The business case for the investment in commercial property within a Council owned incorporated group structure

REDACTED VERSION

JUNE 2019
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1.0 Introduction

1.1 The purpose of this business case is to provide a comprehensive appraisal of the objectives, risks, expected financial returns, options considered and the resourcing of a commercial property investment enterprise, working title, ‘Guildhall Capital Ltd’. In preparing the business case, regard has been had to the statutory guidance on the power in Local Authority Act 2003 and the Local Authority (Best Value Authorities) (Power to Trade) (England) Order 2009.

1.2 In developing this business case advice has been specifically commissioned from specialist advisors in the field;

- Trowers and Hamlin LLP – Legal advice (vires, structures, state aid and taxation)
- James Goudie QC – Vires and the specific implications of recent CIPFA guidance on Council trading activity and the treatment of Minimum Revenue Provision (MRP)
- Jones Lang Lasalle (JLL) – Investment Strategy
- Link Treasury Services – The Council’s financial strategy and treasury management approach
- ARK Consultancy Ltd – Oversight and management of the project, the drawing together of this business case and any future business plan.

2.0 The Business Objectives

2.1 Whilst the notion of commercial property investment may not be what many would prefer, the Council has accepted that such income can make a strong financial contribution. The Council already has approximately 150 commercial assets let to third parties from which it derives a gross income of £5.5 million per annum. In expanding this investment activity through a new trading company, ‘Guildhall Capital Ltd’, the Council considers its objectives to be;

- To make intelligent investment decisions and expertly manage a new fund to ensure income returns are sustainable over the longer term
- To reduce the geographical risk in current property holdings (currently all held within the Borough) by expanding ownership of new property into the south-east of England geographical area
- To make a significant financial contribution into the medium and long term towards the Council’s regeneration activities and capital projects as laid out in it’s Investment Policy and updated from time to time.

2.2 The different types of investment properties (or asset classes) to be targeted could include retail (albeit this is not the strongest of asset classes at present), industrial, hotel, leisure, office, and warehouse assets. The rationale for such commercial assets being targeted is;
The residential investment market whilst emerging, has yet to establish itself as an institutional asset class. Avoiding residential also mitigates conflicts with the councils housing responsibilities and policies.

Applying a mix of asset classes, outside the Councils boundary, not only mitigates risk in the portfolio but makes earlier safe investment more likely.

Strong risk-adjusted returns: Over time, commercial real estate has produced strong returns with low volatility compared to other investment classes. (Table 1)

Table 1 - Over time, commercial real estate has produced strong returns with low volatility compared to other investment classes

![Graph showing returns over time]

Source IPD/JLL research

- Large range of purchasing opportunities: Commercial real estate is the third-largest investment class, giving investors a wide range of strategies and opportunities.
- Real Returns: Commercial real estate provides long term real returns set against inflation.
- Recession: Commercial real estate has been found to be income positive during periods of recession (Table 2).
Table 2 - Commercial real estate found to be income positive during periods of recession

3.0 Options Analysis – Commercial Property Investment

3.1 In considering how RBK might undertake property investment in future, the strengths and weaknesses of three potential options have been considered. These are:

- Option A – Stand still with existing assets
- Option B - Continuing with further investment (on balance sheet and within Borough as now)
- Option C - The setting up a wholly owned company for the purposes of wider geographical investment.

<table>
<thead>
<tr>
<th>Option A – Stand still with existing assets</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strengths</td>
<td>Weaknesses</td>
</tr>
<tr>
<td>Simplest of all options with no further acquisitions</td>
<td>Additional income budgeted for in the MTFP from additional assets won’t be achieved requiring operational savings to be made elsewhere</td>
</tr>
<tr>
<td>Council remains in direct control without additional governance</td>
<td>Recent analysis shows that the current RBK portfolio &lt;REDACTED DETAIL&gt;</td>
</tr>
<tr>
<td>No further acquisitions mean current risks and rewards continue subject to market conditions and asset management</td>
<td>Assets can be managed in-house without in depth commercial expertise</td>
</tr>
<tr>
<td>No ongoing strategy for acquisitions required although asset management strategy will be required to maintain value</td>
<td>Potential for some disposals and asset management improvements but unlikely to return substantial rewards beyond those already being achieved</td>
</tr>
<tr>
<td>Assets can be managed in-house at low cost</td>
<td></td>
</tr>
</tbody>
</table>

