

CABINET

DATE OF MEETING: 2 AUGUST 2018

TITLE OF REPORT: COMMERCIALISATION AT HART

Report of: Joint Chief Executive

Cabinet Member: Councillor David Neighbour, Leader

I. PURPOSE OF REPORT

- 1.1 This report presents a 'strategic business case' for progressing the Commercialisation project across the Council as part of its project management programme.
- 1.2 It presents the proposed scope of what will be considered for 'commercialisation' and the key principles for capturing the resultant financial benefits. It does not provide a specific breakdown at this stage of exactly how and where the net commercialisation additional income will be achieved. This will be developed from the detailed work which will follow across a diverse range of activities as part of the project. However, it does show some initial areas where a more commercial approach could reap dividends.
- 1.3 An important element of this report is to allow the Council to be bold and to increase income through strategic property investment. This is the main focus of the report (Recommendation 1(a)) but the remaining elements (Recommendation 1(b) and (c)) are also constantly being kept under review.

2 OFFICER RECOMMENDATION

- 2.1 That Cabinet agree, subject to regular review at appropriate intervals, the following framework for the Council's commercial strategy:
 - 1. That the commercial strategy has three key themes:
 - a. To increase income broadly via asset based investments;
 - b. To reduce costs through such approaches as the LGA insurance mutual, better utilisation of the civic offices and other Council owned assets, and a review of the value of shared services;
 - c. To improve efficiency of services, decreasing current or future costs e.g. through digitalisation and demand reduction.
 - 2. That the objective of the asset based investment strategy is to secure long term additional income returns rather than capital growth.
 - 3. That any additional income received pursuant to this Commercialisation Strategy should aim for a 4% net yield on any investment

4. That commercial asset based investment should be within the local region e.g. within the M3 Enterprise LEP area, Solent LEP or Thames Valley Berkshire LEP but residential asset based investment should be within the District.
5. That any asset purchased for the purpose of this Commercial Strategy is held for income gain only. Any income received from the asset can then be allocated according to the priorities of the Council.
6. That, subject to proper scrutiny of any spend, a £500k ‘invest to grow’ budget is allocated to the Joint Chief Executives, for use to:
 - (a) utilise specialist expertise or resources, and/or
 - (b) increase commercialisation capacity within the organisation;
 - (c) instil commercial principles in management;
 - (d) increase commercial awareness throughout the Council and thereby increase opportunities.
7. That the Joint Chief Executive be authorised, in consultation with the Leader, the Chairman of Overview and Scrutiny Committee and the Section 151 Officer, to take all further decisions in respect of property acquisitions pursuant to this Commercialisation Strategy, irrespective of value, and on conclusion of the matter to report back to Cabinet at the earliest opportunity.
8. That upon the completion of the first acquisition pursuant to this Commercialisation Strategy a reflective review should be carried out to learn from experience and the findings reported to Overview and Scrutiny Committee.
9. That it be recommended to Council that the Financial Regulations in the Constitution be amended to facilitate the speedy acquisition of property transactions and to amend Article 12 of the Constitution to exclude property transactions pursuant to this Commercialisation strategy from the definition of a ‘Key Decision’.
10. That an ethical framework should be followed in any asset procurement pursuant to this Commercialisation Strategy.

3. BACKGROUND

- 3.1 This report is set against the context of anticipated negative revenue support grant next year of £500K and the expected phased reduction in New Homes Bonus (NHB) from 2020/2021 (at £2.2m NHB currently represents approximately 20% of the Council’s income). Although not yet confirmed it is anticipated that the phased loss of NHB will need to be replaced in full by an alternative income stream by 2023.
- 3.2 Commercialisation can have a range of definitions. However in the local government realm, it is normally identified as an action or range of actions, which leads to
 - an increase in income,
 - a reduction in costs (e.g. overheads)

