ADUR & WORTHING COUNCILS

Joint Audit and Governance Committee
21 March 2024
Joint Strategic Committee
17 July 2024

Key Decision [Yes/No]

Ward(s) Affected:

Strategic Property Investment Fund

Report by the Assistant Director for Regenerative Development

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To note: This report is based upon previous year's reports and as such reflects the approach to non-residential investment property management that the Councils have adopted for some years.

From next year, we expect to present a revised approach built around a model of Active Asset Management which should give us scope to improve the approach to management of the SPIFs. The Councils also own other commercial investment property (provisionally called the Second Tier Funds) which is not included in this report but is expected to be included next year. It is anticipated that future reports will also include a richer approach to data following the completion of the Strategic Asset review to be completed Summer 2024.

Executive Summary

1. **Purpose**

Statutory guidance places a duty on Local Authorities to prepare an annual investment strategy to be approved by the full Council or equivalent, in advance of forthcoming financial years.

This report provides an update on the recent investment activities and current position of the Strategic Property Investment Fund as of January 2024. This covers:

- The current overall Fund structures and completions within the current financial year to date.
- Review of economic situation and Public Works Loan Board (PWLB) Funding criteria.
- Review and update of processes to support the ongoing structured and measured approach to property income generations and proactive risk management inherent in any property investment.
- Update mechanisms to support the ongoing retention of a balanced portfolio with a move from initial income generation to income return approach as the Fund matures, with a focus on strategic asset management and long term capital preservation and growth.
- Outline the future strategy to re-focus investment within the Councils' geographic areas including seeking more acquisitions where the Council can add commercial and social value to assets through repositioning, repurposing or redevelopment and for social housing, emergency and temporary homes.

The primary objective of the Commercial Property Investment Strategy (CPIS) is to build a balanced portfolio generating consistent revenue for the Councils' delivery of services for the benefit of Adur and Worthing.

It is recommended that both of these reports be approved by the respective Councils as the Commercial Property Investment Strategy for 2024-2025.

2. Recommendations

- Members were asked to note this Report which was recommended to the Joint Audit & Governance Committee on 21st March 2024 and no feedback and/or recommendations have been referred to the Joint Strategic Committee (JSC).

- It is recommended that the Joint Strategic Committee:

  a) Agree the suggested delivery and governance model as set out in the report which will be approved by the full Council as part of the overall CPIS.

  b) Approves that the average lot size be adjusted from £2m - £20m to £2m - £25m.

  c) Recommends to Adur District Council and Worthing Borough Council to adopt the Commercial Property Investment Strategy for 2024/25.

  d) Approves that the budget for future years may be brought forward with the approval of the relevant Executive Members for Resources, following their consideration of a business case.

  e) Approves that value add and opportunistic investments, as per section 4.3.9, 4.4.9 and 4.6.3, can be acquired and approved under the CPIS in consultation with the Executive Member for Resources considering a robust outline business and financial case.

  f) Approves that assets which were purchased for operational, local economy and regeneration purposes, will be separated in future SPIF reporting to those purchased for investment purposes.

1. Report Context

1.1. Due to continued reductions in Central Government grant Funding, Local Authorities are increasingly reliant upon income generating models to support the delivery of Council services.

1.2. Direct investment in commercial properties is one of the ways that Councils across the country have sought to increase their income growth in support of delivering Council services.

1.3. Direct property investment is commonly undertaken by Local authorities who have acquired assets both within their administrative boundaries and nationally.

1.4. Typically these investments have been Funded through Public Works Loan Board (PWLB) long term lending. Historically, this lending has been on preferential terms to the market enabling authorities to utilise this to generate income over and above borrowing costs. This surplus is used to contribute towards the Funding of services and mitigating the impact of cuts to services whilst also protecting services that would otherwise be at risk of closure.

1.5. Members will be aware that in 2022/23 the PWLB increased borrowing rates but nevertheless, the rates still represented good value.

1.6. Revised 2021 onward PWLB Funding arrangements resulted in increased scrutiny on borrowing, preventing the use of this loan facility to Fund investments primarily for yield. In parallel to this restriction, the PWLB rate was reduced by 1% for qualifying investments.