Source IPD
### Option B – Continue with further investment (on balance sheet and within Borough as now)

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Simple approach consistent with activity already undertaken</td>
<td>• Not possible to legitimately buy outside of borough creating a geographical risk in the portfolio</td>
</tr>
<tr>
<td>• Council remains in direct control without additional governance structures being required</td>
<td>• Continued reliance on external acquisition support will be required directly funded by the Council</td>
</tr>
<tr>
<td>• Council reliant on in-house team with consultancy support to create business case for each purchase</td>
<td>• Public procurement rules apply to all support contracts</td>
</tr>
<tr>
<td>• Can, and has been undertaken quickly without overarching strategy on portfolio outcomes</td>
<td>• Decision making on individual asset acquisitions is slower meaning that only certain assets are targetable</td>
</tr>
<tr>
<td>• Officers retain control of the process without a company structure to service</td>
<td>• Recent analysis shows that the current RBK portfolio derives &lt;REDACTED DETAIL&gt;</td>
</tr>
<tr>
<td>• Geographical boundary is restricted to Kingston</td>
<td>• Exit from project <em>in extremis</em> can only be achieved by selling assets rather than company shares</td>
</tr>
<tr>
<td>• Returns can be higher given the higher risk being taken.</td>
<td>• Investment business cases considered by officers and members who may not have specific expertise in commercial property.</td>
</tr>
</tbody>
</table>

### Option C – The setting up a wholly owned company for the purposes of investment

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Business plan is in place, reviewed annually, and provides a strategic framework for all future asset acquisition</td>
<td>• Buying property for a return is a risk and losses are always possible</td>
</tr>
<tr>
<td>• Allows for acquisition outside of RBK boundary</td>
<td>• Companies are seen by some commentators as being too remote in governance terms</td>
</tr>
<tr>
<td>• Non-executive directors with specific talent in the business stream can be appointed to support the delivery of the business plan</td>
<td>• Rewards are generally lower reflecting the lower risk compared with other options</td>
</tr>
<tr>
<td>• Councillors sitting on the Board develop business expertise which can transfer to other projects</td>
<td>• More complex structure than buying directly on balance sheet</td>
</tr>
<tr>
<td>• Council remains in control always through a robust governance structure</td>
<td>• Structure requires executive support to maintain effective operation</td>
</tr>
<tr>
<td>• Board can appoint property expertise to drive out value from the portfolio</td>
<td>• Conflicts can arise with councillor/officer director appointees where those conflicts are not managed effectively.</td>
</tr>
</tbody>
</table>
| • The outcome portfolio is agreed at business plan stage, so risks are mitigated through targeted acquisitions  
• Procurement advantages - Company can be structured to operate outside of public procurement rules giving it a market competitiveness  
• Risk in the portfolio is reduced through a spread of assets, sectors, and geography  
• Exit from the project can be achieved through sale of shares rather than the assets themselves  
• Is arguably a more ‘professionalised approach’ to asset buying akin to pension fund activity  
• Quick acquisition and decision-making process consistent with the marketplace. |

3.2 Consideration of each of these options against the objectives laid out in paragraph 2.1 have led to the conclusion that **Option C** should be the approach to be explored further in this business case. Even if this Option was adopted as the primary way forward the Council will still own its current portfolio which it might choose either to expand or contract as local opportunities arise and good asset management dictates. The consideration of Option C is therefore not an option that overrides all others but could be argued to compliment it after risks have been considered.

4.0 **The Power to Trade and General power of Competence** (See full legal advice in appended to the covering report to this business case)

4.1 The Council has two general powers granted under legislation that it may use to set up a company. Namely, the general power of competence contained within section 1, Localism Act 2011 (the **2011 Act**) and the power to trade contained within section 95, Local Government Act 2003 (the **2003 Act**).

4.2 **Power to Trade** - As stated above, section 95 Local Government Act 2003 gives the Council the power to trade but is subject to restrictions contained within Regulation 2 of the Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009 (the **2009 Order**).

