ADUR & WORTHING
COUNCILS

Joint Strategic Committee
5 March 2019

Joint Governance Committee
26 March 2019
Agenda Item 10

Key Decision [No]

Ward(s) Affected:All

Strategic Property Investment Fund 2019 (SPIF)
The Commercial Property Investment Strategy (CPIS) 2019/20

Report by the Director for the Economy

Executive Summary

This document comprises the Strategic Property Investment Fund 2019 (SPIF) Commercial Property Investment Strategy (CPIS) 2019/20. This document is split into two elements, this Business Case and also the Investment Strategy 2019/20, which is attached as **Appendix 1**.

It is recommended both these documents, which collectively comprise the commercial property investment strategy, are approved by the respective Councils.

Statutory guidance places a duty upon local authorities to prepare an annual investment strategy, which must ideally be approved before the start of the forthcoming financial year, by full Council, or its closest equivalent.

This Business Case, the attached Investment Strategy and other appendices, collectively:

- detail the current fund structures and completed investment purchases up to February 2019.
- detail mechanisms to support the ongoing structured and measured approach to property income generation, pro-actively managing the risk inherent in

investment.

- detail measures to support the ongoing development of a balanced portfolio delivering long term sustainable income, for the purpose of supporting the continued provision of Council Services.
- outline the future strategy to continue building and developing the property investment funds including recommendations to increase fund size from £75M per council, to £125m per council, capital reserves allocations and resourcing and management requirements for the funds.

The primary objective of the CPIS, is to build a strong and resilient portfolio, generating consistent income, to facilitate ongoing core service delivery, mitigating the impact of reductions to central government funding.

1. Purpose

1.1 The purpose of this report is to set out a robust commercial property investment strategy, building upon the existing portfolio, 2018/19 CPIS (link provided under background documents) and previous Strategic Property Investment Fund (SPIF) reports.

1.2 To meet the statutory guidance on investment strategy, as detailed under s12 below, which stipulates councils are to prepare an annual investment strategy which must be approved before the start of the forthcoming financial year by full Council.

1.3 This report will support the Councils' Medium Term Financial Strategy, providing a basis for expansion and management of each Council's portfolio, by setting : -

- Robust parameters to guide and support the development of risk managed, financially resilient, income generating commercial property portfolios.

- Governance criteria to facilitate purchase of investment property, ensuring diligent analysis and transparency, supporting an informed decision making process. This remains unchanged from last year's CPIS.

- Governance criteria to facilitate a commercial approach to the asset management of the investment properties, supporting proactive management, analysis and forecasting, in order to support strategic decisions, whilst qualifying risk and opportunity. This remains unchanged from last years CPIS.

2. Recommendations

2.1 The Joint Governance Committee is asked to consider the contents of the report and provide any feedback, or comments, to the Joint Strategic Committee**.**

2.2 The Joint Strategic Committee is recommended to:

2.2.1 Note the requirement to create a further additional post as part of the 2020/21 revenue budget to ensure the delivery of the Commercial Property Investment Strategy to provide additional necessary resourcing (Ref 9).

2.2.2 Agree the suggested delivery and governance model as set out in the report.

2.2.3 Recommend to Adur District Council the adoption of the 2019 Commercial Property Investment Strategy.

2.2.4 Recommend to Adur District Council to:

i) increase to their Commercial Property investment fund from the current £75,000,000 to £125,000,000 with a maximum investment in any year of £50,000,000

ii) Increase the operational and authorised borrowing limits by £25,000,000 in 2019/20.

2.2.5 Recommend to Adur District Council to resolve that the Strategic Property Investment Fund budget for future years may be brought forward with the approval of the Executive Members for Resources, following their consideration of a business case.

2.2.6 Recommend to Worthing Borough Council the adoption of the 2019 Commercial Property Investment Strategy.

2.2.7 Recommend to Worthing Borough Council to:

i) increase to their Commercial Property Investment fund from the current £75,000,000 to £125,000,000 with a maximum amount invested in any year of £50,000,000

ii) Increase the operational and authorised borrowing limits by £25,000,000 in 2019/20.

2.2.8 Recommend to Worthing Borough Council to resolve that the Strategic Property Investment Fund budget for future years may be brought forward with the approval of the Executive Members for Resources, following their consideration of a business case.

3. Context

3.1. Due to ongoing reductions in central government grant funding, local authorities are increasingly reliant upon income-generating services. By 2020/21, the revenue support granted to Councils as the main source of government funding will no longer exist and Councils will need to be self-funding from raising local taxation (Council Tax and Business Rates). In order to sustain service provision, this has led many local authorities to implement strategies to generate additional income, including commercial property investment.

3.2. Adur and Worthing Councils have to jointly make £8.3M of savings over the next 4 financial years.

3.3. *Achieving Financial Sustainability - Budget Strategy for the 2019/20 budget and beyond(2018/19 to 2023/24)*, presented to the Joint Strategic Committee (JSC) on 10th July 2018, set out changes to council funding over the next few years, detailing our strategic response and increasing reliance upon income generation. The paper illustrated that either income growth, or significant savings, will need to

be delivered to balance the budget. Property investment was identified as an option to generate *"a return of between 2% and 3%... after financing costs"*.

3.4. Direct Property Investment is now commonly undertaken by local authorities, acquiring assets both within and outside of their governance boundaries. Public Works Loan Board (PWLB) long-term lending is at very preferential rates (c.2-3%), when compared to the wider commercial sector lending rates. Property investment is capable of generating returns above PWLB rates, creating positive income. This can be used to fund current services and mitigate the impact of ongoing cuts to council services, protecting services that would otherwise be at risk.

3.5. The Councils have a statutory ability to borrow from the PWLB on long-term preferential fixed-interest terms, typically below rates available in the wider market. Borrowing is subject to guidance and regulations to ensure appropriate assessment, overview and scrutiny, in relation to any borrowing activity.

3.6. The Councils approved the establishment of a Strategic Property Fund (SPF) in July 2015, following a report to JSC. Further SPF reports in July 2016 and July 2017 built upon the initial strategy, containing a series of approved contributions to increase the budget to the current £75M per Council.

3.7. The 31 May 2018 Joint Governance Committee report, *"Managing Investment opportunity and risk when investing in Commercial Property"*, details how both Councils are managing risk in the acquisition of property and the implications of the changes to both the regulatory framework and the associated guidance.

3.8. In July 2018, the Commercial Property Investment Strategy (CPIS) was approved by JSC, reflecting medium-term financial strategy objectives. The main body of the report provided guidance on governance, scrutiny and resourcing requirements to build and maintain a property investment portfolio. The Investment Strategy was included as an Appendix, detailing investment objectives, fund policy/structure, purchase guidelines, mechanisms to proactively manage risk and promote financial resilience. The strategy also provided mechanisms for strategic asset management, including annual reviews, KPIs. The purpose of this is to ensure ongoing proactive and strategic

management, to optimise performance, promoting capital values and maximising returns. This years Investment Strategy 2019/20 (**Appendix 1**), follows the same format.

3.9. In accordance with statutory requirements, as detailed below under Section 12, an investment strategy is to be produced annually. This 2019/20 CPIS report essentially follows the same format as last year's 2018/19 CPIS report, having been updated, proposing measures to manage the expanding portfolio, changing investment market and economic outlook.

3.10. It is proposed to continue building upon the successes to date, raising capital through the PWLB, to invest directly in the UK property market.

4. SPIF - Commercial Property Investment Fund - Current Position

Financial Position

4.1. Please note all capital values quoted in this report are based upon initial purchase price, excluding purchasers costs. The two portfolios' investment properties will be subject to market valuations, following the end of the 2018/19 year and annually thereafter.

4.2. At the end of the previous financial year on 31 March 2018, the commercial fund was as follows: -

i) The Worthing Fund comprised four assets, valued at £11.935M, generating a net annual income, after borrowing costs, of £346,100.
ii) The Adur Fund comprised one asset, valued at £10.93M, generating a net annual income, after borrowing costs, of £287,760.
iii) The combined total commercial fund market value stood at £22.865M, generating a net annual income, after borrowing costs, of £633,860.

4.3. For the current financial year ending on 31 March 2019, the commercial fund has increased, to the end of February 2019, as follows: -

Worthing Fund

i) three new commercial property purchases have been completed, amounting to an investment of £25.14M and a net annual income, after borrowing, of £522,210 per annum.

ii) the total commercial fund now comprises seven assets, equating to £37.075M and a net annual income, after borrowing, of £868,300 per annum.

Adur Fund

a) three new commercial property purchases have been completed, amounting to an investment of £24.98M and a net annual income, after borrowing, of £521,730 per annum.

b) the total commercial fund now comprises four assets, equating to £35.91M and a net annual income, after borrowing, of £809,500 per annum.

4.4. The commercial funds for both Councils now comprises a combined total of £72.985M, an increase of 219% during 2018/19 financial year. The total net annual income, after borrowing, is £1,677,800 per annum.

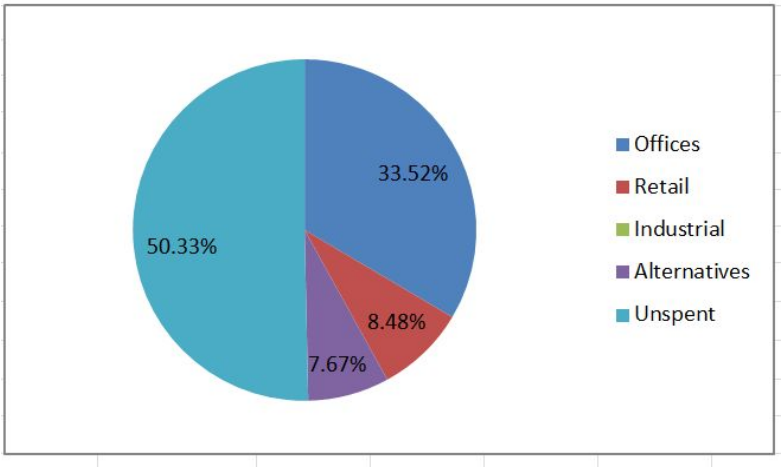
4.5. The 2018/19 net revenue target of £416,000 per council from new purchases has been exceeded for Worthing Council by 10.03%, whilst 98.19% of the Adur target has been achieved, to date. It is important to note that whilst the net income target of £416,000 per council for the 2018/19 year has been exceeded for both councils in terms of a full-year's income from new investments, due to the timing of individual purchases throughout the financial year, the apportioned net annual income from various purchase dates to year end, equates to a different figure for each council of £452,380 for Worthing, £408,460 for Adur.

