to cover for foreseeable future costs and unforeseen events. For example:

- when tenants move out and we have a void period before the next tenant moves in
- when we need to refurbish a building

What has been the impact of Brexit?

We are investing on a long-term basis and we fully expect to hold these assets through a number of economic cycles. We have made allowances for things such as refurbishment costs and void periods and we are building up sinking funds to ensure the money is there when we need it. We currently have £11m set aside and by April 2023 this will rise to £35m.

If offices become empty as a result of tenants going bust, the Council has funds set aside to cover this until the offices are leased again to new tenants.

Similarly, if rental values decrease we have funds set aside to cover the shortfall. As we say above, we are investing for the long term and expect to see peaks and troughs in the economy.

The reason for having substantial sinking funds is to avoid the position where we have to consider sales of property which we are holding for the long term. If Council strategy changes, we have good options because we have invested in the highest quality of asset which we believe to be the safest and best approach as we will always have attractive, saleable assets. We will look to ensure that we protect the long-term underlying value of the portfolio as a whole.

Councils shouldn't be playing the property market. Do you know what you are doing?

Local authorities have a long track record of investing in property in order to regenerate their areas and provide housing and income. Other local authorities have assets far in excess of Spelthorne.

Although this is a relatively new strategy for Spelthorne, we have recruited expert staff into the Council from the private sector and we also use top City firms of surveyors and solicitors to advise us.

Isn't this like the Icelandic banking scandal? Is there a risk that taxpayers will have to foot the bill if it all goes wrong?

Spelthorne Council did not have any funds invested in Icelandic banks.

The banking scandal arose when local authorities risked their money in banks with unusually high interest rates and did not do enough upfront research. When the financial crisis hit, lots of them lost money.

There are no parallels to this strategy:

- we are investing in best-in-class assets which are attractive to investors generally

- we do not invest in assets which offer unusually high rates of return as this is a sign of underlying risk. We only bid on a very prudent basis. We adopt the same approach as a prudent pension fund would take
- we undertake thorough research and use specialist experts and consultants to understand and manage the risk of purchasing and running these properties
- we own the assets, which can be freely traded at a later stage if needs be

Could the Council go bankrupt if these investments go bad?

No, the Council cannot go bankrupt. We manage our risks by having a diverse portfolio of assets and a mix of tenants from different sectors of the economy.

Why is the Council paying out such big sums of money to consultants and lawyers?

We believe it is a false economy to seek advice based purely on cost. We want residents to be assured that we have chosen the best people to do the job of looking after their interests, and this costs money. We always seek to get best value from all of our partners.

How much money is the Council making? Where is it going?

The Council is receiving around £50m a year in rental income. After deductions, we are able to spend around £10m of this on services for residents and new homes for residents.

The remainder of the money goes into paying interest, paying off loans, making provision for the management costs of the buildings and contributing to our sinking fund for the future.

How much have we spent and how much are those assets now worth?

Since 2016, we have invested £914m in commercial assets. We will have the assets valued on an annual basis. We have no current plans to sell any of the assets but this revaluation is for good estate management purposes.

All these figures are publicly available in our accounts. In addition, we have also published details of our assets in our residents' magazine, the Bulletin and in an annual commercial assets report. We will continue to inform residents of these details because we want to encourage questions and transparency.

How do you know you haven't paid too much for these assets?

We receive independent advice from more than one source before we proceed.

Shouldn't the Council have a balanced portfolio of investments, not just property?

Property investment is just one aspect of the way in which the Council invests.

The Council invests surplus cash funds in other pooled investments such as banks, bonds and other financial funds. Our track record is that we can usually (although this initially dipped during the COVID-19 pandemic) earn an average 4-5% on these investments.

We will be investing our sinking funds in a similar way to make sure that these funds increase in value.

We are not allowed to borrow with the sole purpose of putting money into these types of investments.

Are councillors qualified to manage commercial property investments? Shouldn't this be left to the professionals?

Councillors represent the voice of the resident and are there to challenge the advice and recommendations of officers and experts. They bring a common sense approach to the scrutiny of our investment strategy.

Councillors need the advice of experts and professionals to help them decide what to do for the best. This takes place at regular fortnightly meetings between officers and key councillors. If they are not happy with the advice they are hearing, they can challenge and stop the investments proceeding.

Any decisions on whether to proceed with an acquisition need to go to the Development Sub Committee and then the Corporate Policy and resources committee. The broad base of councillors on these committees means there is a range of expertise which can be brought to bear from their professional financial, business and property perspectives.

How are councillors accountable for their decisions?

Councillors are directly accountable to their electors. If you have concerns about what the Council is doing, you can **contact your councillor**.

Both the Corporate Policy and Resources Committee and Council makes decisions about property investments within the financial parameters set by the whole Council. Currently this means that any regeneration investment needs to go to the Council if the sum is over £1m. These meetings take place in public (except where commercially confidential information is discussed) and residents can attend these meetings and get copies of reports from our website.