4.3 The 2009 Order states at Regulation 2 that "a best value authority" (such as the Council) is authorised to do, for any commercial purpose, anything which it is authorised to do for the purpose of carrying out its ordinary functions and will be required to prepare a business case supporting the exercise of the section 95 power and the council must approve this. The 2009 Order goes on to state that a best value authority shall recover the costs of accommodation, goods, services, staff or any other
thing that it supplies to a company in pursuance of any agreement or arrangement to facilitate the exercise of the power to trade.

4.4 **General power of competence** Local authorities have the power to do anything that an individual may do in accordance with section 1 of the 2011 Act. This is referred to as the "general power of competence", and a local authority may use this power for its own purpose, a commercial purpose or/and for the benefit of others. This power is however, subject to a number of limitations, including "pre-commencement limitations"; which confirms that any legal restrictions, prohibitions or limitations that existed prior to 18 February 2012 (when the 2011 Act came into force) will remain in force.

4.5 Whilst the provisions of section 1 of the 2011 Act as noted above provide the general power of competence, section 4 (2) 2011 Act states that where a local authority wants to exercise the general power for a commercial purpose, it must use a company. This has been reinforced by subsequent case law.

4.6 Section 2 of the 2011 Act limits the general power of competence where it 'overlaps' with a power which predates it. This means that where the Council relies on the general power of competence and there is the same power which pre-dates it and is subject to restrictions, then the general power of competence will be subject to these restrictions. An example of this is section 95 Local Government Act 2003, which gives the Council the power to trade, but is subject to restrictions contained within regulation 2 Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009 (the **2009 Order**).

4.7 Reviewing both the power in the 2009 Order and the 2011 Act, Trowers and Hamlins LLP recommend that the general power of competence under section 1 of 2011 Act is used, establishing the company in accordance with section 4 of the 2011 Act. Whilst the requirement of a business plan is specific to the 2009 Order, it is of course prudent for the Council to prepare this in advance of setting up each company to show that the Council has given due regard to all relevant considerations.

5.0 **Anticipated Business Returns**

5.1 The business case has considered forecasts that show that the UK commercial property yields are anticipated to remain steady over the coming years in a range across all property. Individual classes of assets vary but follow a similar path. *(Table 3).*
Table 3 - Yield forecasts are anticipated to remain steady over the coming years

Source JLL June 2018

5.2 The expected company returns from the initial £68 million investment portfolio are:

- **<Redacted Figure> % net initial yield**
  - This represents the aggregated entry price of the portfolio of assets when fully invested
  - Net yield is defined as net of purchase costs including stamp duty and professional fees
  - Individual assets will show different return profiles ranging either side of the target initial yield reflecting varying risk profiles
  - The portfolio would be anticipated to contain between <REDACTED FIGURES> properties.

- **<Redacted Figure> net distribution**
  - This represents the indicative distribution yield to the Council net of all costs including finance
  - There are no income growth assumptions made as this is implicit in the purchase yield.

6.0 Financial Strategy <Redacted Section>

7.0 **Investment Strategy and Portfolio Mix – Asset ‘Type’ and Asset ‘Class’**

7.1 The timing, type and mix of investment acquired will be dependent upon both market conditions and opportunity. Whilst this business case sets out the initial investment criteria, it should be recognised that the investment strategy must be kept under review (annually) so that material changes in occupational markets or emerging investment markets may be accessed and decisions taken to exit or enter these. Over time therefore the initial makeup of the portfolio of assets will change.

7.2 JLL has been engaged to provide strategic investment advice and, in doing so, have categorised suggested portfolio’s individual assets into three principal asset types. (Table 7) The types are:
core - These assets are lower yielding, lower risk with limited added value
Core Plus – These are higher yield, higher risk, but with added value opportunities
Opportunistic – These are high risk but come with greater reward and are often development led.

Table 7 - Target split recommended by JLL for the fund once fully invested

7.3 Each of the categories has a ‘profile’ which has led to this weighting assessment. The profile for each of the three types, including liquidity considerations, is summarised as follows; <REDACTED LIST>

7.4 Beyond this asset type, balance in the portfolio is also achieved through a mix of asset classes. Although available opportunities determine the final portfolio and mix, JLL has considered how the fully invested fund asset allocation could be targeted. (Table 8). The principal asset classes targeted for investment are <REDACTED LIST>

7.5 The targeted geography is an area covering <REDACTED>. This offers the best opportunity of establishing a balanced portfolio swiftly and safely with a wider pool of assets available. JLL analysis shows that in the last two years Kingston Borough in isolation has seen 25 major commercial property transactions with a value of £285 million. The target area for this business case however has achieved 864 transactions in the same time frame with a value of £10.1 Billion.