- improve efficiency of service which decreases current or future costs.
- 3.3 The Council has, over a series of years, taken some bold decisions which have helped reduce costs and increase service sustainability. Most notable amongst these have been the approach to Shared Services, with almost 60% of Council spend within shared services arrangements and the delivery of the new Leisure Centre and outsourcing of Leisure Services, which has provided benefits to both community and financial sustainability. These actions have historically been however, considered as isolated projects.
- 3.4 At its September 2017 meeting, Cabinet agreed a broader framework on the approach to be adopted towards commercialisation for Hart. That paper set out some of the key drivers for commercialisation, focussing on the clear risks to long term sustainability due to the anticipated financial position by 2020/2021.
- 3.5 Having established this framework, the Local Government Association (LGA) Peer Review was asked earlier this year to look in some detail at the Council's approach to Commercialisation. The Review found that the Council had positively recognised the importance of taking a more commercial approach. However the Review team felt that it would be useful for the Council to
- clarify the priority given to commercialisation,
 - further define its approach and ensure this is widely understood and
 - support this work with appropriate resources.
- 3.6 The Review went on to suggest however, that *'commercial activities often require initial 'invest to save' funding and the Council should consider providing resources (from reserves) to support commercial or other transformational activity. This could take the form of a 'transformation fund' under the control of the senior management team'*.

4. KEY CHOICES

- 4.1 To achieve financial stability and long term service provision to our communities, significant commercialisation is required and there are a number of key choices for the Council to make:
- **Identification of key strands to the commercial strategy** – what key narrative does the Council wish to provide key stakeholders, staff and residents on its proposed approach to commercialisation; on what key themes does it wish to focus?
 - **Revenue v Capital Income** – does the Council intend to focus on capital receipts or long term revenue income?
 - **Criteria for investment** – will the Council set a target rate of return, above current returns available within the financial sector, and how will this be balanced against risk?
 - **Where to invest** – will the Council constrain itself on the location of asset based investments and if so, will it consider commercial and residential assets in a different way?
 - **Commercial return v social return** – will the Council seek social benefit from each asset based investment or seek to invest for the greatest rate of

return, enabling income to be focussed on the key priorities of the administration?

- **Invest to Save Approach** – does the Council want to invest (from reserves or through borrowing) to enable the prioritisation of the commercial approach?
- **Governance** – will the Council seek strong and effective decision making which will support commercial decision making?

4.2 To make these choices the Council will need to consider a number of factors:-

- The balance between **risk and reward** it wishes to strike;
- The balance between **commercial and social return** it wants to achieve;
- The balance between **control and choice** it wishes to exercise in the location of asset based investments;
- The amount of **flexibility and commercial capacity** it wishes to retain and the governance structures required to enable this.

Identification of key strands to the commercial strategy

4.3 Councils may focus on a range of key approaches when considering commercialisation. The LGA in their report ‘Enterprising Councils – supporting Councils’ income generation activity’ highlight a range of options including charging, trading, and asset investment.

4.4 For Hart, it has been a journey which has seen the Council move towards a ‘buyer pays’ approach for those services where there is flexibility of charging at a local level. This should mean that (in most cases) the cost to serve is covered by the cost to the resident. The Council have also effectively utilised shared services as a key method to reduce service costs, whilst enhancing service resilience. Essentially many of the ‘low hanging fruit’ that many councils would take up through commercialisation, have already been used at Hart.

4.5 Therefore in focussing on the future, the following key themes are suggested:

4.5.1 Income generation

To focus on income to be achieved broadly via asset based investments (see paragraphs 4.9 and remainder of paper below by way of rationale)

4.5.2 Cost Reduction

To continue to strive to reduce costs (including overheads) through such approaches as the LGA insurance mutual, better utilisation of the civic offices, and other Hart assets. Also, as proposed by the LGA Peer Review, to take stock of the shared services we have with partners, to ensure that they remain value for money. This will be subject to a separate paper in due course, to Cabinet.