Current Fund Structure

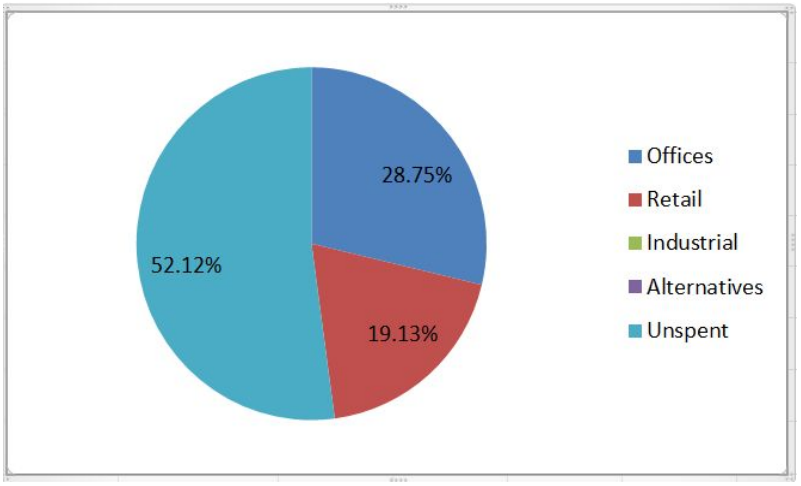
4.6. During the 2018/19 financial year, net initial yields in the region of 5-6% have typically been targeted, striking a balance between risk and return. Acquiring assets below 5% typically offers a limited return after the deduction of financing and operational/management costs and any such purchases require strong underpinning fundamentals illustrating positive future growth.

4.7. The pie charts below, detail the current weighting by sector of all purchases to date, based on the current total fund size of £75M per Council: -

Worthing



Adur



4.8. The above charts illustrate the heavy weighting into offices, for which a total investment in the region of 30% has been targeted during the 2018/19 year, essentially in the south east office market. This was expected, as stated in last year's strategy, *"At the outset, the portfolios will be heavily weighted into certain sectors and classes, driven by opportunities and market performance"*. It is to be expected that a fully diversified fund is a longer term objective, whereas shorter term purchases will be heavily influenced by market performance and opportunity.

4.9. Purchases to date are summarised in Appendix 2. These have initially concentrated on Greater London, the South East and established regional centres, on the basis these are established mature markets that have typically experienced a longer term trend of lower voids and vacancies, when compared to the wider UK. Key considerations underpinning this approach are: -

Offices

i) The office sector has been the subject of particular focus this year, driven by strong market performance, particularly in Greater London and south east office market. During 2018, take-up in the south east office market was above the 10-year average. During the 2018/19 year, the Councils have acquired four office buildings, making up a significant proportion of the year's investments. This is not unexpected, given the current challenges of retail and industrial market purchases, as detailed below.

Retail

ii) The retail market has been facing some notable headwinds, with onerous business rates, the ever-expanding threat of online shopping and decreasing profit margins. This has seen weakening pricing and occupier uncertainty, with significant insolvency and Company Voluntary Arrangements (CVAs). The financial impact of a CVA-imposed rent reduction can be significant.

Certain retail investments have remained attractive to investors and we have made some cautious and limited investment into the retail sector. It is likely that prices will continue to soften into 2019, giving rise to some carefully chosen opportunities.

Industrial

iii) The industrial market has been performing well, with strong occupier demand and the lack of stock in London and the south east continuing to drive rental growth across the region. As a result, prime stock is strongly priced, typically below 5% net initial yield, which equates to a nominal return, after accounting for financing and operational costs. As a result, acquiring suitable quality industrial stock remains challenging, particularly

in the south east. Looking ahead, regional centres may present some suitable opportunities and will therefore be considered.

Alternatives

iv) Specialist alternative investments traditionally cover those assets not included within the traditional commercial property sectors of offices, retail and industrial. Alternative investments include hotels, healthcare, certain leisure facilities, student accommodation, car parks and petrol stations. Acquiring some alternatives supports overall fund diversity, which can diversify risk exposure, supporting overall fund performance. To date, a car park and a petrol station have been acquired in this sector, with both offering long leases with index linked reviews, which is attractive. Looking ahead, subject to judicious specialist advice, further alternative sector purchases may be recommended, particularly with index linked fixed uplifts.

5. SPIF - Commercial Property Investment Fund - Strategy Review

5.1. The funds have been steadily increased over the 2018/19 financial year, judiciously applying last year's strategy, to ensure fund development remains robust and the approach reflects the key Investment Strategy objective: -

"To adopt a structured and measured approach to property income generation, pro-actively managing the risk inherent in investment, creating a balanced portfolio delivering long term sustainable income, for the purpose of supporting the continued provision of Council Services."

5.2. The current portfolios have been comprehensively reviewed, in the context of the wider economy, to shape future fund direction. In addition to the annual in-house review, the endorsed CPIS principles of arms-length scrutiny and objectivity have been applied, commissioning a specialist consultancy report (SCR), whereby a private sector property consultancy firm has undertaken an arms-length independent review of the CPIS. Their report is attached as **Appendix 3** and was commissioned to answer three questions: -

1) to provide guidance on the optimal size and scale of The Fund in the context of financial needs and broader commercial property market conditions.

2) to provide recommendations for the preservation of some income derived from Fund revenue which should be set aside for irrecoverable expenditure, potential capital expenditure and incentives/rent free periods on re-letting of voids.

3) to recommend a number of initiatives which the Councils may wish to consider in order to develop a robust, liquid and diversified fund providing stable and predictable levels of income while aiming towards future rental and capital growth.

5.3. The SCR concludes there are no concerns regarding the commercial strategy checks and balances in place for developing and monitoring the funds, making the following recommendations: -

i) **Fund Size**
"the optimal size for a local authority investment fund is in the order of £250m". (£125M per Council)

Recommended actions are detailed under 7.0 below

ii) **Prioritise Active Asset Management**
developing the ability to absorb changes to the rental income stream to enable lease re-gears.

Recommended actions are detailed under 7.3 below

iii) **Funding Spread Over Three Years**
The SCR suggests the inability to deploy more than £50M in any one year constitutes a potential weakness that may hinder acquisition of available assets meeting the Council's criteria and hold back investment.

Recommended actions are detailed under 8.0 below

iv) **Resourcing**

The importance of resourcing is emphasised, the report stating:

"An in-house or independent investment advisor role is critical to ensure that local authority funds have sufficient resources in place to benchmark their portfolio and provide independent advice on acquisitions both before and during the period of ownership."

And

"An active asset management function is crucial to unlocking future growth, revenue protection and enhancement"

Section 2 of the 2018/19 Investment Strategy (Appendix 1), details proactive risk and opportunity management mechanisms, including Asset Management principles for cash flows, capital expenditure forecasting, annual review and equivalent yield projection. The same principles apply this year. In addition, further measures to improve resourcing are recommended, as detailed under 9 Resource and Capacity, below.

6. Capital Reserves

6.1. To strengthen the financial resilience of the CPIS funds and protect core income revenue, which directly sustains service provision, it is necessary to allocate a percentage of income to a capital reserve. This reserve is a conventional mechanism that will be deployed against future voids, incentives (such as rent free periods) and capital expenditure (such as refurbishment/repair).

6.2. Capital reserves are an important risk management mechanism to meet forecast costs, that will be projected in cash flows, whilst also providing a buffer against unexpected costs. This provides a layer of protection against core income revenue disruption, increasing fund stability.

6.3. The SCR includes advice regarding a suitable level of income retention to meet costs. The SCR reviewed our investment strategy, providing an illustrative analysis of the estimated costs for three notional assets over a 10 year period to sit between 15-18%, excluding major refurbishment costs. Their report concludes that a 20% retention of revenue is acceptable.

6.4. In consideration of the foregoing, this report recommends the capital reserve should remain unchanged at **20% retention of income revenue**. The precise mechanism to deliver this will be determined by finance who confirm that currently the Council has a policy of gradually increasing the amounts set aside from the rental streams for future revenue losses and capital maintenance requirements. The aim is to achieve a 20% annual set aside over a 5 year period. In the interim, any surplus commercial income over and above the budget will also be set aside.

7. Fund Size

7.1. According to the Ministry of Housing, Communities and Local Government (MHCLG), local authorities invested £4 billion in land and buildings in the financial year to March 2018, of which £1.8 billion is considered to be property investment. It is estimated that this figure will rise slightly to £1.9 billion for the 2018 calendar year.

7.2. The currently approved fund sizes of £75m per council are small, when considered in context the wider property investment market fund sizes. Smaller funds will have less overall spread and diversity of assets, increasing volatility and exposure to the underperformance of any single asset. Smaller funds can also lack economies of scale, resulting in higher expenses running the funds, which can increase as the funds grow. A larger fund would enable a greater spread of investments, further diversifying overall risk and increasing fund resilience, providing the parameters detailed within the commercial strategy are applied.

7.3. Currently, the income revenue from property investments, after deduction of costs, is predominantly allocated to core revenue requirements for the provision of Council services. As a result, the Councils are unable to hit the target of a 20% retention of income revenue from property investments being put into capital reserves. Increasing the overall fund size, will, once further investment property purchases have been completed, generate an income that sufficiently exceeds the Councils' core revenue requirements, facilitating the growth of capital reserves.

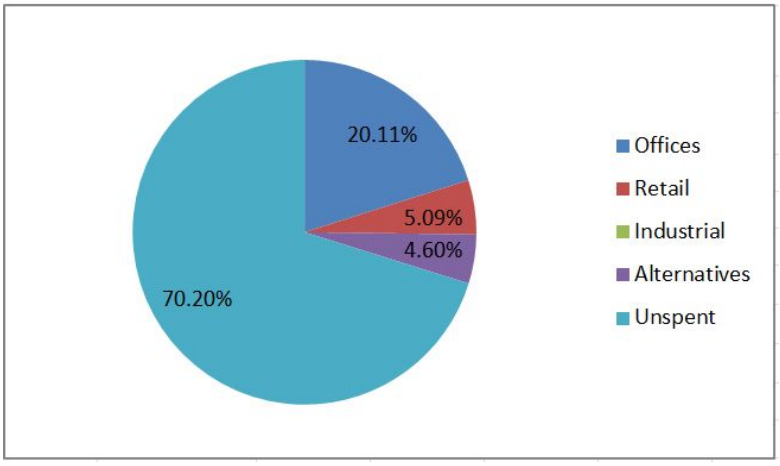
7.4. The SCR advice on overall fund size recommends *"the optimal size for a local authority investment fund is in the order of £250m"* (£125M per Council).

7.5. There is clearly potential to further increase the returns available to the Councils through continued judicious investment in commercial property acquisitions. Given the opportunity this provides to balance the budget.

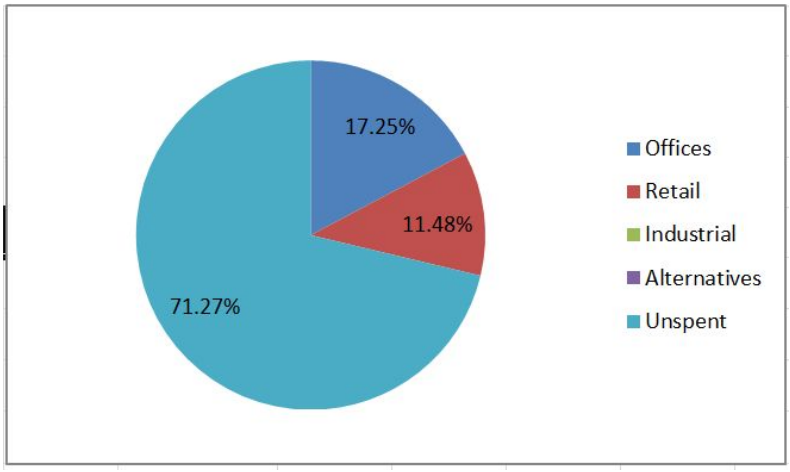
7.6. It is recommended to increase the fund's size to £125M per Council from 2019/20.