Table 8 – Sample asset class allocation for the fund once fully invested

8.0 Risk Mitigation

8.1 There are, as with all commercial investments, risks associated with returns. The financial case should be read alongside the risk register in Appendix B, Table 9 and Table 10 below.

8.2 The investment criteria have been set specifically to mitigate risk in the portfolio. Table 9 highlights the key investment criteria and the outcome associated with each risk should that attribute not be present.

Table 9 – Investment Criteria Risk Mitigation

8.3 In addition, there are other individual asset attributes which impact on business case risk and if not mitigated might have an indirect impact on performance over time. Table 10 below identifies these.
There has been significant speculation in the financial press over the past months that CIPFA guidance will be strengthened to restrict, as far as possible, this type of investment activity using borrowing. Previous guidance has reminded Council’s about the restrictions of ‘borrowing in advance of need’ to invest in commercial ventures, although stopped short of restricting this activity in its entirety. Counsel advice has been sought on the current position a written opinion upon which has been supplied separately to this business case but should be read in conjunction with it.

Comparing returns with other investment opportunities

This investment decision is made against a background of historic low interest rates which, in part, has made the option for gearing these types of investments that much more attractive. This however won’t be the case even in the medium term and returns will be lower now than they might have been just a year or two ago.

The Council has been using cash balances to internally borrow for its capital programme as opposed to using more expensive external borrowing. This has driven the level of cash balances down. Any remaining cash balances are largely used for cashflow purposes and as such are kept relatively short dated and largely overnight. There are not therefore significant existing investments to compare this opportunity with. The Council does however hold small sums with Royal London and has invested in commercial property ‘on balance sheet’.

For comparison, as of June 2019, indicative yields for various other investments (including current investments already being funded by the Council) are identified in Table 11.

The Council acquired both Conquest House, an office and associated retail asset and Kingsmill, a mixed-use business and industrial asset in the Borough in 2017. These deliver gross yields of <REDACTED FIGURES>. The net return yielded to the Council after borrowing costs for each are <REDACTED FIGURES>. This business case indicates a slightly lower net yield at <REDACTED FIGURE> arguably reflecting the lower spread of risk in the investment.

Corporate Structure Legal Advice (See full legal advice appended to the covering report to this business case)

Local Authorities have general powers to acquire and dispose of land either for the Councils functions or for the benefit or improvement or development of their areas, but when trading or exercising their power of general competence for a commercial purpose this must be done through a company.
10.2 Trowers and Hamlin LLP have been appointed to support the Council with legal advice regarding the most appropriate delivery and governance framework for a Capital Investment Fund Company and other companies that the Council may want to set up in future.

10.3 The proposal is that the Council sets up a wholly-owned company ‘Holdco’ or parent company (working name RBK Holdings Ltd) that would hold shares in this and other subsidiaries it might set up in future. Day to day oversight of the holding company would be undertaken on behalf of the Council by a Shareholders Committee populated by members of the Council. Table 12 shows a graphic representation of the structure.

10.4 Although this structure seems at first sight to be complex, in fact it affords maximum flexibility for the Council and is highly resilient to potential political, corporate, constitutional or governance changes. This is because shares in companies can be transferred to other parties (such as another local authority, a private sector investor, employees), assets and potential liabilities are "hived off" within separate legal entities, companies can be wound up in the event of a desired exit and new subsidiary companies can be established relatively quickly to fulfil different objectives. If not trading for ‘public purpose’ there can be procurement advantages and companies can also be merged if it is felt desirable to amalgamate/consolidate operations.

Table 12

10.5 Incorporated group structure – The suggested structure is a group corporate structure with a holding company and separate subsidiaries and is considered the most appropriate given the multiplicity of objectives RBK wishes to achieve. This, they advise, will help ensure clarity of purpose, more focused business plans, increased resilience and better legal compliance in terms of separation of statutory functions, the ability to separate commercial from social policy objectives and facilitate risk management.
10.6 **Public procurement implications for the proposed structure** - RBK will be familiar with the public procurement rules in the form of the UK Public Contracts Regulations 2015 (PCR) which implement the European Public Procurement Directive 2014. This means that the Council (as a contracting authority) and any company classified as a "body governed by public law" must generally advertise in OJEU and competitively tender public contracts for supplies, services, works, works concessions and services concessions above the relevant applicable contract value thresholds unless a specific exemption can be proven.

