

Public Accounts Committee: Inquiry into the Regeneration Investment Fund for Wales

Paper from former Board members of the Fund

Introduction

1. This paper responds to the Public Accounts Committee's request to former Board members of the Regeneration Investment Fund for Wales for comments on the Auditor General's report as part of its inquiry. The Committee asked for information on the Board's role, perspective and actions taken on the property sales.
2. The paper is submitted on behalf of five of the six former Board Members of the Fund, namely: Ceri Breeze (Welsh Government - Board member from March 2010; Chair from October 2011); Councillor Christopher Holley (WLGA Representative – Board member from November 2010; Jonathan Geen (Acuity Solicitors – Board member from December 2010); Richard Anning (Sydney and London Properties – Board member from December 2010); Richard Harris (Welsh Government – Board member from July 2012 to June 2013).
3. The following pages highlight information the former members of the Board consider important to the Committee's inquiry. The points major on the portfolio sale and the valuation which underpins the report's findings. Where appropriate, information is also provided on matters which were put forward during the study but which are not reflected in the report.

Background

4. The Auditor General's report sets out in detail the concept of the Fund, its structure and how it was established. Without repeating its contents, the former Board members believe there is a need to highlight some aspects of the Fund as discussions during the Value for Money study revealed some confusion and misconceptions about its nature and purpose. As the report acknowledges, the Fund was innovative and quite different to most bodies established by Government.

Wales-Wide role

5. The Fund was established to invest money in regeneration projects in order to create jobs. Whilst there was a prominent EU element to the Fund, it was set a clear Wales-wide role by Ministers. This was at the forefront of the Board's role and thinking

Operating environment

6. The establishment of the Board and the Fund's operation from January 2011 coincided with deep recession, which had significant impact on the property market and property values. Forecasts were of declining property market and

very poor prospects for recovery. Any review which takes place some years later will inevitably encounter difficulties in achieving a full understanding of the operating environment at that time and the prevailing circumstances.

7. In 2011, rising unemployment and a lack of senior bank debt combined to create an environment of severe economic uncertainty. The fund had been created with the specific intention of assisting in alleviating these types of issues; i.e. market intervention to address finance problems encountered by projects so that regeneration and job creation in particular could proceed. In 2011 and 2012, there was a significant degree of urgency to assist the economic regeneration in all parts of Wales.

Investment vehicle not property speculator

8. The report puts forward an alternative approach to the disposal of assets with a phased disposal over several years and developmental action to secure higher returns over an extended period of time. However, the Fund was not established as a property investor or developer and therefore had a completely different set of commercial drivers. The Fund was designed specifically to compete in the secondary banking sector, providing finance for regeneration for organisations which were not been in a position to obtain sufficient senior debt from traditional sources.
9. As stated in the report, the Fund's chief assets were land, which it needed to sell to facilitate investment in regeneration projects. The time between the sale of assets and the receipt of cash was a key consideration, together with projected cash needs of pipeline projects both inside and outside the ERDF area. The Auditor General's report is clear that, given this context and in difficult economic circumstances, the Board's decision to arrange for the early disposal of the Fund's portfolio was reasonable based on the advice it received.

Business Plan

10. The Asset Realisation Plan was dictated by the Business Plan. The Business Plan had three core elements, namely the "Pan Wales" investment plan to meet the Fund's Wales-wider remit, the investment plan requiring ERDF requiring match funding, and finally, and perhaps not given sufficient prominence in the report, to create a business model which would attract significant external equity investment representing a significant multiple of the public investment of £55,000,000.

The portfolio sale

11. The Fund was referred to the Auditor General specifically in relation to the portfolio sale of its assets. Whilst the Auditor General extended his Value for Money study to consider the establishment of the Fund by the Welsh Government and matters relates to its oversight of the Fund, the primary issue is the sale of the portfolio of properties and whether or not it was undersold.
12. The Auditor General concluded neither the Welsh Government nor the Fund can provide public assurance that the land and property portfolio sale achieved best

value for money. There are two elements to this. Firstly, the return on the assets as they were sold i.e. as stated above, an early disposal via a portfolio sale. Secondly, and quite different, the return which might have been possible from the alternative, completely different, strategy of holding on to sites and phasing sales over an extended period based on speculation on the recovery of the property market.

13. The alternative approach is recognised by the former Board members as another option but one which is at odds with the prime purpose of the Fund i.e. an investment vehicle, and the way it was constituted. It is clear the Welsh Ministers did not envisage the Fund as a property developer. It was not in the brief given at public appointment of Members and had it been the intention, it is likely a larger Board would have been appointed to include members with the relevant development expertise.
14. This paper focuses on the former, which is the nub of the original referral to the Auditor General i.e. whether or not the sale, in the way it was done, was made at under value. The report's conclusion about being unable to demonstrate best value was achieved is acknowledged. However, this does not mean the portfolio was actually sold at undervalue, and our view is the valuation evidence presented cannot support any such assertion.