7.7. If the funds for each Council are approved for increase to £125M per Council, the current fund weightings by sector will reduce, to the following: -

Worthing



Adur



8. Funding Structure

8.1. Currently, available funds have been capped at £50m (£25m per Council) per financial year for 2018/19, 19/20 and 20/21. The inability to deploy more than £50m in any financial year constitutes a potential weakness in the funding structure that may hinder the acquisition of available assets which meet the Councils' criteria. Currently it is not possible to acquire existing portfolios, in whole or part, that come to market, which can provide economies of scale. Furthermore, when competing against other investors their ability to acquire multiple assets from a single portfolio, can make their offers more attractive to the vendors. It is, therefore, recommended that funds are made fully available, to support the acquisition of available appropriate assets.

8.2. The potential weakness detailed in 8.1 has been addressed by giving the Executive Member for Resources the authority to approve the drawdown of future years resources, subject to the approval of a business case.

8.3. This is supported by the SCR which recommends "*there is full and immediate access to remaining funding to ensure that all suitable investment opportunities can be investigated and acquired.*"

9. Resource and Capacity

9.1. The success of the Strategic Property Investment Fund 2019 (SPIF) Commercial Property Investment Strategy (CPIS) 2019/20 will have a direct impact on the Councils' finances. Ensuring the correct level of capacity to undertake diligent fund acquisition/disposal, asset management and wider market intelligence to shape fund direction and strategy, is crucial to overall success. The approach will need to be commercial, adopting normal 'private sector' principles for the day to day management of the investment portfolio. The growth of the investment funds necessitates additional resourcing. Currently limited resources are restricting overall capacity, which is becoming an increasing issue, as the funds grow. To address this, the following mechanisms are progressing: -

i) Property management of the investment portfolio is currently being outsourced to a large RICS firm, to undertake the day to day management.

ii) Property Officers are being upskilled to carry out some of the investment portfolio activities. We currently have two property officers undertaking the assessment of professional competence (APC), the training scheme that graduates need to complete, on the job, to qualify as Chartered Surveyors. In addition, a property support officer has been enrolled to complete a degree and his APC to become a Chartered Surveyor.

iii) Where necessary, we engage external consultants to provide specialist market intelligence, surveys, valuations and advice/reporting.

iv) Access has been purchased for online specialist property market research system, CoStar. This provides real time market research, insight, analysis and intelligence to property professionals.

v) A new professional post has been created in the 2019/20 budget, for a dedicated property investment officer, following recommendations in last year's JSC approved commercial investment strategy. This role will drive SPIF acquisitions and disposal work This will either be an appropriately accredited specialist consultancy role, or an internal appointment. The establishment of this post is recommended in the SCR report, which states, *"In our opinion, an in-house or independent investment advisor role is critical to ensure that local authority funds have sufficient resources in place to benchmark their portfolio and provide independent advice on acquisitions both before and during the period of ownership."*

In addition it is recommended that: -

vi) A new professional post is created for an Asset Portfolio Manager. This role will provide asset strategy, managing the SPIF properties, including forecasting cash flows, reviewing and identifying value add opportunities such as re-gearing and repurposing assets. The role will include an 'intelligent client' in-house function to monitor and oversee external managing agents, as well as reporting internally. The role will also review the councils non-operational portfolio to drive income generating opportunities, recommending operational and strategic actions. This is supported by the SCR report recommendation to seek a

"Greater focus on active asset management", also stating that *"An active asset management function will be crucial to unlocking future growth and ensuring that revenue is both protected and enhanced."*

9.2. In relation to both new posts detailed under v) and vi) above, these are important roles that will be key to fund performance. Appointees will need to be property professionals, ideally RICS, with demonstrable and extensive relevant knowledge and expertise, including significant private commercial property market experience.

9.3. In recognition of the increasing resourcing requirements as the SPIF expands, a business case will be prepared in due course, recommending appropriate additional resourcing is put into place during the 2020/21 budget round.

9.4. Last year's Strategic Property Investment Fund (SPIF) Commercial Property Investment Strategy (CPIS) 2018/19 report, was approved by JSC, including the allocation of 5% of net investment income, for increasing capacity and resources within the Head of Major Projects and Investment team to create a property investment team. Included in the 2019/20 Budget is the creation of an investment surveyor post to support the implementation of the strategy. Proposed for the 2020/21 Budget, will be the creation of an asset strategy post, to support long term proactive management of the funds.

10. Councils' Non-Operational Property Portfolio

10.1. The Councils' non-operational property portfolios consist of retail/leisure units, offices, industrial units and an extensive range of low-value commercial interests situated across the district and borough. The portfolio generates a gross annual income of circa £3.03M across both councils.

10.2. Like many Councils, the majority of revenue is derived from a small number of assets, reflecting the diverse reasons they were acquired, and retained, by the Councils in the past. A significant proportion of the stock held currently for non-operational purposes is now aging and dilapidated, management intensive, poorly located, unfit for purpose and/or difficult to let. These factors impact upon the rental return and its corresponding capital value. To address this, an Asset Strategy is being prepared, initially to set a pathway for a comprehensive review of

the estate, with the view to identifying opportunities to increase efficiencies, generate income and achieve revenue savings.

11. SPIF - Commercial Property Investment Fund - Future Fund Direction

11.1. The current weighting of funds into offices has been driven over the last year in consideration of market performance. The current office weighting does not preclude further office investment, particularly if the overall fund sizes are approved for increase, which will reduce office investments as a proportion of the increased fund sizes. It does however highlight the rationale to increase the focus upon alternative sectors for opportunities during 2019/20.

11.2. The SCR recommends the following areas of investment focus during 2019/20:

a) *Target investment opportunities which hold potential for additional revenue streams, i.e. retail parks with surplus parking for drive thru/car wash, prominent sites with signage options,*

b) *Adopt some exposure to well-let secondary assets with higher yield in the range of 7%-8%+, possibly through regional stock which preserves the required lease term. This will help to provide greater flexibility in the running yield for asset management initiatives.*

c) *RPI indexation within a proportion of the portfolio will generate more stable income in the Core category*

11.3. The advice from the SCR endorses the continuation of the current CPIS and Investment Strategy measures.

The following sections, 12 - 17, from Investment Evaluation to and including Scope of Investment, materially remain the same as detailed within last years 2018/19 CPIS, for which a link is provided under “Background Documents” below, with some nominal changes to layout and phrasing, to support transparency. For simplicity and ease of reference, they remain set out below.

12. Statutory Guidance

12.1. When investing in property, local authorities must comply with statutory guidance. This includes two codes of practice (Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes and The Prudential Code for Capital Finance in Local Authorities) issued by the Chartered Institute of Public Finance and Accountancy (CIPFA), in addition to, the Ministry for Housing Communities and Local Government (MHCLG) February 2018 publication, "Statutory Guidance on Local Authority Investment Activity". Copies of this guidance are attached to the CPIS 2018/19, for which there is a link under background documents at the end of this report.

12.2. This statutory guidance on investment strategy includes requirements for councils to: -

- prepare an annual investment strategy which must be approved before the start of the forthcoming financial year by full Council, or its closest equivalent.
- ideally present the strategy prior to the start of the financial year.
- ensure the Strategy is publicly available on a local authority's website.
- disclose the contribution that all other investments make towards the service delivery objectives and/or place making role of that local authority.
- include quantitative indicators within the strategy, that allow Councillors and the public to assess a local authority's total risk exposure as a result of its investment decisions. This should include how investments are funded and the rate of return.

The investment strategy must include:

i) details of the processes used to ensure effective due diligence, defining the authority's risk appetite, including proportionality in respect of overall resources.
ii) qualify independent and expert advice and scrutiny arrangements.
iii) disclose the contribution that investments make "towards the service delivery objectives and/or place making role of the local authority".

iv) propose indicators that enable councillors and the public to assess the authority's investments and the decisions taken.

- The investment guidance is clear that Councils may not "borrow in advance of need" to profit from the investment of the sums borrowed. The definition of investment has recently been extended to include investment in property and the granting of loans to third parties.

- In recognition of the importance of commercial income to councils at a time when government funding is steeply declining, a council can choose to disregard the Prudential code and this part of the guidance. In this case, its investment strategy should set out why this is the case and what the council's relevant policies are.

12.3. The implications of the guidance are that in future the Councils will need to have at least one Investment Strategy ("the Strategy") that meets all the disclosures and reporting requirements specified in the statutory guidance.

12.4. For Adur and Worthing Councils, there will be two separate elements to the Strategy:

i) The annual treasury management investment strategy which covers all cash investments.
ii) The annual SPIF commercial property investment strategy covers the Councils' approach to property investment.

The annual Treasury Management Investment Strategy was approved by the Councils in February 2019. This Business Case and also the Investment Strategy 2019/20, which is attached as **Appendix 1**, provide evaluation criteria for the assessment of investment properties, risk profiling, evaluation, resourcing and monitoring, accounting for the statutory guidance.

13. Investment Evaluation Process

13.1. Prospective investment opportunities are reported by suitably qualified and experienced in-house MRICS (Member of the Royal Institute of

Chartered Surveyors) professionals, in a risk matrix (**Appendix 4**). This risk matrix provides analysis of a set of key criteria against which every prospective purchase is evaluated. The presentation of information highlights fundamental matters such as tenant covenant strength, lease length and location, in a transparent and consistent format, to support clear scrutiny and decisions. The risk matrix provides a basis for scoring and weighting risk, to support the analysis of potential acquisitions and qualify overall suitability for inclusion in the portfolio. A minimum score threshold is set, below which it is not recommended to proceed. The score threshold is not an absolute, but set to guide decisions, reflecting the **Fund Structure** objectives, as detailed in the Investment Strategy (**Appendix 1**), which assumes a low risk profile. The process is further supported by the inclusion of a Strength, Weakness, Opportunities, Threat analysis (SWOT).

13.2. To ensure arms-length objectivity and scrutiny, external agents and consultants provide professional market analysis, specialist data and advice, to support the evaluation and internal reporting process.

13.3. Since tenant default is a significant threat to the performance of the property investment fund, in-house reports are undertaken by Credit Safe and/or Dun and Bradstreet, providing an assessment of tenant covenant strength and financial resilience. This is augmented by additional internal assessment of the tenants' covenant and likely future performance, where relevant.

13.4. If a decision is made to proceed, in-house surveyors lead negotiations, via the introducing/retained external agents, who are professional property firms with relevant market specialism.

13.5. To ensure independent and expert advice and scrutiny, all pre-sale technical due diligence is undertaken by arms-length external professional advisors, including as required: -

i) A valuation, in accordance with the RICS Red Book, Professional Valuation Standards, issued by RICS as part of their commitment to promoting and supporting high standards in valuation delivery worldwide. The publication details mandatory practices for RICS members undertaking valuation services.
ii) A Building Survey report, as part of the proposed purchase for investment purpose, including preparation of a Site

Environmental Assessment and preparation of a Reinstatement Cost Assessment for insurance purposes.

iii) Environmental, services and any further surveys required to qualify the investment.

iv) Specialist investment market advice, including, as required, occupational market context and financial modelling to qualify and forecast prospective investment performance.