10.7 It is possible to establish a Council owned or controlled company which is not a "body governed by a public law" and hence the company does not itself need to comply with the PCR. "A body governed by public law" is defined in PCR Regulation 2(1) as an entity which has the following characteristics: -

(a) established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character;

(b) having legal personality; and

(c) having any one of the following characteristics: -

(i) **financed**, for the most part, by the State, regional or local authorities (e.g. the Council), or other bodies governed by public law; and/or

(ii) subject to **management supervision** by those authorities or bodies; and/or

(iii) having an administrative, managerial or supervisory **board, more than half of whose members are appointed by the State**, regional or local authorities (e.g. the Council), or by other bodies governed by public law.

10.8 If the relevant company were to meet the requirements (as set out in (a), (b) and any one of (i) or (ii) or (iii) (c) above) of a body governed by public law, then that company would be considered to be a 'contracting authority' and would have to advertise and competitively tender for its works, service and supply contracts in OJEU and follow the PCR.

10.9 In terms of the recommended structure, a holding company could be established as a "body governed by public law" and hence subject to the PCR. The holding company could then hold the property investment subsidiary which is established for commercial purposes/having commercial character (and therefore is not a body governed by public law and not subject to the PCR). This would leave the company with the advantage of having the same legal position in procuring services as its market competitor.
11.0 Appointment of Council Directors and preventing conflicts of interest

11.1 Elected members who act as Council-appointed company directors would not be entitled to remuneration above and beyond normal members' allowances. It would be advisable and is proposed within the emerging business case for the venture, to appoint one or more non-executive directors to the boards who have relevant experience in the relevant business sectors: i.e. commercial property investment, if they are not elected members they can receive remuneration.

11.2 The Council's participation in a company inevitably gives rise to governance issues to ensure adequate checks and balances to ensure public money is being wisely spent and there is reasonable accountability and transparency in relation to the company's business whilst not unduly hampering the company's need to act commercially.

11.3 Council-appointed directors (especially if they are officers and above all, if they are elected members) should be aware that their position as company director can place them in a position of potential personal or professional conflict of interest with their duties as an employee/elected member of the Council.

11.4 Company directors are under a personal statutory duty to act in the best interests of the company (rather than the interests of the entity who appointed them or any individual shareholder) and company directors may sometimes be under confidentiality obligations pursuant to non-disclosure agreements in respect of company transactions. This can put an individual who is a Council-appointed director in a difficult position.

11.5 Typical examples are where that individual who is a company director is also involved in making decisions or recommendations about planning applications (for example either as a member of the development control committee or an officer advising that committee). Where such an individual has a conflict of interest then this can lead to potential personal and (in the case of a disclosable pecuniary interest) criminal liability.

11.6 Training will be given by the Council's legal advisors to all new Directors as part of an induction process prior to any trading commencing.

12.0 Shareholder's or Investor's Committee

12.1 The potential for establishing a Shareholder's Committee has been explored to replace the Holding Company function and provide day to day oversight of trading company activity.

12.2 Although this could ensure that the company is delivering on its business plan and holds the company/companies to account for a return on the Council's investment, it could also extend the practical process for investment and make the company less competitive in the marketplace. In addition, the role could, in the process, be conflated with the Council's role as a commissioner or purchaser of services from the
company which is separate and, in some instances, may even potentially conflict with the shareholder/investor role.

12.3 The Council in its capacity as shareholder is subject to various duties and responsibilities including monitoring the performance of the companies it holds shares in and minimising any loss of shareholder value. Investors of public money and shareholders of companies owned by public bodies are accountable for taxpayers' money and must have in place clear procedures for evaluating the performance of an investee company and demonstrating value for money.

12.4 The following table (Table 13) summarise the points covered in this report into three options and then by advantages and disadvantages. The options are:

- Shareholders Committee and Direct Council subsidiary model
- Holding Company with subsidiary model
- Holding Company with subsidiary model and oversight Shareholders committee.