1.7. Adur District and Worthing Borough Councils already have an established Strategic Property Investment Fund (SPIF) following a report to JSC in July 2015. Since this time, subsequent reports (the most recent being March 2022) have built upon and developed this workstream following the introduction of the two Strategic Property Investment Funds and have increased the current Fund size (capital spend) to £125m per Council.

1.8. The approval of the 2020 CPIS provided mechanisms to grow the portfolio and monitor performance through improved asset management, continued annual reviews and monitoring. This report reinforces the continued need to monitor performance and moves to take a longer term “total return” approach and analysis of the portfolios. The investment strategy as part of this year’s report follows the same format as previously.

1.9. This investment strategy was significantly affected by the Council’s deficit position with officers re-focusing their efforts on rent collection and tenant engagement, driving outstanding rent reviews and securing lease renewals in an uncertain market. Officers sought to preserve the Council's revenue position. Very little of the planned Fund reserves for the year were spent by either authority reflecting the prudent and cautious management approach that has underpinned the development and management of the Fund since its inception.

1.10. As a result, rent collection data (% of all rents collected in advance) for the last financial year for all occupied property was 100% across each quarter with no bad debts. The above figures take into account all rent collection data for all assets currently managed under the SPIF.

1.11. Against the backdrop of the slow recovery from the COVID 19 Pandemic, the portfolios have performed positively during the 2022/23 financial year. The success in rent collection is in part due to the relationships developed with our tenants, but also through the careful evaluation and governance process that has been applied to purchases. Where recoverable, officers will continue to work with tenants with arrears in a proactive and supportive manner to improve the rent collection for the financial period.

1.12. The quality of the assets and their locations reflects a great deal of forethought on the part of the Councils' acquisition team, but this is not taken for granted and periodic reinvestment is required to keep the estate relevant to the market conditions and tenant needs at the time. For example, the Adur SPIF currently has two vacant office suites and each requires investment to position them for the modern office market and revised tenant expectations. The Worthing portfolio contains one office investment that will need significant attention and possibly investment in 2026 but is otherwise fully let.

1.13. This year's investment strategy reflects on the changes in the market over the last 12 months as a result of the long lasting and fundamental changes in the commercial property market as a result of the Pandemic, global and national economic factors and changing consumer trends. This strategy looks ahead to the future providing context for considering and changing the approach to include opportunistic and value add opportunities within the Councils' areas to better support our local economies whilst retaining the context of Council revenue requirements and regulations on this activity.

2. Points for Consideration

2.1. New Acquisitions

2.1.1. During the current financial year, the Councils have not been active as in previous years, but have looked at opportunities as they have presented themselves.