The Council decides how much it wants to invest in property. Members of the public can attend Council and ask questions (if submitted in writing and in advance) about any aspect of the investment strategy. As an example, the Council's Capital Strategy is updated and approved by Council every February and information will be available on our website in advance.

Ultimately, if enough residents decide they want a different strategy they can make their views known at the ballot box.

Why has SBC got hundreds of loans?

The Council does not take one loan per asset. Based on expert financial advice, we look for the best way to get the lowest loans over the life of the asset. The result is that the cost of the assets is being paid off steadily on a year by year basis similar to a mortgage. All these loans are at a fixed rate. By using this approach on the BP deal, for example, we saved £14m interest over the life of the loan. There are no extra administrative costs from this approach.

Has SBC got expertise to manage a £1bn property portfolio?

Yes. Since 2016 we have recruited additional expert staff into the Council from the private sector with experience of managing investment portfolios.

We use expert property managers for the different buildings.

We rely on a range of external consultants to supplement our capacity on a project-by-project basis.

Is BP your biggest tenant?

Yes. In 2016, income from BP represented 97% of the income from commercial property.

Following portfolio diversification in 2018 and the addition of new buildings and tenants, BP now represents 40% of our income.

Does SBC have an acquisition strategy?

Yes. When the Council made acquisitions in the past, it had a set of investment parameters. These investment parameters were agreed by councillors in consultation with residents. These investment parameters were agreed in December 2017 (Cabinet agenda, item 7). (**Cabinet agenda, item 7**).

The Council's Capital Strategy which is refreshed annually and published each February provides more detail about our approach.

Are you planning more acquisitions?

We have not investment made asset acquisitions since Autumn 2018.

The current strategy is to focus towards maximising the rent from our current investment portfolio to support our revenue budget and regeneration & housing programme, as well as increase our capital reserves.

Should a suitable property become available that supports our regeneration & housing programme in particular, we will carefully consider all our options before acquiring it. This decision would have to be made by Council.

Are any properties held offshore?

No. This is not part of our investment parameters.

Have the properties been bought outright?

Yes. All are owned on a freehold or long leasehold basis (eg 999 years).

Who advises the Council on acquisitions?

Our advice comes from teams within the Council and from external specialists:

- Cushman and Wakefield
- Deloittes
- Savills
- Clyde and Co
- Landid

What housing developments are being supported through acquisitions?

The income from our commercial property investments is helping us to fund our **developing housing** which aims to meet the pressing need for new affordable homes in the Borough.

Are all acquisitions openly reported?

We take reports through our Committee system for each acquisition. Some of the detail is confidential before we conclude a deal because of commercial sensitivity, but we are committed to being as transparent as possible about all of our investment portfolio and development projects.

Where do you borrow the money for the investments?

We borrow short term from other local authorities and long term from the Public Works Loan Board (a government agency (effectively part of the Bank of England - which provides development finance to local authorities).

What if interest rates rise?

All the loans we take out are on a fixed rate basis ie the rates we pay will not change over the duration of the loan. This allows us to model cash flow with some certainty and consider different scenarios over the life of the assets.

If interest rates rise in the future, it may have an impact on whether we can afford to borrow on the same basis to acquire further assets.

Why have SBC invested in one sector - offices - in one region rather than looking to diversify across broader sectors and locations in order to spread risk?

The Council has diversified its investments and tenants. We may in future consider changing our investment parameters to look at other regions if economic circumstances alter. The Council has deliberately avoided investing in retail, especially out-of-borough, because of the higher risks associated with that sector.

How will this affect my Council Tax and Business Rates? Am I going to pay more for the Council's debt?

On Business Rates, this is set nationally by Government and we have no discretion on what we charge.

On Council Tax, the vast majority of this goes to Surrey County Council. Spelthorne residents pay only 11% of their bill towards Spelthorne Council services.

The money from the Council's investment strategy supplements what we can receive from Council Tax and it protects services for our residents which might otherwise be cut. If we generated no investment income we would not be able to consider, for example, building affordable housing for the future.

If we did not have income from investments then the Council could keep the Council Tax at the same level but drastically reduce its service levels. The alternative would be to ask residents in a referendum if they would agree to pay a hugely increased rate of Council Tax to avoid cuts. In either scenario, provision of affordable housing would not be possible.

How many properties has the Council purchased?

View our **full list of investment acquisitions**

What impact have the investments had on the Council's finances?

Spelthorne Borough Council has published its draft Statement of Accounts for 2020-21

The investments made to date have made a positive impact on the Council finances, providing financial support to our Revenue budgets, regeneration projects and housing initiatives in the short term. In the medium to long term, the investments are helping to grow our reserves and provide greater stability to the Councils finance as each year passes.

Whilst our investment strategy produces short term benefits, the main focus is on the long term, as we no intention of selling our investments.