<table>
<thead>
<tr>
<th>Option 1 - Shareholders Committee and subsidiary model</th>
<th>Option 2 - Holding Company with subsidiary model</th>
<th>Option 3 - Holding Company with subsidiary model with oversight Shareholders Committee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advantages</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Council maintains responsibility for approving capital financing for the investment and approving its business plan annually. Shareholder Committee has direct control over the company appoints/dismisses all Directors. Could be considered by observers to exact the control that should be expected over a Council owned commercial entity.</td>
<td>Council has direct control over the holding company and appoints/dismisses all Directors. The Holding Company is not constituted as a Council Committee so can act upon its authority under the approved business plan swiftly and maintain commercial advantage. A Holding Company could be established as a &quot;body governed by public law&quot;</td>
<td>Council has direct control over the holding company and appoints/dismisses all Directors. The Holding Company is not constituted as a Council Committee so can act upon its authority under the approved business plan swiftly and maintain commercial advantage. A Holding Company could be established as a &quot;body governed by public law&quot; and hence subject to the PCR.</td>
</tr>
</tbody>
</table>
and hence subject to the PCR. The holding company could then have its investment subsidiary which is established for commercial purposes/having commercial character (and therefore is not a body governed by public law and not subject to the PCR).

A Shareholders Committee, ‘the eyes and ears’ of the Council coupled with a commercial Holding Company to enact the approved business provides governance oversight and commercial purpose with clearly defined responsibilities.

<table>
<thead>
<tr>
<th>Disadvantages</th>
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<tbody>
<tr>
<td>Shareholder Committee will be responsible and has direct control for releasing funds as assets for acquisition arise. The nature of its role as both a Council Committee and commercial lead may cause conflict for those sitting on it.</td>
<td>A Holding company with direct oversight for the Council might not be considered by observers to exact the control that should be expected over a Council owned commercial entity despite directors being elected members.</td>
</tr>
<tr>
<td>The necessary governance surrounding Council Committees may inevitably result in delays in the commercial process and put the trading company at a trading disadvantage.</td>
<td>More complex than options one and two with increased levels of reporting. Possible duplication.</td>
</tr>
</tbody>
</table>

Table 13

12.4 It is proposed therefore that the Council does appoint a Shareholder Committee but instead of replacing the Holding Company function, is put in place by the Council to provide regular oversight in a manner that may be less effective if undertaken by full Council itself. The structure allows for strong oversight by a Shareholders Committee, the release of trading funds by a Holding Company to the Capital Investment Fund Company when needed, but at the same time allows this company to undertake its activities promptly and compete in its chosen market.
12.5 The Council’s Shareholders Committee would be an ‘eyes and ears’ Committee, populated by elected Members only constituted as other Committees of the Council and appointed to as per the Council’s constitution. The Committee would adopt the Institutional Shareholders' Committee's Statement of Principles in relation to the companies and establish a work programme which:

- Regularly monitors the performance of all Council companies
- Establishes timescales to facilitate the regular dialogue with investee companies
- Sets out triggers where it will intervene (e.g. reappoint directors if there is no progress against the Business Plan for say 1 or 2 years, or if the company is dormant)
- Evaluate the impact of the company
- Set out a clear policy on discharge of responsibilities
- Timetable public reports on how the companies are performing against their business plan.

12.6 The Council should ensure this Committee incorporates an annual audit framework' which seeks information from companies in which the Council is a shareholder or has an investment. This information should at the very least, comprise the annual accounts, reports and statements that are required under the Companies Act 2006.

12.7 The Holding Company will be populated solely by directors who are also elected Members.

12.8 The selection of Directors will be based on a comprehensive skills and experience evaluation process which will seek to appoint based on skill and experience. Ideally all elected members would be considered for these roles if they have an interest, the aim being to select competent Directors from the widest pool to maximise the opportunity for trading success. It might also be appropriate to select a company secretary (although not a legal requirement) from SLT to support the Board. This shouldn’t however be an officer holding a statutory role.

12.9 It is anticipated that the following appointments will be necessary for the Holding Company Board; (A role profile developed for the role is attached as Appendix C1)

- Three Elected Members
- A member of the senior officer team to provide executive support.