2.1.2. Neither Council made any acquisitions during the 2023/24 financial year.

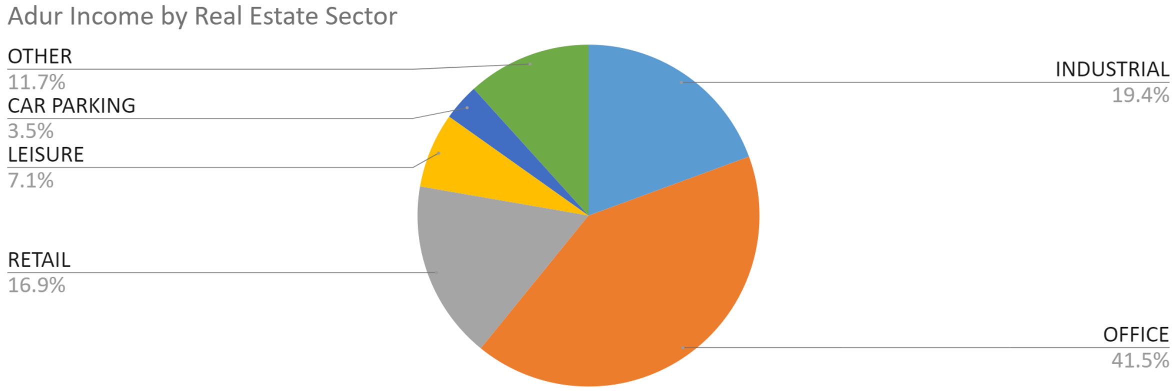
2.2. Current Fund Structure

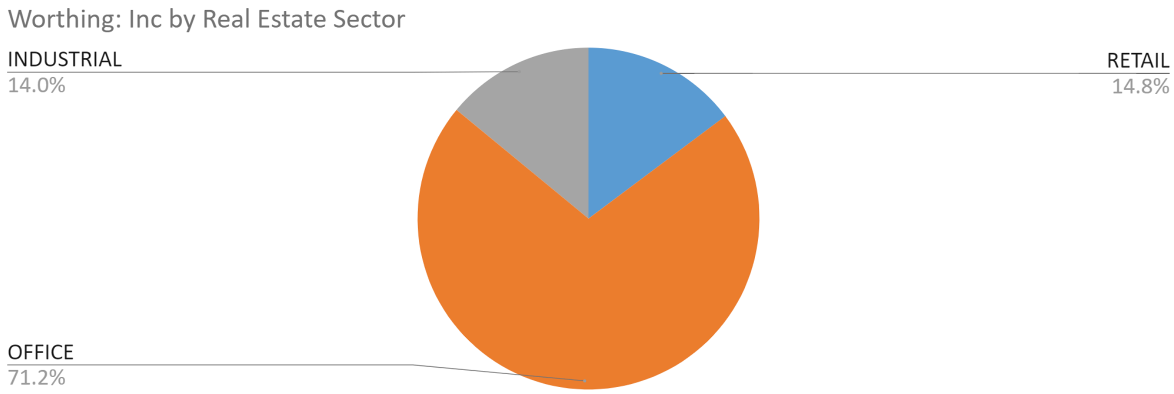
2.2.1. The Council has an established Strategic Property Investment Fund following a report to JSC in July 2015. The overall Fund objective is to invest in commercial property in the UK so as to obtain a high level of secure income and long term capital growth to support the Councils in delivering local services following reductions in Central Government grant Funding.

2.2.2. As a result of this the Councils have sought to acquire assets that present a minimum hurdle average net return of at least 1% over the assumed hold period after all costs and expenses including principal and interest debt payments.

2.2.3. The acquisitions have still sought to minimise risk exposure, seeking strong underpinning factors with the investment but with the objective to obtain stable income and long term capital appreciation. The portfolio is under constant review and where asset returns diminish to an unacceptable level, disinvestment will be considered.

2.2.4. The Funds have maintained a balanced spread between asset classes and geographical locations. The pie charts below detail the current weighting of the Funds considering all purchases to date:





2.2.5. The above pie charts do not include any purchases made which have been acquired for operational purposes, housing or regeneration (with one exception) and local economy purposes.

2.2.6. The above charts show that the latest financial year still leaves both Councils weighted highly towards office investments as this has been driven by a combination of historic market opportunities and strong Fundamentals within this sector (location of properties, strong demand from the UK's service lead economy, high quality of construction and low maintenance).

2.2.7. The office sector makes up a significant proportion of the commercial real estate value in the UK in terms of value. The office sector has experienced challenges, in that office usage rates have fallen owing to a combination of hybrid working, reluctance in some quarters to return to the workplace full time and an acceleration of digitisation. This acceleration and enablement of improved remote working has changed the requirements of office tenants.

2.2.8. Our portfolios are not immune to these factors. Ongoing discussions with our tenants show that although some are not using their space fully, some did downsize space needs in 2023, with one subletting space by agreement, but others are experiencing a very slow or nil return to higher utilisation of office space.

2.2.9. The diversification within the portfolios, and an asset allocation focused on strong underpinning Fundamentals, has resulted in a resilient performance overall given the weighting towards offices which have arguably experienced the most disruption across investment property classes. The Funds' low exposure to traditional retail and greater allocation to food retailing, and industrial and logistic sectors, has been helpful to the Funds' performance. These specific sectors saw significant investor demand and yield compression since the start of the Covid-19 Pandemic. Since the Pandemic, economic pressure has weighed in and the increase in base rates is still affecting capital values.

2.2.10. As income driven investors, the Councils are (relative to the market) not entirely agnostic as to absolute capital value, but focus on strength and consistency of income instead, as well as total return, across the economic cycle. If and when capital values rise and fall, as they will, the focus remains on driving income. The Funds will monitor rent collections and tenant viability with a view to diversification.