4.5.3 Improve efficiency

This theme has two limbs, the first is to improve the productivity of our staff through the use of improved work process flows and mobile working (in cloud based environments) to improve functionality, reduce duplication of work, and improve integration between systems.

Recognising that Hart is the least deprived local authority in the country, with high educational attainment and hence high levels of customer expectation the next limb is to use technology to reduce demand on our services. By enhancing and improving functionality to our website, interoperability with our other databases, we should be able to establish significant enhancements in customer experience enabling our residents to 'self-serve' at any time of the day or night. This area of innovative technology is being explored and will be subject to a separate paper to Cabinet.

Recommendation I:

That the commercial strategy has three key themes:

- a. To increase income broadly via asset based investments;**
- b. To reduce costs through such approaches as the LGA insurance mutual, better utilisation of the civic offices and other Council owned assets, and a review of the value of shared services;**
- c. To improve efficiency of services, decreasing current or future costs e.g. through digitalisation and demand reduction.**

Revenue v Capital Income

- 4.6 The Council has seen a substantial reduction in Government Grant and at present, is predicted to move into negative grant in 2019. In addition, NHB, which has equated to 20% of the Council's revenue budget, is due to be phased out from 2020/2021 (noting that this is subject to further consultation).
- 4.7 At a time of dwindling revenue, the Council's capital position has been improving. Currently the Council's unallocated reserves are £5.5m (current allocated reserves are £20.96m making a total reserve of £26.46m). The Council's Treasury Strategy sets out how the Council will act to maximise benefit from these reserves, balancing risk and reward. However even with careful management, the level of returns from investments are currently significantly lower than 2% or the rate of inflation. This would suggest that there is a need to use the opportunity to invest capital to secure improved revenue returns.
- 4.8 It must be recognised that significant investments may require use of external funding options, such as the Public Works Loan Board, or alternative providers. As with the other key decisions, such as to build the Leisure Centre, the cost of borrowing would need to be factored, long term, into any business case for asset based investment.
- 4.9 Whatever the case, the primary objective must be to make investments for the benefit, improvement or development of the area, through a balanced investment of acquisition, retention and management of good quality investments, whilst also delivering an effective and significant income return to the Council. In all instances the principle of being relatively risk-averse whilst maximising the return to the Council should be taken in respect of investment opportunities.

Recommendation 2:

That the commercial strategy is to see long term revenue returns, as opposed to capital growth.

Criteria for Investment

- 4.10 Achieving a spread of risk across a greater number of investments and by acquiring them across the range of different property asset classes, namely leisure, office and industrial, is to be desired. It spreads the risk although it has to be recognised that opportunities to do this may not arise, and ultimately if individual business cases are robust, groupings in any individual property class should not pose any increased risk to the Council.
- 4.11 Traditionally the highest returns come from the office and industrial sub-sectors. Currently offices can provide a gross income return of around 7.5%. Industrial income yields can range from 6.0% up to 7.5% for acceptable quality assets and it is known that demand is relatively high for such accommodation – particularly small business units. The retail sub-sector for prime retail property is however, much lower than comparable office/industrial assets and comes with far greater risk. On this evidence it is likely that predominantly office and industrial/warehouse will be targeted for acquisition with no emphasis on retail. Leisure and mixed use investments will also be eligible under the strategy. Residential opportunities are also desirable although they may come with higher management costs.
- 4.12 The investment portfolio will include acquiring some properties to hold and some properties to dispose of depending on the anticipated lifespan of the asset, so as to ensure that the Council has a rolling stock of investments in order to achieve maximum benefit for the Council.
- 4.13 An assessment of all risks will be required in each case of fresh investment in order firstly to value it and then to check its suitability for inclusion in the portfolio. The risks fall into two categories, firstly economic and property market risks in specific property market sub-sectors and locations and secondly asset-specific risks. These can be measured and an assessment made of the likely future performance of the investment carried out based on, for example, the ranges of likely future rental growth and voids of the property and also the projected disposal price or capital value at the end of the period over which the cash flow analysis is being measured. For this reason, in making any decision to acquire or invest the Section 151 Officer will need to prepare a full and auditable assessment of risks and options, including financial forecasting to enable informed decision making.