Valuation

15. The critical factor is property valuation, which is influenced by a wide range of factors. The Auditor-General commissioned the District Valuer to produce a valuation and it is the foundation for many of its conclusions. It is not for the former Board members to specifically challenge the individual valuations of the District Valuer, as the Board relied upon the advice it received. However, a number of points are important to the Committee's inquiry.
16. We have significant concerns about the methodology which underpins the District Valuer's valuation, which is unconventional, and the lack of transparency around it. Unfortunately, the former Board members have not been allowed access to the valuation, and therefore have been unable to undertake any proper scrutiny. This contrasts with the Board's approach of allowing unfettered access to the valuation it commissioned from Colliers. The lack of access puts the former Board members at a disadvantage in commenting on the valuation and it therefore welcomes this opportunity to highlight to the Committee its concerns and questions to inform the inquiry.
17. From our discussions, there appears to be a possible departure from the aim of the Valuation Brief issued to the District Valuer. It is clear the District Valuer was not considering the valuation exercise in the context of the Fund's Business Plan. His approach allowed for phasing of disposal to obtain the maximum possible value and he appears to have concluded the potential for creation of additional value by speculative capital expenditure as a property developer. As stated earlier, the Fund is not a property speculator or developer and was not established as such.

18. There is a question on whether the District Valuer has taken a different approach to the valuation of the Lisvane site for the Auditor General to that he has undertaken in his commission for Cardiff City Council. As the Committee is no doubt aware, the District Valuer was also commissioned by the Council to advise on the planning process for the Lisvane site. This is further discussed under “Outcomes” at the end of this paper.

Planning advice

19. Of all the valuations presented in the report, the District Valuer’s is the outlier. It is considerably higher than those of four major firms. Significantly, it is the only one which, to the Board’s knowledge, has not been subject to any professional Planning advice, which is considered a prerequisite for a valuation of this nature.

Hope value or overage but not both

20. The District Valuer’s valuation is based on an unconventional approach and there is a question on whether it meets the Royal Institution for Chartered Surveyors’ Red Book standards. The valuation is a quite different approach to the other professional valuations and therefore, is not “like-for like”. The report acknowledges the District Valuer’s figures are predicated on different valuation assumptions and an alternative approach to disposal but unfortunately, it has been perceived as being a like-for-like comparison with the other valuations, which it is not.

Open marketing and a willing buyer

21. The report (footnote 71, page 76) explains the District Valuer’s valuation is based upon an open sale of the portfolio, supported by proper marketing, between a willing seller and willing buyer, in which both parties acted knowledgeably, prudently and without compulsion.
22. On the point of open marketing, it is important to note even with such a campaign it does not automatically mean the assets could have achieved a higher figure. This is Deloitte’s view in its report for the Welsh Government.
23. A valuation cannot be realised without a willing buyer. By the very fact of the sale, the Fund can demonstrate a willing buyer for the portfolio at the valuation price. The District Valuer has been unable to produce any plausible evidence of a willing buyer at his, much higher, valuation figure.

Prudent Lotting / Phasing of development

24. “Lotting” refers to the parts of an asset or collection of assets which can be broken up and sold separately. The valuation of such assets should be done on the assumption that they will be lotted in such a way as to maximise the proceeds of sale. In relation to undeveloped land, prudent lotting can take place without phasing for a valuation certificate provided the valuer is confident that at the specific valuation date there will be sufficient parties to exchange contracts on every one of the lots being put forward. In reality, lotting usually takes place where the phasing of development is envisaged.

25. The lotting of large areas of land which does not have the necessary infrastructure or planning consent is counter-productive. The attraction for a property speculator is the ability to control the planning process and the timing of the infrastructure. At Lisvane, there are already a number of land owners and therefore, to some extent, a "committee" approach has had to be coordinated. This would have been exacerbated by any sub-dividing of the Fund's land at Lisvane at the point of sale and would have made it far less attractive. If such an approach had been taken by the Fund, in all probability it would have attracted a lower overall price.

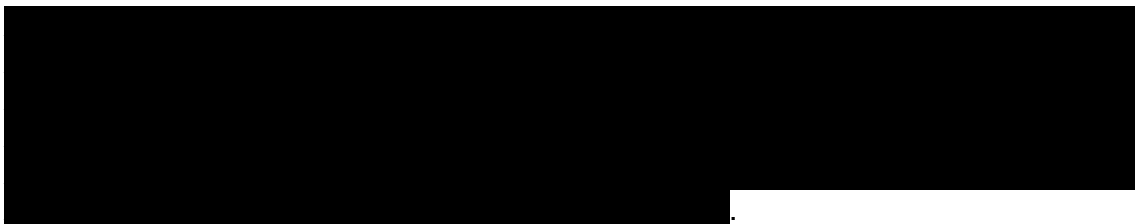
Net Present Value

26. The phasing of payments for large land sales is common. There is an opportunity costs to such arrangements. The critical issue is that that an appropriate discount value is used when calculating Net Present Value. The District Valuer appears to have used a discount value which would be appropriate for a property developer. Given that Fund is not a property developer, a discount value for a vehicle similar to the nature of the Fund would have been more appropriate.