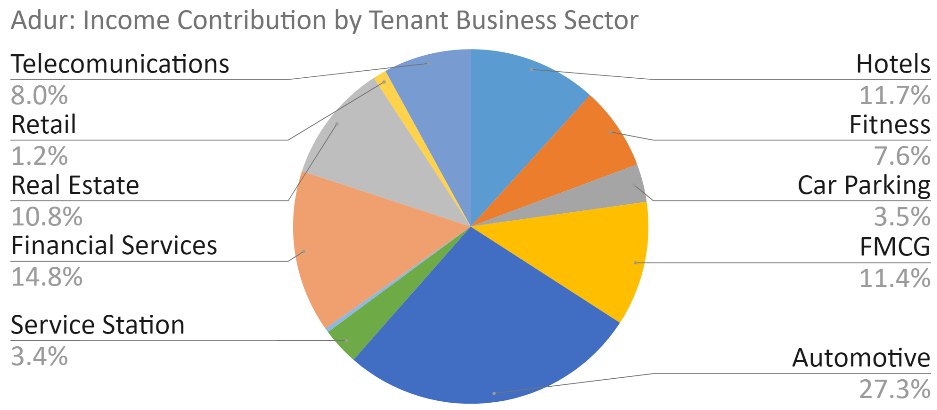
2.2.11. It is important to note that this diversification will continue as the Funds mature and we seek a total return approach rather than immediate short term income. This may mean that assets present challenges as well as opportunities from an asset management perspective and through asset management plans for the individual assets, potentially investment, re-gearing of leases.

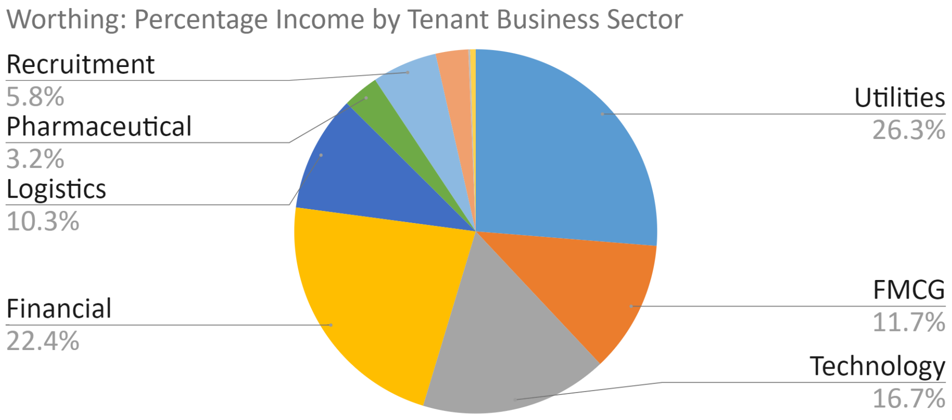
2.2.12. Disposal for reinvestment to reduce exposure may further be required where appropriate returns have not been achieved or if future performance prospects of an asset diminish to an unacceptable level.

2.2.13. Purchases will now solely focus on the Borough and District area of the Councils, specifically targeting opportunities where there is significant regeneration, economic or social value to build a portfolio for a longer term position, balanced with the need to secure long term revenue income for the Councils.

2.2.14. The portfolios will require ongoing investment to achieve long term returns and maintain the estate's appeal to tenants. The forthcoming Minimum Energy Efficiency Regulations (MEES) will put increased pressure on all owners to upgrade space. There is to be a minimum Energy Performance Certificate threshold of A/B in 2030 and C in 2027 beyond which it will be illegal to let space at a lower grade to new occupiers. Within the Funds we have identified where there are shortfalls and are planning to address these which will require a capital programme which is being prepared.

2.2.15. The key considerations underpinning the historic local acquisitions have been about supporting our local economy and employment opportunities and value add opportunities within our area. A market commentary and a key update is provided below on the 'pure' investments across commercial property asset classes. Equally important is diversity across sectors. The graphs below show the tenant sectors.