13.6. The above is reviewed by the Asset Portfolio Manager as an experienced in-house MRICS (Member of the Royal Institute of Chartered Surveyors) professional, with support from the internal multi-disciplinary property teams, for final decision by the Head of Investment and Major Projects, on whether to proceed.

13.7. The Head of Investment and Major Projects receives regular updates on market activity, trends, forecasts and occupier activity from RICS firms and in-house surveyors to support the decision process. In addition, it is also recommended that all members and officers involved in the decision process are provided with annual updates on the commercial investment market, including occupier activity and trends.

13.8. A separate paper will be presented in due course, detailing a proposal for a disposals strategy.

14. Property Investment Governance

14.1. Clear, robust and transparent governance is critical to the strategy, meeting the statutory guidance and ensuring an appropriate level of due diligence and scrutiny is applied, together with objective arms-length external advice where appropriate. It is also important to ensure any decision process retains fluidity, so officers are empowered to respond promptly and competitively, to investment opportunities in the market and avoid missing opportunities through delay.

14.2. The current Scheme of Delegations provides that the authority to acquire or dispose of land, is vested in the Head of Major Projects and Investment, and where the land is purchased through the Strategic Investment Fund, the delegation is only exercisable in consultation with the relevant Leader, Executive Member for Resources and the Chief Financial Officer.

14.3. It is proposed that a formalised staged governance approach is adopted in relation to Strategic Property Investment Fund (SPIF) purchases, as follows:

Stage 1

Asset Portfolio Manager/investment surveyor identifies suitable opportunity in the market, having undertaken appropriate investigative and due diligence assessment, in accordance with the above "Investment Evaluation Process".

Stage 2

The opportunity is reported in writing, with all supporting information as detailed in the "Investment Evaluation Process", to the Head of Major Projects and Investment, in consultation with the Chief Financial Officer/s151 officer, notifying the Head of Legal Services, Director for the Economy and Chief Executive.

The report will include: -

1. A risk matrix and SWOT analysis
2. A financial appraisal
3. A summary of the investment, including a request for authority to bind the Council to a range of terms and indicating an acceptable price point for acquisition.

If the proposal is supported, the potential acquisition will progress to Stage 3.

Stage 3

The Asset Portfolio Manager/investment surveyor, will progress negotiations, seeking to formally agree Heads of Terms with the vendor, including price and basis/terms of acquisition. If negotiations lead to the agreement of acceptable terms, final approval to proceed will be sought in accordance with Stage 4.

Stage 4

A recommendation will be reported in writing to the Head of Major Projects and Investment. In making any decision to purchase, the Head of Major Projects and Investment will carry out a consultation, as provided for in the Scheme of Officer Delegations, with the relevant Council Leader, Executive

Member for Resources and Chief Financial Officer.

The relevant Council for any acquisition will be determined, applying the principles in the Investment Strategy (**Appendix 1**) in relation to financial resilience and risk diversification requirements, to support the development of balanced portfolios.

Subject to approval, written authority to proceed, will be provided by the Head of Major Projects and Investment to the Asset Portfolio Manager/investment surveyor, who will then seek to acquire the asset, which will be subject to an external Red Book valuation, building and other necessary surveys and legal reports and conveyancing, providing pre-acquisition due diligence.

A decision notice will be completed and published in accordance with the Officer Decision Making Protocol, and such decisions will be subject to the call-in provisions.

Stage 5

Completed purchases will be reported to the next available Joint Strategic Committee meeting for noting.

Should any proposal to purchase prove abortive, this will also be reported to the next available Joint Strategic Committee meeting for noting.

15. Risk Management

15.1. Property investment will necessitate exposure to risk, whereby the total invested can exceed the Market Value. Prices are prone to fluctuation, particularly due to changes in locality, the general economic outlook, or asset specific risks, such as tenant failure. Furthermore, property investment is relatively illiquid, requiring a longer term approach. In the event of a market crash, property is much less liquid than other assets and can be hard to sell.

15.2. The Councils' exposure to risk equates to the total amount of capital invested, plus financing costs (such as interest due on loans), property operational running costs (management, vacant business rates, service

charges, professional fees etc.) and legislative compliance. The Councils' risk quantum will be defined as this total exposure, less the value of held assets.

15.3. Whilst risk is a natural, necessary, part of investment that cannot be eliminated, it can be proactively managed.

15.4. The Property Investment Strategy is built upon a series of conventional measures to manage risk, reflecting the key objective:

"To adopt a structured and measured approach to property income generation, pro-actively managing the risk inherent to investment, creating a balanced portfolio delivering long term sustainable income, for the purpose of supporting the continued provision of Council Services."

15.5. The Investment Strategy (Appendix 1) Fund Objectives and Fund Policy build upon this key objective, providing a series of controls to direct the Investment Strategy towards a prudent low risk fund with a cautious perspective on investment, limiting exposure to unnecessary capital risk, whilst generating a return.

15.6. Financing property investments is based upon utilising reserves, capital receipts and borrowing. Borrowing is currently available with fixed interest for the duration of any loan, via the Public Works Loan Board funding, mitigating the risk associated with exposure to interest rate fluctuations.

15.7. The Minimum Revenue Policy (part of the treasury management strategy statement) details the Council's position and deals with the Minimum Revenue Provisions (MRP) that must be made to mitigate that risk. The MRP is the amount the Councils must set aside each year from the annual revenue budget for the repayment of debt.

15.8. The Investment Strategy (Appendix 1) Financial Resilience section details a series of measures to guide decisions, based around spreading capital across a variety of asset classes, locations and sectors. This diversification reduces the risks of exposure to a single asset, tenant, or market failure.

15.9. Funds that are excessively concentrated in one particular sector or region increase risk, whilst a good spread of properties across retail,

office and industrial diversify sector-specific risks and varying the locality, reduces local market risk.

15.10. The average property size is a measure to ensure the fund does not only hold a very small number of large properties, which increases risk, such as a single large tenant failing. This measure also assumes a number of properties will be transferred into the fund from the existing asset portfolio, to create a sufficient number of properties within the fund to generate diversity.

15.11. The Council's exposure to investment risk can also be profiled by defining the acceptable parameters. The Investment Strategy (Appendix 1) Fund Structure details a series of different segments that provide a basis for dividing commercial property investments, based upon their position at differing points on a risk v return spectrum.

15.12. The fund has been structured to include some allocation toward more risk exposed investment. This will enable the fund to respond fluidly, should a suitable opportunity arise, particularly where there is an opportunity for socio-economic benefits to residents, repurposing or re-gearing assets, to generate income. The proposed Investment Strategy distribution of purchases across the above four categorisations is weighted heavily towards lower risk assets. This reflects the Investment Strategy (Appendix 1) Fund Objectives and Fund Policy targets to adhere to a cautious perspective on investment, generating a return, whilst, insofar as possible, limiting exposure to unnecessary capital risk.

15.13. The ability to vary the distribution of purchases between each of the above four categories, is a common portfolio investment tool. This provides flexibility to respond fluidly to opportunities and changes in the economy, market climate and differing performance across asset classes, as the fund evolves. Such agility is key to maximising operational efficiencies.

15.14. The proposed portfolio weighting offers a lower return, which reduces overall exposure to invested capital risk. This portfolio profile favours acquiring premises leased to strong covenant tenants in established markets, which are typically more attractive to investors, thus easier to sell if required, when compared to higher risk investments.

15.15. Whilst acquiring properties offering higher returns may appear attractive, the additional yield typically reflects higher risks such as tenant default, low liquidity, obsolescence and market risk. These increase the prospect of the investment generating an income and capital loss.

15.16. The Investment Strategy (Appendix 1) Annual Review sets out a series of measures to provide detailed analysis of investment performance. This is to ensure detailed periodic arms-length objective monitoring is undertaken, using conventional measures, as a means to identify any emerging hazards or opportunities. This will support proactive management, which is key to driving a successful strategy and managing risk.

16. Annual Performance Monitoring

16.1. Active management of the portfolio is key to proactively maintain the buildings to maximise value and monitor occupiers. Tenant covenant strength, compliance with lease obligations, such as repair and maintenance, management of the payment of rent and service charge needs to be actively managed. External Managing Agents are in the process of being appointed to manage investment portfolio properties and to support the Investment Strategy Annual Review **(Appendix 1)**.

16.2. In addition to ongoing monitoring, the Investment Strategy (Appendix 1) details a series of measures to undertake a comprehensive annual re-evaluation, including detailed assessment of key performance indicators, to quantify, monitor and benchmark the portfolio operation and strategic direction.

17. Scope of Investment

17.1. A holistic approach to property income generation will be undertaken. In addition to acquiring investment property, the Councils are already successful commercial landlords and will build upon this: -

- Retaining existing assets where appropriate, to generate income, investing where necessary to enhance returns.
- Re-evaluate the existing property portfolio to identify opportunities to maximise the financial benefit.

- The asset portfolio manager/Investment Surveyor will review the existing portfolio and report any of the existing property portfolio that fit the investment criteria, recommending transfer into the Property Investment Fund, whereby they will be funded and managed with an express focus upon income generation. This will support a more tailored approach for relevant premises that is proactive and focussed solely upon income, as opposed to wider socio-economics drivers, that apply to the existing estate.
- Any capital return generated from the investment fund, will be ring fenced for future property investment, after deduction of financing costs and professional fees.

17.2. A Disposal Strategy will be provided as part of a separate report, subject to the adoption of the Property Investment Strategy and any conditions or amendments following consultation.

18. Corporate Implications

18.1. If the Councils had not taken the decision to invest, this would have led to an overall reduction in the capacity of the Councils to deliver, with cuts in services, particularly those we are not under a statutory duty to deliver.

18.2. The additional income delivered from CPIS investments, has contributed to the delivery of more robust and sustainable Revenue Budget for 2019/20 and the MTFP.

18.3. As part of this initiative, the councils will inevitably be taking on more risk. Consequently, a robust risk management strategy should be adopted, both in acquiring property and managing the portfolio for the future, to ensure that there is sufficient revenue income, to repay the debts the councils are acquiring and to continue to contribute to council's financial health.

19. Engagement and Communication

19.1. This report builds upon the previous Commercial Property Investment Strategy Report 2018/19, taken to JSC in July 2018

19.2. Consultations have taken place with legal and finance and their comments are contained within.

19.3. Consultation has taken place with private sector property investment firms and consultants report was commissioned (SCR Report), attached as Appendix 3.

20. Financial Implications

20.1 The Councils have in the past three years addressed significant budget shortfalls. The investment in commercial property has enabled the Councils to protect front line services and increase the level of spend in areas such as Housing Need.

	2017/18	2018/19	2019/20
Adur			
Level of annual savings	£1.089m	£1.333m	£0.757m
Net new annual income from new commercial property	£100,000	£493,000	£200,000
% of savings from commercial property income	9.2%	37%	26.4%
Worthing			
Level of annual savings	£1.669m	£1.853m	£1.367m
Net new annual income from new commercial property	£200,000	£420,000	£150,000
% of savings from commercial property income	12%	22.67%	11%

This investment continues to be an important strand of the budget strategy, helping balance the budget as the Council continues to address significant financial challenges, particularly in 2020/21.