Apportionment

27. When land is sold, there is an apportionment of the income or expenses between the vendor and the purchaser. The table in Appendix 3 does not include the apportionment of the sale consideration for the portfolio. This is particularly important when assertions are made concerning properties which should, or should, not, have included overage in the contract. We confirm the extent of the knowledge of, and recommendations received by, the former Board members concerning the two sites which should have had an overage calculation attached to them. In a sale, it is in the interest of the vendor, in this case the Fund, to secure the lowest possible base values of sites which are most likely to provide the greatest uplift and therefore the greatest percentage increase in additional income from the sale.

28.



Discount for Property Portfolio Sale

29. The former Board members relied upon the advice of Amber and Lambert Smith Hampton. The subsequent valuation advice from the various valuers suggests different discounts. This is clearly a matter for conjecture.

30.





Action by the former Board members post sale

31. In view of the concern raised about the terms of the contract for sale, the Board decided to undertake its own independent review. Messrs Colliers International was instructed to prepare an independent comprehensive report, which was supportive of the value achieved. The full report was made available to the Wales Audit Office.

Outcomes

32. In relation to Monmouth and Lisvane, it is important to note the current environment is completely different to that which existed in 2011 and 2012. There is now ample senior debt available for housing development and the national House Builders are keen to acquire land and commence development as soon as is practical. In any consideration of the outcome with the benefit of hindsight, the different economic conditions must be reflected.

Monmouth

33. The Board was correct to accept the advice that this was a speculative residential site. The granting of Planning Consent by Monmouth District Council was on the basis of a split vote and a majority of one.
34. The former Board members are not fully aware of the commercial matters associated with the recent disposal of the site. However, we understand that a detailed report on the marketing campaign, its results, subsequent negotiations, and conclusions was submitted by Lambert Smith Hampton to the Wales Audit Office prior to the publication of its report. It is understood that following a full marketing exercise, there was a competitive bidding process and detailed negotiations, which arrived at a headline price but on the basis of a phased payment. This is normal for large land sales. The headline price achieved is understood to be slightly below the valuation advice given to the Board at the time of sale. This indicates that Lambert Smith Hampton had appropriate knowledge of residential land values as at the date of sale.

Lisvane

35. The planning position has yet to be resolved. A Planning Inquiry in relation to the proposals was held in July 2015. We understand significant discussion took place as to the potential land value for the purposes of Community Infrastructure Levy. It appears Cardiff City Council has been promoting a rate of £400,000 per acre, whereas the national House Builders have been promoting a rate of £600,000 per acre. Under normal timetable arrangements, the Planning Inspector's report would probably now be with the relevant Minister for review and decision. However, we understand that the Inspector is likely to reconvene for two days later this month, which means it may not reach the relevant Minister until the end of the year.

36. None of the former Board members were present at the Inquiry but we are aware representatives of both Lambert Smith Hampton and Amber were present and heard the evidence given by the District Valuer. We understand that as part of his evidence and during cross-examination, he stated it was particularly difficult for valuers to assess “hope value”, presumably because of the lack of certainty as to density, “abnormals”, the risk that Planning Consent might not be obtained, and the time taken to achieve that consent. In light of this, it would seem reasonable for the District Valuer’s “hope value” valuation of the Lisvane site to be reviewed against the range of valuations produced on or around the time of sale given the fact that his is the outlier.
37. It should be noted that the rate adopted by Lambert Smith Hampton for the net developable acre was in line with the House Builders’ opinion at the Public Inquiry.

Conclusion

38. This paper is provided to assist the Committee’s in taking evidence on matters relating to the Fund. As requested, it focuses on matters relating to the Board’s role, perspective and actions taken on the property sale. It summarises key points on a range of matters, behind which is detailed, technical, information relating to land and property transactions. The former members of the Board attending the Committee session will be pleased to answer questions from Assembly Members.
39. As a broad but important point on which to end, the process by which the portfolio was sold has been scrutinised and the report identifies ways in which it could have been better. In acknowledging this, the former Board members believe the final outcome i.e. the initial sales price achieved plus all additional income from overage clauses, is the most significant factor to any consideration of whether or not the portfolio was sold at undervalue. Lambert Smith Hampton, Amber and the current Board members may be able to provide the Committee with the most up-to-date information on this. The Planning Inspector’s report for Lisvane may also be of assistance to the Committee.