2.3. Portfolio Breakdown

2.3.1. Offices

Office markets remain subdued due to the lasting impact of the shift to home working, which overlapped with inflation, economic uncertainty and fluctuating interest rates.

This has led to a reduction in investment volumes with market liquidity focused around the life science and biotech sector assets or traditional office assets with long dated income from secured investment grade tenants. Demand for space, and supply, remains thin in our area for the time being. Investment yields have moved out in non-core offices and volumes are lower than previous years but may be recovering later this year.

Offices have typically been considered to be the least volatile commercial property asset class and it is not unexpected that both Councils became heavily weighted towards offices within the portfolios. The reality is that people will always want somewhere to work collectively, and most of our Fund office assets would present well in any occupier's search for space.

Looking to 2024 office occupier markets are likely to continue to perform modestly for high quality stock however there remains some uncertainty around structural changes in this sector as some occupiers are still examining how they will move to more flexible working. This is resulting in an acceleration of secondary office stock being repurposed where they face economic and physical obsolescence. Some of our office stock will require updating at lease expiry (if tenants leave) as is normal procedure with any portfolio as there is a need to anticipate and meet changing tenant needs.

Locally the lack of supply is not met with enough demand to encourage rental levels to rise so that it is viable to build new stock. Any new stock might challenge the value of the existing stock. The same may be said for other markets in which we own offices. The largest known threat on the horizon to value and rents though is not new supply, nor lack of demand, it is the forthcoming MEES regulations.

2.3.2. <u>Retail</u>

The decline in 'bricks and mortar' retail was exacerbated by the Pandemic which accelerated the move to digital trading. Although it is anticipated that this decline may continue, those town centres that have something to offer as destinations in their own right will perform ahead of the market. Some retail property has halved in value across this cycle, but arguably from over inflated values. Many former shop units are being re-used as quasi retail space, housing 'internet-proof' end users whose service is a destination for customers, for food and beverage sales or where personal attendance or click and collect are factors.

Retail properties will continue to present risk until a sustainable model for traditional retail is established. Other than food store retail, or where the Councils see a regeneration or social opportunity, it is recommended that unless there are compelling reasons for an acquisition, that this asset class continues to be avoided.

It is anticipated that there will be continued and accelerated structural change in UK retail in 2024.

In our Funds we are relatively underexposed to retail, owning regeneration and local shops, together with a secure ground lease. Within the two SPIFS, well located retail units offer long dated income.

2.3.3. <u>Industrial</u>

Industrial and logistics investments remain highly sought after, both prime and secondary stock, with net yields until 2022, often reflected at sub 5%, now having moved out to c 5.75%. The Councils have invested into this asset class and could look to increase its allocation to this sector where pricing permits, except that in our area most industrial investments are tightly held and do not enter the market frequently. Industrial investments will remain highly priced due to continued investor demand for industrial stock particularly in relation to last mile distribution. The Councils will remain alert to opportunities, although due to competition, opportunities remain limited. Within areas there is little new stock due to come on stream, other than Decoy Farm which when delivered will increase much needed supply and free up older space in our area for new and younger businesses.

2.3.4. Alternatives

The Councils added alternatives such as an hotel, car parking, gym and laboratory investment to the Funds, acquiring long index linked income with strong investment grade covenants. These sectors have recovered, and subject to detailed risk management, will continue to present as attractive investment opportunities.

The Councils should seek further alternative sector investments to diversify risk across the Funds, meaning sites within Adur District and Worthing Borough and the functional economic areas.

2.3.5. Fund Size

a) The overall Fund size of £125m per Council is relatively small within the context of wider commercial property investment Funds, however due to the risks presented by smaller Funds officers have sought to proactively ensure a diverse portfolio composition and balanced approach.

b)This has proven resilient against increased volatility in the market and has reduced the Council's exposure by spreading risk across a number of assets, lot sizes, sectors and geographical locations. Officers are acutely aware that the portfolio will require reinvestment through a capital programme and Funds will be set aside on a case by case basis for this.

2.3.5.1. There are currently no proposals to increase this Fund size beyond £250m but that the Councils should move to the overall Fund being determined with assets comprising not more than £125m of debt per authority.