20.2 The Councils have already approved an overall investment of £75m per Council which was allocated as follows:

	2016/17 £'000	2017/18 £'000	2018/19 £'000	2019/20 £'000	2020/21 £'000
Adur		11,579	25,000	25,000	13,421

Worthing	3,472	9,464	25,000	25,000	12,064
Total	3,472	21,043	50,000	50,000	25,485

The Executive Member for Resources can approve an accelerated spend in any given year subject to the provision of a business case to justify a higher level of spend.

20.3 The recent consultants report has highlighted the need to increase the overall portfolio size from £75m to £125m per council to enable the Councils to better manage risk. The report also recommends that the Councils set a higher maximum level of annual purchases so that opportunities to acquire suitable properties that meet the Councils' investment criteria are not missed. If the increase to the portfolio is approved the Council will need to amend the borrowing limits contained within the prudential indicators.

20.4 It is clear from the consultant's report that the Councils should seek to retain an average of 20% of rental income towards future expenditure on repairs, refurbishment, lettings incentives, and void periods. To achieve this the Council will take three measures:

i) A regular contribution to earmarked reserves is to be created over the next 5 years to equate to 15 - 20% of annual rental income;
ii) Any over-achievement against the commercial income budget set will be placed into earmarked reserves at the year end;

iii) Where commercial properties are disposed of, all the surplus income in excess of any associated debt and the original purchase price, will be placed into a specific reserve for future capital reserve requirements. In the short term, this reflects the need to build reserves. In the medium term, it is envisage these funds could also be released for reinvestment into the portfolios.

Finance Officer: Sarah Gobey
Date: 18th February 2019

21. Legal Implications

21.1. S.111 Local Government Act 1972 provides the Councils with the power to do anything (whether or not involving the expenditure, borrowing or lending of money or the acquisition or disposal of any property or rights) which is calculated to facilitate, or is conducive or incidental to, the discharge of any of their functions."

21.2. s.1 of the Localism Act 2011 provides the Councils with the general power of competence to do anything that an individual may do.

21.3. The Scheme of Officer Delegations includes the following delegation to the Head of Major Projects and Investment at paragraph 3.13.2: "To acquire land in connection with the Council's functions and to take leases, easements, licences and wayleaves of, in, or over buildings or land in connection with the Council's functions. (Where acquisition of land is purchased through the Strategic Investment Fund, the delegation is to be exercised in consultation with the Leader, Executive Member for Resources and the Chief Financial Officer).

21.4. The Officer Decision Making Protocol in each Council's Constitutions provides a procedure for giving notice of key decisions, Officer Decision making, the publication of Decision Notices, and the procedure for Call-In of such decisions.

21.5. Any decisions made to acquire under the Strategic Investment Strategy are subject to scrutiny by the Council's Joint Overview and Scrutiny Committee in accordance with the Joint Overview and Scrutiny Procedure Rules in each Council's Constitutions.

Legal Officer: Susan Sale
Date: ……..

Background Papers

CPIS and Investment Strategy, JSC Report July 2018

JSC Report 2 February 2016 - Strategic Property Investment Fund - Investment Strategy

Platforms for our Places - Platform 1 - Our Financial Economies. 1.4.2 Use the Councils' Strategic Property Investment Fund to deliver new revenue streams and support investment projects.

Ministry for Housing Communities and Local Government (MHCLG) February 2018 publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes The Prudential Code for Capital Finance in Local Authorities

Officer Contact Details:-

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Role: Asset Portfolio Manager
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Email: simon.moore@adur-worthing.gov.uk

Sustainability & Risk Assessment

1. Economic

The proposal forms part of the Council's Capital Strategy to produce additional income

2. Social

2.1 Social Value

Matter considered and no issues identified.

2.2 Equality Issues

Matter considered and no issues identified.

2.3 Community Safety Issues (Section 17)

Matter considered and no issues identified.

2.4 Human Rights Issues

Matter considered and no issues identified.

3. Environmental

Matter considered and no issues identified.

4. Governance

This aligns with the Councils' Capital Strategy. Investment in good quality commercial property to produce additional income is part of a combined strategy in the Councils' approved budget strategy.

SECTION 1

THE INVESTMENT STRATEGY

SECTION 1 – The Investment Strategy

1. Objectives

The key objective:-

"To adopt a structured and measured approach to property income generation, pro-actively managing the risk inherent in investment, creating a balanced portfolio delivering long term sustainable income, for the purpose of supporting the continued provision of Council Services."

This key objective will be delivered through the application of the following principles: -

- To invest in commercial property to generate a sustainable income, with clear margins exceeding the costs of acquisition (including purchase costs), management and financing.

- To build financial resilience through the creation of a diversified portfolio, to spread and balance risk and return.

- To acquire established commercial properties generating an immediate stable income and preserve capital (notwithstanding market changes).

- Supporting economic growth within the District and Borough, where suitable opportunities arise, provided the return covers the costs of any associated financing.

- Re-evaluate the existing property portfolio to maximise the financial benefit.

- Retain/re-purpose/dispose of the existing property portfolio, where/when appropriate, to maximise long term revenue generation in consideration of wider market outlook and opportunity.

2. Fund Policy

- Retain existing assets, where appropriate, to generate income, investing where necessary to enhance returns.

- Review the benefits of an investment vehicle, such as a holding company, to retain acquired assets.

- Capital receipts from the sale of Strategic Investment Fund (SIF), or other council properties, to be considered for ring fencing to: -
  - Reinvestment in SIF property, to sustain income generation and maximise opportunities
  - Repayment of capital borrowing to improve the return on existing assets.

- Allocation of new prospective purchases to either Adur or Worthing Portfolios, will be driven by fund diversification and risk management considerations.

- We will not engage with occupiers who may present a significant unmitigated reputational risk.

SECTION 1 – The Investment Strategy

3. Financial Resilience

We will always undertake thorough due diligence to ensure risks associated with any proposed acquisition are understood and mitigated.

The following table details a series of guiding principles, employing conventional measures that are intended to assist decisions to create a balanced portfolio, by providing a basis to manage risk through diversification.

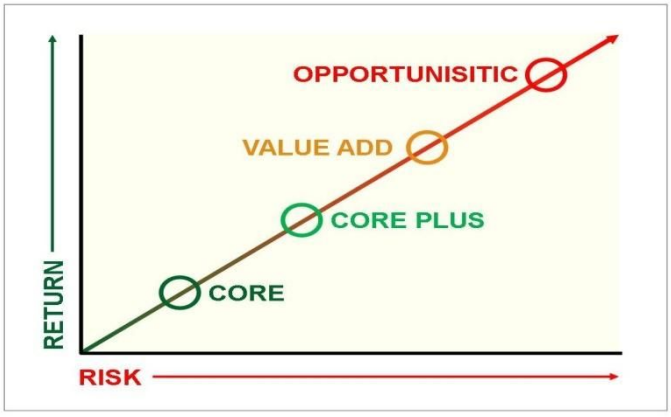
Risk Diversification		
Geographical Diversification	Maximum of 30% of the Target Fund size is invested in any single town.	Given the relatively small size of the funds, initially concentrating on outer London and the wider South East area, with consideration given to wider geographical diversification, as the funds grow and approach their target sizes.
Asset Class/Sector Mix	Industrial/Warehouse 25% Offices 30% Retail 20% Alternatives 25% (e.g. car parking)	To ensure a spread of risks, acquisition across office, retail and industrial sectors. At the outset, the portfolios will be heavily weighted into certain sectors and classes, driven by opportunities and market performance. It is expected weightings will progress towards targets as the portfolio matures in the longer term.
Average Property Size	Guide Size c.£5-15m	Assuming a combined fund size of £150M, this will support a spread of investments. Acquisition outside the guide sizes will be considered where they offer a good return, support diversity within the portfolios, do not create over exposure to a large single tenant/asset.
Leases Expiring within 5 years	Maximum 30%	Spread and diversity sought in future lease expiries across acquisitions to protect revenue streams
Target Return	A return exceeding the cost of borrowing	Initial return exceeding the cost of borrowing, preferably by 2%. Lower returns considered if there is a viable business case/portfolio fit.
Target Fund Size	£250M	In order to make a meaningful contribution to the financial challenge, the Councils has agreed to build a portfolio that will generate an initial yield of at least 5%.
Capital Reserve Fund	20% of the gross rental income	Held in a fund to provide a long term contingency to mitigate future d capital expenditure , maintenance, refurbishment etc.

It is important to acknowledge that the above principles are ongoing long term objectives and attaining balance will progress as the fund matures.

SECTION 1 – The Investment Strategy

4. Fund Structure

Commercial property investments can be divided into different segments, based upon their position at differing points on the risk v return spectrum.



The following guideline Fund Structure is the basis of investment, adopting a prudent, income focused, strategy: -

	%	
Core	50% (+/-20%)	Modern, or extensively refurbished buildings, fully let on long leases to good covenant tenants in major core markets.
Core plus	30% (+/-20%)	Single or multi-let buildings, with various lease lengths and tenant covenant. Opportunity to add value.
Value Add	Max 20%	Higher risk assets that can be repurposed to generate income.
Opportunistic	Max 10%	

SECTION 1 – The Investment Strategy

5. Purchase Guidelines

- Target area UK wide, with focus upon Greater London and the south east.
- Commercial real estate.
- Freehold, or long leasehold nominal rent purchases.
- Income producing properties, leased on conventional terms, secured against good covenant tenants.

SECTION 2 – Investment Portfolio Management

6. Annual Review

To monitor performance and ensure proactive risk and opportunity management, the Annual Review will consider: -

Portfolio

- Market update on activity and forecasts to identify any re-purposing of any asset(s)
- Review of the current investment strategy
- An external market valuation of the portfolio to monitor and benchmark performance, meeting financial requirements.
- An updated three to five year cash flow forecast
- An update of three to five year capital expenditure forecast
- A review of retain, sale, repurpose or re-gear of each asset
- Review of the previous year performance including any (Key Performance Indicators) KPIs
- Review of the underlying life cycle of the asset and refurbishment expectations.

Asset Management

Report to include: -

- Rent collection rates, arrears, service charge reconciliations.
- Advise on all critical lease matters including rent reviews, lease renewals, lease breaks, re-gearing opportunities.
- Dilapidations, health and safety, insurance claims.
- Capital expenditure over the preceding 12 month period.
- Forecast 5 to 10 year Capital Expenditure
- Forecast main plant, mechanical and electrical lifecycle and major refurbishment timeline and costs.