12.10 The following appointments will be necessary for the ‘Guildhall Capital’ Company Board; (A role profile for the role is attached as Appendix C2)

- Two Elected Members from the Council
- Three Independent Non-Executive Directors with specialist commercial property experience (Remunerated).
13.0 VAT Implications for the various entities within the group

13.1 The Council benefits from a favourable VAT regime which is not applicable to Holdco or the subsidiaries. Trowers were asked to comment on the VAT implications for each entity within the group.

13.2 In broad terms, Trowers would expect the subsidiary investing in commercial property to be in a full VAT recovery position i.e. it should be able to recover all of the VAT it incurs on land acquisitions, construction, fees etc. This is on the basis that it opts to tax each property it acquires which is common for commercial property. They would also expect it to be able to acquire most let properties without paying VAT under the transfer of going concern provisions (which should save SDLT as SDLT is payable on the purchase price plus VAT).

14.0 Summary and Conclusions

14.1 This business case, in summary, indicates reasonable returns, once fully invested of up to £1.4m in earlier years depending on the financing strategy progressed which compares favourably with existing and alternative investments, after reasonable mitigations in risk associated with the venture. The variable, as with all geared investments, is the cost of borrowing, treatment of MRP and equity. The various options for this are presented in Section 6.0 of this business case. With low borrowing costs (albeit rising) and access to finance, the conditions are currently reasonably favourable for such an investment although not as advantageous as they were only a year or two ago.

14.2 This business case is predicated on appointing experienced and remunerated non-executive directors to the trading Board, with a track record in the commercial property industry. The strength of the outcome will be based upon the competent and professional future management of the fund, robust acquisition choices and a coherent process for acting and acquiring assets quickly once identified. The appointment of acquisition support and a fund manager would be undertaken by the appointed Board and that Board appointed through a robust skills audit and external selection process.

14.3 The appropriate balance of political membership, executive support and independent non-executive directors is a key decision in ensuring optimum performance. Should this business case be approved the next stage is the development of a specific business plan for approval by Council, based upon this business case, which will be the fixed basis upon which the company will be delegated to trade. The target for commencing trading is from September 2019.

- An agreed financing model with cashflow forecasts
- Specific taxation advice
- Skills audit process and the appointment of Directors
- Final review of Risk and Business Strategy prior to trading
- Governance, delegations and risk/performance reporting policies
A linking of the financial returns generated with wider projects as outlined in the Council’s investment policy
Glossary of terms

**All risks yield** - The return an investor seeks, after costs, taking account of all aspects of the property, and economic assumptions. Essentially the reciprocal of “Years Purchase” – the number of years’ nominal rental income needed to recover purchase price x 100%.

**Balanced Portfolio** – These are the assets that the company will hold in a variety of sectors, such as retail, industrial, office for example. The mix ensures that no one asset will place undue risk on the portfolio as a whole.

**Book Value** – The value of an asset as held on the Council’s balance sheet and reviewed each year.

**Capital Invest Fund Company** – This is the investment company that will own assets on behalf of its owner RBK Council

**FRI Lease** - Tenant is fully responsible for repairs, insurance and all property costs i.e. landlord receives rent and need not deduct anything whilst lease is in place. Repairs and maintenance are recovered via a service charge for multi-let properties.

**Internal Rate of Return (IRR)** - A return calculation or projection based on a cash flow of income streams and costs over a set period. Generally calculated on a 5 or 10-year basis, with specific assumptions on value growth, costs and occupancy.

**Lot Size** – The price that would be paid for an individual asset.

**Net Equivalent Yield** - A time weighted average return (allowing for acquisition costs) interpolating between net initial yield and net reversionary yield. A useful tool to contrast assets with differing rent review patterns.

**Net Initial Yield** - The return to an investor after allowing for deduction of acquisition costs – namely property advisors, legal fees and stamp duty.

**Net Reversionary Yield** - The return that will accrue to an investor in the future on the basis of an expected rental increase (due to rise in the market) after allowance for acquisition costs.

**Upwards only rent review** - Rents are reviewed at intervals during the lease, often 5 years – even if the market rental value has fallen, the rent payable is in lockstep – it cannot go down, only up if the market has risen.