2.3.5.2. Due to the impact of changes to the PWLB lending criteria, it is recommended that, following a review of typical transactional opportunities within the functional economic area, the average lot size be amended to £2m - £25m. This also gives a broader scope to catch opportunities not just for the SPIFs, but for sites that can deliver other uses for the Councils' objectives.

2.3.5.3. This will enable the Councils to operate in a window of opportunity partly below that of typical institutional investors (pension Funds and private equity) in order for the Council to remain competitive in the market.

2.3.5.4. It is also anticipated that opportunities below this size are not cost efficient from a transactional and resourcing perspective and there will be limited opportunities above this level in the boroughs.

2.3.5.5. This target average lot size should not restrict the Council from seeking opportunities higher or lower than this subject to the usual due diligence procedures.

2.3.5.6. Proposals to alter the average lot size will not change the Council's acquisition and risk management process other than for redevelopment opportunities.

2.3.5.7. Where an acquisition presents as a value add and opportunistic opportunity, or where there is a repositioning, repurposing and redevelopment opportunity, it is recommended that the acquisition process have an additional requirement to produce a detailed outline business case and appraisal for the redevelopment prior to acquisition, and that a full business case be required in order to release the Funds for development.

2.3.5.8. This will enable the Councils to proactively seek more opportunities in a restricted search area.

2.3.5.9. Officers will continue to evaluate opportunities both higher and lower than the average lot size as well as assets across the evaluation criteria to ensure that opportunities of interest and benefit to the Councils are not unduly ruled out.

2.3.6. Resources and Capacity

2.3.6.1. During 2023-24 the Property and Investment Team led the asset management of this portfolio to support the delivery of the CPIS.

2.3.6.2. Officers are supported on rent collection and service charge management by outsourced day-to-day property management of the portfolio. The Councils' have procured Savills, a FTSE250 RICS regulated property firm with over 130 offices across the UK and 39,000 employees globally.

2.3.6.3. The Property and Investment team was expanded in 2020 with the recruitment of a Principal Surveyor but that staff member and two others have left and a support officer has been assigned elsewhere within the Council. Now there are two Principal Surveyor vacancies and some temporary shortfall in support capability. The SPIFs are being asset-managed by the Property and Investment Manager who has the appropriate experience and qualifications.

2.3.6.4. The composition of the team is being altered to fit the new demands of the Councils by focusing on active asset management, focusing on income and resilience. In practice this partly means a more commercial and end -to end approach so that the team can generate income to support council services and enable the delivery of property assets outside the SPIFs and within the Borough and District for the benefit of the community.

2.3.6.5. The Property and Investment Team will continue to engage specialist consultants where required and appropriate and subscriptions maintained for specialist property software/data to ensure the Councils are well informed in delivery of the CPIS.

2.3.6.6. The Property and Investment team will also continue to maintain relevant CPD requirements for the RICS, seeking to develop trainees and apprentices through their Assessment of Professional Competence, and subject to budget, for more senior officers to develop specialist skills to supplement the service delivery.

2.4. Future Fund Direction and Update to Commercial Property Investment Strategy

2.4.1. The current weighting of the portfolio into the varying asset classes has improved in diversification from previous years as the Funds mature. It is anticipated that this will continue although until the Fund is full it is to be expected to have periods of imbalance whilst further properties are acquired or repositioned. This activity must inevitably slow down given the restricted area of acquisition, budget pressure and relative lack of Grade A investment property in our areas.

2.4.2. It is recommended that through the production of the annual individual asset plans, that officers continually review opportunities within the existing portfolio to re-shape this accordingly in order to manage risk. This will be reviewed against the individual asset performance and ensure that the portfolio has a balanced asset mix representative of the core aims of the SPIF.

2.4.3. Due to the restrictions on PWLB Funding, officers can only consider investments within the functional economic areas of the Council's where there are opportunities to enhance economic regeneration prospects, or maintain and support economic recovery. This may mean the investment and delivery of new employment space, or opportunities where Councils can add value to existing assets through the Council covenant, perhaps by way of under-writing new developments through forward Funding or head leases.

2.4.4. The Councils could consider expanding its investment into alternative asset classes, including the purpose built residential sector i.e. student housing / build-to-rent and temporary accommodation, healthcare, renewables and educational investments.