INVESTMENT PROPERTY NEW PURCHASE PERFORMANCE 2018/19 financial year

	ADUR	WORTHING	COMBINED TOTAL pa
INCOME TARGET			
Net Income Target	£416,000	£416,000	£832,000
Net Income Target - Surplus/ Deficit	£7,544	-£41,723	-£34,179
Target Delivered to date (%)	**98.19%**	**110.03%**	
PURCHASES			
Completed 2018/19 (Purchase Price excl purchase costs)	£24,980,000	£25,140,000	£50,120,000
Prev Years	£10,930,000	£11,935,000	
Sub-Total	**£35,910,000**	**£37,075,000**	**£50,120,000**
Committed Future Expenditure (under offer)	£5,600,000		£5,600,000
Committed Future Expenditure (exchanged)			
Total	**£41,510,000**	**£37,075,000**	**£78,585,000**
NET INCOME (per annum after financing costs)			
2018/19	£521,733	£522,207	£1,043,940
Prev Years	£287,764	£346,097	£633,861
Total	**£809,497**	**£868,304**	**£1,677,801**

ADUR

YEAR	Address	Description	Tenure	Rent Passing (per annum)	Purchase Price	Purchase Date	Gross Yield	Net Yield (purchase costs deducted @ assumed rate of 6.75%)	Net Income (per annum after financing costs)	Tenant (incl Company No)
Prev Years	Highdown House, Yeoman Way, Worthing, West Sussex BN99 3HH	Office with 359 car spaces, single tenant	Freehold	£700,000	£10,930,000	Jun-16	6.40%	6.00%	£287,764	Equiniti Ltd (06226088)
	Sub-Total			**£700,000**	**£10,930,000**				**£287,764**	
2018/2019 f/y	Portsbridge Service Station, Portsmouth Road, Cosham, Hants PO6 2SJ	Petrol Station with Morrisions convenience store	Freehold	£150,000	£2,700,000	Sep-18	5.56%	5.20%	£22,450	Rontect Service Station A1 Ltd (108480)
	One York Road, Uxbridge, UB8 1RN	Office with 72 car spaces, let to three tenants	Freehold	£736,966	£10,630,000	Sep-18	6.93%	6.49%	£292,136	Multi Let to: - TM Lewin & Sons Ltd (00340508) NFON UK Ltd (08510507) London Square Ltd (07774351)
	Waitrose Altrincham WA14 5ZL	Waitrose supermarket and car parking	Freehold	£639,333	£11,650,000	Jan-19	5.49%	5.14%	£207,147	Waitrose Limited (00099405)
	Sub-Total			**£1,526,299**	**£24,980,000**				**£521,733**	
Total				**£2,226,299**	**£35,910,000**				**£809,497**	

WORTHING

	Address	Description	Tenure	Rent Passing (per annum)	Purchase Price	Purchase Date	Gross Yield	Net Yield (purchase costs deducted @ assumed rate of 6.75%)	Net Income (per annum after financing costs)	Tenant (incl Company No)
Prev Years	85-91 Montague Street, Worthing, BN11 3BN	Two High Street retail units, multi let to two tenants	Freehold	£190,000	£1,700,000	May-16	11.18%	10.47%	£100,634	Multi Let to: Burton/Dorothy Perkins Properties Ltd (04464946) Bon Marche Ltd (07909526)
	81-83 Montague St, Worthing, BN11 3BN	High Street retail unit, single tenant	Freehold	£115,000	£1,360,000	Aug-16	8.46%	7.92%	£60,950	Clarks (00099857)
	73-79 Montague St, Worthing, BN11 4BN	Two High Street retail units, multi let to two tenants	Freehold	£237,000	£3,300,000	May-17	7.18%	6.73%	£112,376	Multi Let to: Caversham Trading Limited ta Brighthouse (05396147) River Island Clothing Co Ltd (00636095)
	Union Place Car Park, Worthing, West Sussex, BN11 1LG	A large surface car park, leased to NCP, 178 spaces. Annual RPI uplift rent	Freehold	£306,335	£5,575,000	May-17	5.49%	5.15%	£72,137	National Car Parks Ltd (00253240)
	Sub-Total			**£848,335**	**£11,935,000**				**£346,097**	
2018/2019 f/y	Matchtech, Building 1450, Solent Business Park, Fareham, Hampshire, PO15 7AF	Office with 99 car spaces, single tenant	Freehold	£275,141	£4,300,000	Nov-18	6.40%	5.99%	£95,904	Matchtech Group (UK) Ltd (04426336)
	Building One, Wyndyke Furlong, Abingdon, OX14 1UQ	Office with 121 car spaces, single tenant	Head lease 250yrs	£593,450	£9,600,000	Jul-18	6.18%	5.79%	£198,516	Gigaclear PLC (07476617)
	Beta Building, Reading RG1 3ES	Office with 41 parking spaces, single tenant	Virtual Freehold	£659,565	£11,240,000	Jan-19	5.87%	5.50%	£227,787	The Prudential Assurance Company Limited (15454)
	Sub-Total			**£1,528,156**	**£25,140,000**				**£522,207**	
Total				**£2,376,491**	**£37,075,000**				**£868,304**	

Combined Total (Adur & Worthing)				
Previous years	**£1,548,335**	**£22,865,000**		**£633,861**
2018/19 financial year	**£3,054,455**	**£50,120,000**		**£1,043,940**
Total Spend to Feb 2019	**£4,602,790**	**£72,985,000**		**£1,677,801**

REPORT ON ADUR DISTRICT COUNCIL & WORTHING BOROUGH COUNCIL'S STRATEGIC INVESTMENT FUND

JANUARY 2019

REPORT PREPARED BY:

JEREMY GIDMAN BA (Hons) MSc MRICS

On behalf of

CITICENTRIC LTD

29th January 2019

This report has been written to advise Adur District Council and Worthing Borough Council ("The Council") on the development of its commercial property investment fund ("The Fund"). Since the approval of its Investment Strategy in July 2018 the Council has purchased seven assets with a value on acquisition of £50.12m. Assets have been acquired both within the Council's administrative district and in other areas within the South East of England. The overall combined fund now comprises 15 assets with an overall purchase value of £72.99m.

The purpose of this report is threefold. Firstly, it aims to provide guidance on the optimal size and scale of The Fund in the context of financial needs and broader commercial property market conditions.

Secondly, it provides recommendations for the preservation of some income derived from Fund revenue which should be set aside for irrecoverable expenditure, potential capital expenditure and incentives/rent free periods on re-letting of voids.

Finally, it recommends a number of initiatives which the Council may wish to consider in order to develop a robust, liquid and diversified fund providing stable and predictable levels of income while aiming towards future rental and capital growth.

1. Analysis of the size and nature of the UK commercial real estate investment market and its participants.

The Office for National Statistics (ONS) National Accounts "The Blue Book" gives the most comprehensive picture of the total stock of property assets in the UK. At the end of 2017, the Blue Book recorded a total of £8.8tn in property assets representing 87% of the total stock of fixed assets and 21% of the national wealth, including equities and bonds. The ONS estimates that commercial property stock in the UK accounts for £935bn of this total.

By floor area, industrial dominates with 56% of the total but, with rental values less than half the average for all commercial property and marginally higher yields, the sector accounts for only 24% of total value as against 38% for retail and 30% for offices.

From 2003 two 2017, the total value of commercial stock (including net additions to stock) has risen at an annual rate of 3.4%, slightly ahead of inflation at 2.9% although a fitted trend over the period indicates a lower underlying growth rate in value, at 2.1% per year. The table below shows the split of stock by investor type, with changes in market share over the last year and over a period of analysis dating back to 2003. Local authority activity is classified within 'Other Owners' and represents the major positive contributor to ownership during the 12 month period analysed.

Table 1 – Commercial investment stock by owner type

UK Investors	2017 £bn	2017 % share	Change in market share (%)	
			From 2016	From 2003
Insurance Direct & Funds	42	8	0.0	-12
Pension Funds	42	8	0.2	-2
Unlisted & Collective Schemes	83	16	0.0	7
Listed Companies & REITs	73	14	-0.8	0
Private Companies	58	11	-0.9	-6
Estates & Charities	23	5	-0.2	0
Private Investors	14	3	0.0	0
Other Owners	22	4	0.3	-1
Sub-total	**357**	**70**	**-1.4**	**-14**
Overseas Investors				
Unlisted & Collective Schemes	52	10	0.4	..
SWF & Government	29	6	0.2	..
Private Companies, Individuals	26	5	0.2	..
Listed Companies & REITs	14	3	0.1	..
Insurance & Pension Funds	12	2	0.1	..
Other Owners	18	4	0.1	..
Sub-total	**152**	**30**	**1.2**	**15**
Total	**509**	**100**		

Source: Own estimates from MSCI, RCA, PFR and other sources

2. Local Authority Activity in the Commercial Investment Market

According to the Ministry of Housing, Communities and Local Government, local authorities invested £4 billion in land and buildings in the financial year to March 2018, an increase of 43% from a year earlier. Officials believe that £1.8 billion of last year's total was for investment purposes, a six-fold increase from 2014. Expenditure on investment property by local authorities during the 2018 calendar year is estimated at £1.9bn.

Despite being historic, the table below highlights the growth in acquisitions during 2016/2017 but also the spread of transactions by lot size and value.

Table 2 – Investment transactions by local authorities 2016-2017

Investment Transactions by Local Authorities	2016			2017		
	No of Transactions	Value (£m)	Average Lot Size	No of Transactions	Value (£m)	Average Lot Size
>£100m	1	£387	£387	4	£561	£140
>£20m-<£100m	11	£494	£45	18	£680	£38
>£10m-<£20m	19	£249	£13	26	£389	£15
<£10m	47	£239	£5	39	£201	£5
Total	78	£1,369	£18	87	£1,831	£21
Inside Administrative Boundary		85%			75%	

Source: Ministry of Housing, Communities and Local Government/Property Data

The majority of local authorities have adopted similar strategies for acquiring well-secured investments on an income yield model targeting returns of between 5% and 6%. Where local authorities tend to diverge in strategy is over geographical focus, with a number of councils pursuing assets only within their administrative area whereas others are prepared to invest anywhere in the UK (see Table 3 below). Certain councils have a stated ambition to invest for town centre regeneration purposes only, e.g. Woking Borough Council, although councils such as these are now making opportunistic acquisitions of long term investment product in order to maintain their own place making criteria.

Table 3 – Alternative local authority investment strategies

Focus of investment	Features	Example
Within council area	• Investment only within council boundaries • Priority is investment in regeneration projects and meeting council's strategic objectives	• Bournemouth Borough Council • Eastleigh Borough Council • Lincolnshire County Council
Within 'economic area' as defined in the relevant investment policy	• Investment within boundaries of council and adjoining local enterprise partnerships	• Scarborough Borough Council • Torbay Council • Northamptonshire County Council • Three Rivers District Council
Outside council area	• Investment only occurs outside area, or there is clear preference for such an investment strategy by council • Policy of clear separation between day-to-day investment and day-to-day asset management • Avoidance of local political interference in investment decisions	• Confidential – given sensitivity of investment out of area
Hierarchy of localities	• Priorities for investment starting with council area, then region, county-wide, and eventually national	• Kettering Borough Council
Anywhere	• Solely driven by financial assessment of opportunity	• Surrey County Council • West Berkshire Council
Separation of objectives	• One fund for investment and one for regeneration	• Torbay Council

Source: Real Estate Works/RICS

3. Guidance on diversification, fund size and structure

Property investments carry unique individual characteristics which means that the individual assets can perform differently, generating different return profiles. It is therefore important for any balanced fund to carefully assess portfolio structure, diversification and individual / aggregated lot sizes.

a) Portfolio Structure

Investment strategies typically allow for a mix of asset profile, and the Council has identified this within its Investment Strategy, targeting assets at both end of the risk spectrum, notably:-

Core – lower yielding, lower risk, with limited added value. For example a modern building led on FRI leases to national covenants for 15 years or more.