Recommendation 3:

That any income received pursuant to this Commercialisation Strategy should aim for a 4% net yield on any investment.

Where to invest

- 4.14 The September 2017 Commercial Strategy established that the Council should “be open minded to opportunities outside of the district, which may provide greater rewards,

without enhanced risks". In considering the question of where to invest, the Council must be mindful of the local context and the level of choice available for investment.

- 4.15 Hart would be the preferred location for fresh acquisitions of investment properties, so that reinvestment is directly retained within the local economy and any additional capital expenditure is made in the local area. However, there is a finite and limited supply of property within the local area, and of that supply only a small proportion may be available for purchase at any time that meet the requirements of the Council. The Council must therefore look across a wider area. The M3 Enterprise LEP area, Solent LEP or Thames Valley Berkshire LEP area should also be considered for fresh acquisitions as there is evidence (such as travel to work information for example) that demonstrates that investment in these areas has a positive impact on Hart's economy. The strategy should also permit opportunities for co-investment with partner organisations of good financial and reputational standing. The options of local joint venture opportunities should therefore be supported.
- 4.16 When considering residential assets, whilst there are opportunities outside of the district, there are a significant number of currently untapped opportunities within the district which could be explored. Again the option for the Council to look at Joint Venture or similar approaches, would be appropriate where it results in the Council secure long term revenue streams.

Recommendation 4:

That commercial asset based investment should be within the local region e.g. within the M3 Enterprise LEP area, Solent LEP or Thames Valley Berkshire LEP but residential asset based investment should be within the district.

Commercial return v social return

- 4.17 The Council is here to support and provide services to its residents and this is clearly set out in the Council's Corporate Plan. Therefore it could be reasonably anticipated that the Council may at some future point in time seek to implement a commercial approach that would deliver benefits both financially and socially.
- 4.18 There is, however, a choice to be made between:
- a. the Council implementing a purely commercial approach, delivering maximum revenue, which it could then allocate to services, subsidies, grants or other form of funding, based on the priority of the Council or
 - b. the Council implementing a social commercial approach, which would balance social benefit with financial return.
- 4.19 The choice between these different approaches depends upon the clarity and focus that the Council wishes to exercise in its commercial approach. The early focus however, must primarily follow a strictly commercial approach with the emphasis being on making the Council financially self-sufficient. Only once financial self-sufficiency has been secured then there an added emphasising on securing greater social benefits.

Recommendation 5:

The early focus of this Commercial Strategy must primarily follow a strictly commercial approach with the emphasis being on making the Council financially self-sufficient. Therefore, any asset purchased for the purpose of commercial strategy should be held for revenue gain only. Revenue received from the asset thereafter can then be allocated according to the priorities of the Council.

Invest to Save Approach

- 4.20 As outlined earlier, it was a conclusion of the LGA Peer Review that ‘commercial activities often require initial ‘invest to save’ funding and the Council should consider providing resources (from reserves) to support commercial or other transformational activity. This could take the form of a ‘transformation fund’ under the control of the senior management team’. Recommendation 6 is a one-off budget provision of £500k to buy in approach capacity and expertise – this funding would not be used to fund ‘business as usual’ expenditure.
- 4.21 It is recommended that this funding could be allocated to the Joint Chief Executives, to enable delegated decisions to be taken to ensure the appropriate level of resource and expertise are available to the Council, to make informed choices. This should result in an agile and professional approach to the commercialisation agenda.
- 4.22 To ensure visibility of benefit of this spending, regular monitoring of the commercialisation progress, including budget spend, would be reported to Overview and Scrutiny Committee and Cabinet.