2.4.5. Due to the specialist nature of some of the above investments, the Councils should continue to review the need for alternative corporate delivery structures, such as wholly owned companies, to ensure it is well placed to manage localised risks with the above asset classes and the changing market.

2.4.6. Owing to market uncertainties and the accelerated decline of retail assets, it is unlikely that the Funds will seek to meet their target percentage of retail stock. It is recommended that the SPIF does not alter its current investment mix as a target percentage but should remain flexible in a fluid and fluctuating market. This will enable the Councils to remain competitive and agile particularly when exploring investments that present strategic opportunities, in an area with limited opportunity.

2.4.7. The Councils should also remain reactive to opportunities that present themselves for additional Council benefit such as where there is the option for site assembly with adjoining properties, longer term regeneration opportunities or other potential windfall acquisitions.

2.4.8. Acquisitions should also be considered for portfolio acquisitions where the investment opportunity meets the Council's KPI to invest but the Fund would need to acquire a number of assets. This can potentially mean acquiring a number of units as part of a single transaction, which may be considered to exceed the average lot size for a single purchase, however individual lots are likely to meet the average size requirements. This is a means to deploy capital in a potentially more efficient manner that generates greater return and opportunities for the Councils.

2.4.9. Councils continue to seek a mixture of 'Core', 'Added Value' and 'Opportunistic' acquisitions within our areas.

2.4.10. The team has carried out a Strategic Asset Review during 2023 which helped to improve asset income and identify underperforming assets for potential disposals. This will be complete by mid 2024.

2.5. Statutory Guidance

2.5.1. 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 2019/20, for which there is a link under background documents at the end of this report.

2.5.2. 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.

2.5.3. The investment strategy must include:

- Details of the processes used to ensure effective due diligence, defining the authority’s risk appetite, including proportionality in respect of overall resources.
- Qualify independent and expert advice and scrutiny arrangements.
- Disclose the contribution that investments make “towards the service delivery objectives and/or place making role of the local authority”.
- Propose indicators that enable Councillors and the public to assess the authority’s investments and the decisions taken.

2.5.4. 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.

2.5.5. In recognition of the importance of commercial income to Councils at a time when Central 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.

2.5.6. The implications of the guidance are that 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.

2.5.7. For Adur District and Worthing Borough Councils, there will be two separate elements to the strategy:

- Annual treasury management investment strategy which covers all cash investments.
- Annual SPIF and CPIS covers the Councils’ approach to commercial property investment.

2.5.8. The annual Treasury Management Investment Strategy 2024/25 to 2026/27 has already been approved by the Councils in February 2024. This Treasury Management Investment Strategy and the Commercial Property Investment Strategy 2022/23, which is attached as Appendix 1, provide evaluation criteria for the assessment of investment opportunities, risk profiling, evaluation, resourcing and monitoring, accounting for the statutory guidance.

2.6. Investment Evaluation Process

2.6.1. Prospective investment opportunities are reported by suitably qualified and experienced in-house FRICS/MRICS (Fellow/Member of the Royal Institution of Chartered Surveyors) professionals, in a risk matrix as Appendix 2. This risk matrix provides analysis of a set of key investment criteria against which every prospective purchase is evaluated. The presentation of information highlights fundamental matters such as macro/micro location economics, tenant covenant strength, lease length, building quality and alternative uses in a transparent and consistent format, to support clear scrutiny and decisions.

2.6.2. 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 wider portfolio. A minimum score threshold is set, below which it is not recommended to proceed unless there are significant factors that require consideration, to include additional regeneration opportunities for the Council, land assembly opportunities or other circumstances that can be suitably justified from a social and environmental perspective.

2.6.3. The score threshold is not an absolute, but set to guide decisions, reflecting the Fund structure objectives, as detailed in the CPIS (Appendix 1), which assumes a low risk profile. The process is further supported by the inclusion of a Strength, Weakness, Opportunities, and Threats analysis (SWOT).

2.6.4. 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. The risk matrix and SWOT analysis is undertaken by the Councils retained external agent and consultants, with officer input and scrutiny.