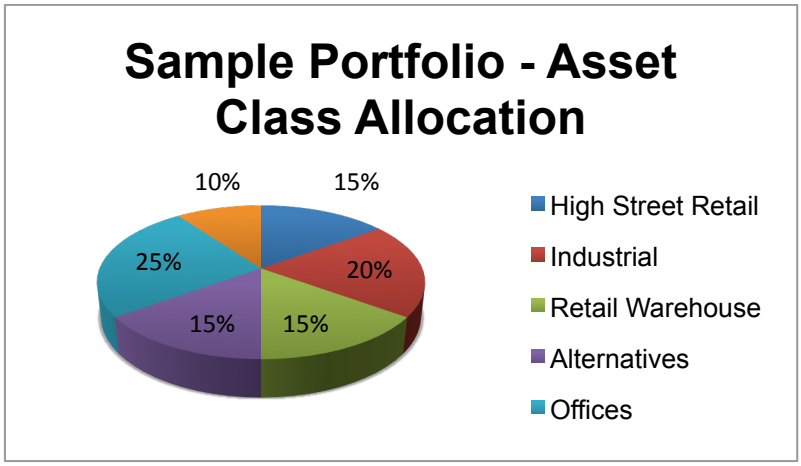
Core Plus - higher yields (risk) but with added value opportunities. Examples include regional office buildings let to a mixture of national and local covenants for a seven-year average lease term, or a multi-let industrial estate fully let to 10 or more tenants with five-year average lease terms.

Value Add / Opportunistic - high-risk but greater reward often refurbishment led. An example might include part vacant office building in a Big Six office location with the opportunity to refurbish and re-let, or a single let retail shop in Bournemouth let to a single national tenant but with a underutilised upper floors capable of being relet or sold off for a higher value use through changes use planning.

Investors looking for income security and income growth will generally place greater weight to the core/core plus categories. Value Add and Opportunistic assets, however, play a part in a balanced portfolio as they can produce superior returns that are often capital intensive (development led) and generate a low income yield in the early years.

b) Portfolio Sector Balance

Property sectors also behave differently, driven by various economic influences, some micro, others more macro. An example is perhaps between retail and offices where we have seen a structural change in the retail consumer market, impacting on how people shop and the demand for retail premises, compared to the office sector which has seen a large reduction of total office stock through conversion to residential. Retail rents have declined whereas office rents have risen due to lack of stock. To provide the right balance between risk and return, a spread of sector exposure is required. Based upon our view of the current property market, a long-term aspirational sector split is shown in the table below.



The term 'Alternatives' refers to assets such as student accommodation, hotels, petrol filling stations, car parks, data centres etc. Our reference to 'Other' means investment in infrastructure or indirect investment in assets / asset classes where direct access may not be possible due to lot size or scale.

The above allocations highlight a fairly balanced approach towards the retail, industrial and office sectors, but with the principal objective remaining a strong income return. Many larger funds have started to reduce their exposure to the retail sector (particularly the retail warehouse sub-sector) due to a weaker occupational outlook. However, we believe that retail assets remain an important element of a balanced portfolio, and indeed there are early signs that certain investors with retail expertise are now targeting re-priced retail assets. In short, we see retail as an opportunity sector for 2019/2020 with the potential for higher yielding income returns subject to careful stock selection.

It is important to stress that ideal fund balance and weightings will continue to change due to a number of factors, not least market conditions. The above model should therefore not be viewed as prescriptive in terms of fund policy.

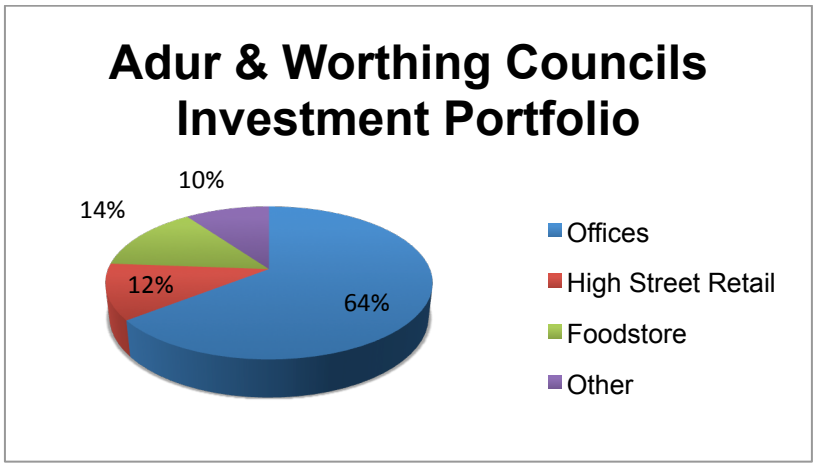
4. Observations on Adur & Worthing Councils' Investment Strategy and Fund.

In preparing this report we have had sight of the Council's Investment Strategy dated July 2018. Broadly speaking, this strategy is in keeping with a number of other local authority fund structures. It provides for investment generally outside of the administrative area with diversification policies in terms of geographical spread, asset class, lease term weightings, lot size and tenant exposure.

We understand that The Council has an endorsed investment fund of £150 million, operating effectively as two separate funds of £75 million pounds per council. Expenditure on assets to date has been £39.9 million by Adur District Council and £37.08 million by Worthing Borough Council. Funding has been via the Public Work Loans Board, typically on 40 year loans at interest rates of below 2% fixed. We are advised that the nature of the loan may be extended to 50 years from April 2019 in return for a higher fixed interest rate of 2.5%.

The investment portfolio currently comprises 11 assets producing a net rental income of £4,602,790 per annum. Based upon the original (but historic) purchase price of £72,985,000 this suggests a net initial yield of 5.91%. Pricing may well have changed on the more historic purchases and we would recommend a portfolio valuation within the next three months. It is noted that the fund has invested just over £50m within the last six months following the establishment of its investment strategy. Our understanding is that there are approvals in place for further acquisitions of £50m per year over the course of the next two years.

The portfolio is currently weighted heavily towards the office sector, with no present exposure to industrial or out of town retail assets. We suspect that it has proved challenging to acquire good quality industrial stock given the strong demand in the market for this sub-sector, placing inward pressure on yields. Many local authority funds are in a similar position.



To a large extent the scale of a Local Authority fund should be governed by its financial need for additional revenue and/or the requirement for investment into its administrative area (i.e. town centre regeneration). As noted within the Council's investment strategy, statutory guidance makes clear that local authorities should not "borrow in advance of need."

The Council has agreed a strategy to build a combined portfolio of £150m, with funding spread over three years at £50m per year. It is noted that £50m has been deployed in the six months from July 2018, suggesting that further investment may be held back by the agreed strategy and opportunities may be missed. In our view the main observations identified with the current fund size and structure are:-

Profile	Comment	Advantages	Challenges	Recommendation
Sector Weightings	Overweight in offices. Underweight in industrial.	Improved running yield.	Higher capital expenditure requirement.	Target good quality secondary industrial.
Geographical Spread	Recent purchases in strong South East locations.	Reduced void/re-letting risk. Improved income return.	High capital values / reduced number of assets.	No change
Tenant Risk	Predominantly single let acquisitions to strong covenants	Reduced management and tenant risk	Exposure to larger voids on expiry.	No change
Average Property Size	Average price of recent acquisitions £7.69m.	In line with Investment Strategy targeting £5m-£15m.	More assets = greater management resourcing	No change
Target Return	Running yield 5.91%	In excess of 5%+ strategy.	Income strategy restricts ability to regear leases / extend income.	Consider value add / opportunistic assets.
Funding Structure	£50m funding p.a.	Structured deployment of capital and allows for orderly management of assets.	Limits acquisition strategy and opportunistic purchases during Q1 2019	Ensure access to full funds is available to enable consideration of all investment opportunities.

Based on the above observations we have no immediate concerns regarding the agreed strategy being pursued by The Council. There is a potential weakness in the funding structure whereby the inability to deploy more than £50m in any financial year may hinder the acquisition of available assets which meet the Council's criteria. We recommend that access to all committed funds is available to ensure that any appropriate investment opportunities can be fully considered as necessary, subject to the robust assessment, scrutiny and check systems which the Council already has in place.

In our view the optimal size for a local authority investment fund is in the order of £250m (in this case we refer to a combined figure for both councils), and we would recommend that, in due course, the size of the aggregated Fund is increased towards this level subject to monitoring of performance. Funds in excess of this threshold tend to adopt an income plus capital model, whereby value can be created through yield shift from lease extensions and regears, which is more of a challenge for income focused funds.

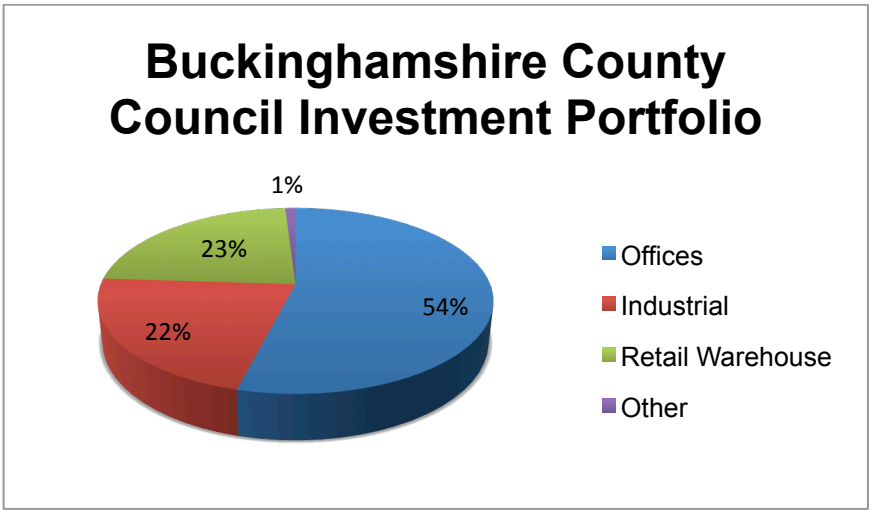
By expanding to a portfolio of this size in due course, the Council should be able to derive sufficient regular and predictable income in order to service the funding gap identified, while also allowing for greater diversification to enable a more effective recycling of capital in a measured and timely fashion when market conditions or opportunity arises.

It will also create greater flexibility and reserves to enable lease re-gears on assets such as Highdown House, where the tenant is willing to re-negotiate lease terms which should enhance asset value.

Case Study – Buckinghamshire County Council

In our experience, most local authorities have ventured into the commercial property investment market through funds of an initial size of £25 million to £50 million, before increasing their exposure on an incremental basis.

An example of this is Buckinghamshire County Council which established a £50m fund in 2016, purchasing two assets in county with a lot size of between £1.5m and £2.2m, before growing the Fund to £75m by the end of 2017 (purchases at £16m to £22m) and to £141m by the end of 2018 (recent lot sizes of £30m and £35m). Their fund currently comprises 8 assets with the following sector spread (by income):-



Buckinghamshire County Council have adopted a strategy of investing within County where possible, based upon a sensible sector allocation and targeting a running yield of 6%. They have found a reasonable level of stock at the desired lot size levels, assisted by their focus in-county which has led to a number of speculative/early approaches by vendors and agents. On the downside they are highly exposed to certain sub-markets such as Maidenhead offices (£75m of portfolio by value). There has also been CVA/insolvency activity affecting both of the retail parks held within the fund.