**Weighted Average Unexpired Lease Term (WAULT)** – The average remaining life of leases within the portfolios.

**Yield** – The income returns from a property in ownership. The calculation is Annual Income received, divided by Property Value, multiplied by 100 (expressed as a percentage).
Appendix A – 'Guildhall Capital Ltd' - High level Financial Summary Year 1 of full investment

Appendix B – Summary Risk Register (To be read in conjunction with Section 8.0)

Appendix C – Company Director Role Profiles

- C1 – Holding Company Board Director Role Profile
- C2 – ‘Guildhall Capital Ltd’ Board Director Role Profile
REDACTED APPENDIX A - High level Financial Summary Year 1 of full investment

REDACTED APPENDIX B - Summary Risk Register
APPENDIX C1 – Holding Company Board Director Role Profile

<table>
<thead>
<tr>
<th>Purpose</th>
<th>Skills/Knowledge/Experience</th>
<th>Behaviours</th>
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</thead>
</table>
| To act on behalf of Royal Borough of Kingston upon Thames and support the activities in, and hold the trading Boards to account, for the activities approved by the Council in subsidiary business plans. | ✷ Knowledge of property, regeneration and asset management and the Council’s asset and investment ambitions.  
✦ Ability to formulate short and long-term objectives for the company.  
✦ Ability to scrutinise, critically appraise and approve business plans and provide constructive challenge in their development.  
✦ Ability to agree annual budgets for both revenue and capital expenditure and approve necessary policy that drives the outcomes set within the business plan and underlying strategies.  
✦ Ability to review and monitor performance data and ensure that management information provided is sufficient to enable the parent Council to be confident in its investment.  
✦ Ability to understand effective controls and risk management.  
✦ Ability to enhance the reputation and image of the company by representing it as an ambassador at key events both internally and externally. | ✷ To uphold the values and objectives of the company and its parent Council and maintain an understanding of its role in providing support for delivering asset and investment strategy ambitions.  
✦ Uphold core policies including the code of conduct, delegated authorities and financial regulations  
✦ Ensure an understanding of the constitutional and legislative powers as they relate to the company and act within them.  
✦ Contribute and share responsibility for Board decisions, including a duty to exercise reasonable care, skill and independent judgement.  
✦ Prepare for and attend meetings any training sessions and other events  
✦ Attend and participate in reviews linked to individual performance and that of the whole Board.  
✦ Declare any relevant interests and avoid conflicts of interest  
✦ Respect confidentiality of information  
✦ Uphold the adopted code of Governance |
### APPENDIX C2 – ‘Guildhall Capital Ltd’ Board Director Role Profile

<table>
<thead>
<tr>
<th>Purpose</th>
<th>Skills/Knowledge/Experience</th>
<th>Behaviours</th>
</tr>
</thead>
</table>
| Undertake property investment activity on behalf of the shareholder and in doing so generate a revenue income to be used to support the front-line service ambitions of the Royal Borough of Kingston upon Thames. | - Knowledge of property sector investment and ability to critically appraise investment opportunities and the returns and risks inherent in such investments. *  
- Ability to drive business direction as set by the group parent company, formulate short and long-term objectives for successful commercial property investment. *  
- Ability to drive the future development of the business plan and provide constructive challenge to the group parent company setting it.  
- Ability to agree annual budgets for both revenue and capital expenditure and approve necessary policy that drives the outcomes set within the business plan and underlying strategies.  
- Ability to review and monitor property asset performance data and ensure that management information provided is sufficient to enable the group parent company to be confident in its investment. *  
- Ability to ensure a framework of prudent and effective controls, which enable risk to be identified, assessed and managed.  
- Ability to enhance the reputation and image of the company by representing it as an ambassador at key events both internally and externally.  

*Desirable for Council Elected Member Directors but Essential for externally appointed Directors | - To uphold the values and objectives of the company and its owners and hold an understanding of its role in providing profit for public service purpose.  
- Uphold core policies including the code of conduct, delegated authorities and financial regulations  
- Ensure an understanding of the constitutional and legislative powers as they relate to the company and act within them.  
- Contribute and share responsibility for Board decisions, including a duty to exercise reasonable care, skill and independent judgement.  
- Prepare for and attend meetings any training sessions and other events  
- Attend and participate in reviews linked to individual performance and that of the whole Board.  
- Declare any relevant interests and avoid conflicts of interest  
- Respect confidentiality of information  
- Uphold the adopted code of Governance |