Recommendation 6:

That a £500K ‘invest to grow’ budget is allocated to the Joint Chief Executives, for use to

- (a) utilise specialist expertise or resources, and/or**
- (b) increase commercialisation capacity within the organisation**
- (c) instil commercial principles in management**
- (d) increase commercial awareness throughout the Council and thereby increase opportunities**

Governance

- 4.23 Where commercial decisions have to be made it is important that the Council has in place strong governance arrangements that allow quick, transparent, and accountable decision making processes. The commercial market is very quick and decisive and the Council needs to recognise that decisions made to procure commercial opportunities will not necessarily suit standard local authority decision making processes.
- 4.24 To ensure both accountability and transparency the recommendation (Recommendation 7) is that Joint Chief Executive, in consultation with the Leader, the Chairman of Overview and Scrutiny Committee, and the Section 151 Officer to take all further decisions in respect of property acquisitions and disposals pursuant to this Commercialisation strategy, irrespective of value (albeit this is already limited

by the Council's Constitutional limit on borrowing to £30m in total), and on conclusion of the matter to report back to Cabinet at the earliest opportunity.

- 4.25 An operating procedure needed to be worked up and the relevant Members, in contributing to any acquisition decisions, would need the appropriate support and advice. A full audit trail of any decision would need to be maintained and External Audit also has a statutory role in giving an independent view on any decisions made to ensure proper conduct of financial affairs and the management of performance and use of resources.

RECOMMENDATION 7

To authorise the Joint Chief Executive, in consultation with the Leader, the Chairman of Overview and Scrutiny Committee, and the Section 151 Officer to take all further decisions in respect of property acquisitions and disposals pursuant to this Commercialisation strategy, irrespective of value, and on conclusion of the matter to report back to Cabinet at the earliest opportunity.

- 4.26 To facilitate the appropriate form of decision making Council will need to agree to change the Constitution to amend the Financial Regulations in the Constitution and also amend Article 12 of the Constitution to exclude property transactions pursuant to this proposed Commercialisation strategy from the definition of a 'Key Decision' (Recommendation 8)

RECOMMENDATION 8

To recommend to Council that the Financial Regulations in the Constitution be amended to facilitate the speedy acquisition of property transactions and to amend Article 12 of the Constitution to exclude property transactions pursuant to this Commercialisation strategy from the definition of a 'Key Decision'".

- 4.27 It is recommended that upon the completion of the first acquisition a reflective review should be carried out to learn from experience, and the findings reported back to Overview and Scrutiny Committee.

RECOMMENDATION 9

That upon the completion of the first acquisition pursuant to this Commercialisation Strategy a reflective review should be carried out to learn from experience and the findings reported to Overview and Scrutiny Committee.

- 4.28 In all instances the Council will follow an ethical framework in assets procurement as agreed in the September 2017 adoption of the Hart Commercialisation Strategy 2017-2022.

RECOMMENDATION 10

That an ethical framework should be followed in any asset procurement pursuant to this Commercial Strategy.

5. ACTION

- 5.1 If the Council is minded to accept these recommendations, work can then start in earnest on the commercialisation approach for the Council.
- 5.2 The Council will firstly consider the need for resources to support the approach and whether this can be resourced externally, or whether there will be an element which will need to be delivered internally.
- 5.3 Once resources are in place, the commercial approach will be further developed and deepened. It is anticipated that further reports will be brought forward, during autumn/winter which will outline in greater detail the anticipated work programme in particular associated with themes two and three – reduced costs and increased efficiency.
- 5.4 Monitoring and reporting on performance will be important to ensure the visibility and benefit of the commercialisation. It is anticipated that there will be Annual reports at the end of this financial year with regular six monthly review reports thereafter.

Patricia Hughes, x4143, patricia.hughes@hart.gov.uk

BACKGROUND PAPERS:-

Commercial Strategy – Cabinet September 2017