Buckinghamshire County Council has also experienced issues with sanctioning lease regears where tenants are prepared to commit to longer leases in return for an extended rent free period. These initiatives were identified at a time when the running yield on the portfolio was at just under 6% and the impact of rental income interruptions would have breached the commitment of the fund to maintain a running yield at close to 6%.

5. Market update including commentary on opportunities, current and future competition and market trends.

Despite the economic uncertainty surrounding Brexit, there remains strong demand from domestic and international investors for good quality, well secured investment stock within the UK. Investment transactional activity during 2018 is predicted to have reached just under £60bn which is consistent with the previous two years, despite Brexit uncertainty.

Prime yields have largely remained unchanged throughout 2018 with the exception of the retail sector, specifically out of town retail and shopping centres where pricing has weakened significantly (see below).

Table 4 – Prime Net Initial Yields

Sector	Dec-17	Dec-18	Sentiment
High Street Retail – Regional	4.25%	5.00%	Negative
Shopping Centres – Dominant Regional	5.50%	7.25%	Negative
Open A1 Retail Parks	4.50%	5.50%	Negative
Foodstores (RPI)	4.25%	4.25%	Positive
SE Industrial	4.25%	4.00%	Stable
SE Offices (Towns)	5.00%	5.00%	Stable
SE Offices (Business Parks)	5.00%	5.00%	Stable

The retail sector has suffered a challenging year with occupier uncertainty spreading from the high street to the out of town retail park market, principally due to the continued increase in online shopping, decreasing profit margins for retailers and the impact on business rates. We predict that there will be further CVA and insolvency activity during the first half of 2019 including further casualties in the travel and food and beverage sectors. As a consequence, yields on high street retail investments have softened by 50 to 75 bps over the course of 2018, with retail parks moving out by 100 bps. However, we are aware that some funds and property companies are beginning to view retail, particularly out of town retail, as good value and we believe that experienced retail investors will begin to acquire re-priced assets during the latter part of the year. Now would be a sensible time to evaluate this sector.

The industrial sector remains aggressively priced at 4%-4.25% NIY for prime stock in Greater London and the South East. Good quality regional stock offers better value at 5.50%-6% and should be considered as an opportunity to increase weightings in this sector. Regional office stock is currently trading at between 4.75% (Thames Valley) and 5.25%/5.75% for other Big Six office locations.

Factoring in capital growth, all property total returns during 2018 were 5.60%, with industrial being the star performer at 16.60% based principally on capital growth of 11.40%. The office sector has also outperformed with total returns of 6.20%.

6. Recommendations on a suitable level of income retention to deploy against future voids, capital expenditure, incentives etc.

The Council's investment strategy makes provision for the retention of 20% of income revenue to put towards future expenditure on repairs, refurbishment and letting incentives. In our experience this is a sensible proportion of income and many other local authorities are preserving much lower levels of 5%-10% of revenues for the purposes of replenishing interruptions in income.

The most effective method of predicting levels of irrecoverable expenditure and revenue interruptions is through the preparation of cash flows at the point of acquisition and at regular intervals as part of the asset management programme. Needless to say each asset will produce a different income and expenditure profile, but the following model may be helpful in testing whether appropriate cash reserves are being held.

The table below sets out the estimated costs of three notional assets over a 10 year hold period, assuming that during this period 50% of the accommodation will become void. It includes the cost of minor refurbishment, as opposed to major overhaul of services (net of dilapidations) together with overall costs of holding the asset while it is not income producing (i.e. non-received rent, business rates, service charge and insurance).

Table 5 – Indicative Expenditure on a 10 year hold basis

Asset	Void Costs	Refurbishment	Total	Proportion of Total Net Income p.a. over 10 years
Multi-let SE office building 30,000 sq ft	£675,000	£150,000	£825,000	**18%**
Multi-let SE industrial estate 40,000 sq ft	£260,000	£100,000	£360,000	**15%**
Multi-let SE retail park 45,000 sq ft	£1,031,000	£169,000	£1,200,000	**18%**

This is an overly simplistic model but based upon the assets being acquired by the Councils, we believe that a 20% retention of revenue is appropriate to prepare for potential irrecoverable expenditure. Where possible, we always recommend that a landlord client implements a planned preventative maintenance programme on multi-let assets in order to manage and predict building fabric and M&E/services expenditure.

7. Conclusion and Recommendations

Our experience of local authority investment shows that many councils are focused on maintaining a running yield and not giving due attention to active asset management opportunities either because of limited resources or because there is insufficient flexibility within the fund structure to allow for changes to income stream. This is a natural symptom of an investment model which focuses principally on income return.

We note that The Council has a strategy in place to appoint external property managers and valuers to support the Annual Review process. In our opinion, an in-house or independent investment advisor role is critical to ensure that local authority funds have sufficient resources in place to benchmark their portfolio and provide independent advice on acquisitions both before and during the period of ownership. We have experience of working with local authorities in this regard and can expand on this further if required.

The Council is at a stage where it has successfully seeded the Fund and it will naturally aim to balance the weightings through the next cycle of investment. Our recommendations for this next stage are:-

a) Target investment opportunities which hold potential for additional revenue streams, i.e. retail parks with surplus parking for drive thru/car wash, prominent sites with signage options

b) Adopt some exposure to well-let secondary assets with higher yield in the range of 7%-8%+, possibly through regional stock which preserves the required lease term. This will help to provide greater flexibility in the running yield for asset management initiatives.

c) RPI indexation within a proportion of the portfolio will generate more stable income in the Core category

d) Greater focus on active asset management and preparation for future recycling of capital

e) Ensure that there is full and immediate access to remaining funding to ensure that all suitable investment opportunities can be investigated and acquired.

We have no concerns over the checks and balances which the Council has in place for developing the Fund. An active asset management function will be crucial to unlocking future growth and ensuring that revenue is both protected and enhanced.

In our opinion the decision by Adur & Worthing to target strong outer London and South East locations is sensible, and should provide confidence to grow the fund size as long as suitable diversification strategies are is in place.

INVESTMENT PROPOSAL

Property Name/Location:
Vendor:
Tenure:
Category:
Price:
Rent per annum:
Rent Free:
Initial Yield:
VAT Election:
EPC:
Net Return After Borrowing

	Criteria	Criteria Description	Comments	Weighted Property Score	Excellent	Good	Acceptable	Marginal	Poor
LOCATION	Location: Macro	Quality of the location (town, city, area) with regard to the property use		0					
	Location: Micro	Quality of the individual situation of the property within the macro location, with regard to the property use		0					
	Building Quality	Quality of the building compared to the Industry standard Grade A for the property type		0					
OCCUPANCY	Tenant Covenant	Ability of the tenant/s to pay the rent for the duration of the lease. Credit rating of the tenant		0					
	Tenure	Freehold / Long Leasehold. Consideration of any ground rent obligations		0					
	Lease Term	Length of the secured income.		0					
	Lease Structure	Tenant repairing obligations, rent review mechanisms		0					
	Rental Growth Prospects	Opportunity / Likelihood to increase passing rent/ ERV		0					
	Occupational Demand	Anticipated level of demand from alternative occupiers if the tenant/s were to vacate		0					
STRATEGY	Management Intensity	Complexity and cost of managing the property		0					
	Liquidity/Exit Strategy	The degree to which the property can be quickly sold in the market without affecting the price. Please provide specific commentary on exit strategy.		0					
	Alternative Use / Underlying Value	The value of the land and the opportunity to explore a change of use should this be required		0					
	Asset Management Opportunities	Opportunities to add value to the property		0					
	Financial Return (risk v reward)	The forecast gross financial return considering the risk profile of the property and in accordance with the sector with a focus upon income v capital values at lease expiry		0					
	Portfolio Strategy Context	The extent to which the property meets the strategy and contributes to the achievement of a diversified portfolio		0					

Weighted Score	A property will be expected to score at least 140 out of 200 (70%) on the above matrix unless there are other economic / wider benefits to be delivered within or to the county.	**0**	

Investment Decision Guide for fillingin matrix

example considerations

Criteria	Criteria Description	Maximum Weighted Score	Excellent	Good	Acceptable	Marginal	Poor
Score numerically between 1 and 5 for each row as follows……..							
SCORE TO APPLY TO EACH COLUMN			5	4	3	2	1

PLEASE SCORE 1 TO 5 IN THE TEMPLATE CORRESPONDING SCORES WITH THE ABOVE ILLUSTRATED NUMBERING

SCORING GUIDE			SCORING CONTROLS				
Location: Macro	Quality of the location (town, city, area) with regard to the property use	15	Major Prime	Prime	Major Secondary	Micro Secondary	Tertiary
Location: Micro	Quality of the individual situation of the property within the macro location, with regard to the property use	15	Excellent transport / footfall				Location with limited benefit
Building Quality	Quality of the building compared to the Industry standard Grade A for the property type	15	New, modern or recently refurbished	Good quality- no spend required for 20 years+	Good quality but spend required in 10 years	Spend required in 5 years	Tired / Significant spend CapEx likely
Tenant Covenant	Ability of the tenant/s to pay the rent for the duration of the lease. Credit rating of the tenant	15	Excellent financial covenant	Strong financial covenant	Good financial covenant	Poor but improving covenant	Poor financial covenant
Tenure	Freehold / Long Leasehold. Consideration of any ground rent obligations	10	Freehold	Long Leasehold 125 years + / peppercorn ground rent	Lease between 100 and 125 years / peppercorn ground rent	Lease between 50 and 100 years	Less than 50 years and/or high ground rent (10%+)
Lease Term	Length of the secured income.	15	Greater than 15 years	Between 10 and 15 years	Between 6 and 10 years	Between 2 and 5 years	Under 2 years / vacant
Lease Structure	Tenant repairing obligations, rent review mechanisms	15	Full repairing and insuring	Full repairing and insuring- partially recoverable	Internal repairing	Internal repairing- partially recoverable	Landlord responsible
Rental Growth Prospects	Opportunity / Likelihood to increase passing rent	15	Fixed uplifts at frequent intervals				Significantly over-rented (tenant paying above the market)
Occupational Demand	Anticipated level of demand from alternative occupiers if the tenant/s were to vacate	15	In demand from many tenants		Reasonable prospect of securing new tenants		Niche with limited demand
Management Intensity	Complexity and cost of managing the property	10	Single Tenant				Multiple Tenants
Liquidity/Exist Strategy	The degree to which the property can be quickly sold in the market without affecting the price	10	Lot size & sector attractive to investors				Attractive to niche purchasers only
Alternative Use / Underlying Value	The value of the land and the opportunity to explore a change of use should this be required	10	Favourable location / planning				No opportunity to change use
Asset Management Opportunities	Opportunities to add value to the property	5	Significant opportunity to add value				No opportunity
Financial Return (risk v reward)	The forecast gross financial return considering the risk profile of the property and in accordance with the sector.	20	Return higher than expected for sector / the risk profile				Return lower than expected for sector / risk profile
Portfolio Strategy Context	The extent to which the property meets the strategy and contributes to the achievement of a diversified portfolio	15	Under-represented sector		**Client to fill in**		Sector already heavily represented
Weighted Score		200	A property will be expected to score at least 140 out of 200 (70%) on the above matrix unless there are other economic / wider benefits to be delivered within or to the county.				

SWOT	
Strengths	**Weaknesses**
Opportunities	**Threats**