2.6.5. Tenant default is a significant threat to performance. This risk has previously been reviewed through undertaking in-house reports such as CreditSafe and/or Dun and Bradstreet, with further internal scrutiny from the in-house financial team. Where proportionate, it is recommended that this process is furthered to include third party advice from an accountant to provide an in-depth analysis of a tenants financial health, business operations and future performance.

2.6.6. Where value-add or opportunistic acquisitions are identified, an additional outline business and financial case will be prepared and shared at Stage 2 below and shared in Stage 4 as part of the relevant consultation process.

2.6.7. 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 and RICS regulated.

2.6.8. 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:

- A valuation, in accordance with the RICS Red Book, Professional Valuation Standards, issued by the 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.
- A Building Survey report, as part of the proposed purchase for investment purposes, including preparation of a Reinstatement Cost Assessment for insurance purposes.
- Environmental, services and any further surveys/technical due diligence required to qualify the investment.
- Specialist investment market advice, including, as required, occupational market context and financial modelling to qualify and forecast prospective investment performance.

2.6.9. The above is reviewed by the Property and Investment Manager as an experienced in-house FRICS (Fellow 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.

2.6.10. The professional team including the Head of Major Projects and Investment 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 and maintain up to date qualifications and continuing professional development.

2.6.11. A separate paper will be presented at an appropriate date, detailing a proposal for a disposals strategy if required, as part of the whole Fund annual review after the year end.

2.6.12. This will present opportunities for capital generation for projects but also to reduce the debt levels across the investment portfolio as the Councils seek to include equity into the investment process, leading to better overall returns.

2.7. Property Investment Governance

2.7.1. 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.

2.7.2. 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 asset is purchased through the SPIF, the delegation is only exercisable in consultation with the relevant Leader, Executive Member for Resources and the Chief Financial Officer.

2.7.3. It is proposed that a formalised staged governance approach is adopted in relation to SPIF purchases, as follows:

<u>Stage 1</u>
Officers identify suitable opportunities in the market, having undertaken appropriate investigative and due diligence assessment, in accordance with the above "Investment Evaluation Process".

<u>Stage 2</u>
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:

- A risk matrix and SWOT analysis
- A financial appraisal
- An outline business case where the opportunity is a 'value add' or 'opportunistic' and likely to require additional capital expenditure
- 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 the acquisition.
- A consideration of any tenant, use or asset from an Environmental, Social and Governance perspective

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

Stage 3

The Property and Investment Team will progress negotiations, with the retained external agent, 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 Assistant Director for Regenerative Development. In making any decision to purchase, the Assistant Director for Regenerative Development 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 Assistant Director for Regenerative Development to the Property and Investment Manager, 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 satisfactory 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 as part of the Annual Review, or through the following year’s Commercial Property Investment Strategy to JSC.

2.8. Risk Management

2.8.1. Property investment will necessitate exposure to risk. Risk is in effect two fold - specific risks, arising from the nature of particular assets, or systemic risks - risk that are Fundamental to the investment market and reliance upon property investments for commercial returns.

2.8.2. Financial risk is notably evident whereby the total invested can exceed the current Market Value. Prices are prone to fluctuation, particularly due to changes in the 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 and may present risk to income and servicing of debt requirements.

2.8.3. 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.

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

2.8.5. Larger investment Funds have greater overall exposure but tend to be better insulated to market fluctuations where they comprise a diverse mix of strong performing assets.

2.8.6. The SPIF 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."

2.8.7. The CPIS (Appendix 1) 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.

2.8.8. In reviewing this strategy, the investment direction has been expanded to include value add and opportunistic investments, where within the functional economic area, additional value can be quantified through social, economic or environmental benefit to the Councils' objectives.

2.8.9. Financing property investments has typically been based upon utilising reserves, capital receipts and borrowing. Borrowing is currently available with fixed interest for the duration of any loan, (albeit subject to much more stringent criteria than previous) via the PWLB Funding, mitigating the risk associated with exposure to interest rate fluctuations.

2.8.10. The Minimum Revenue Provision Policy (part of the treasury management strategy statement) details the Council's position and deals with the Minimum Revenue Provision (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.

2.8.11. The CPIS (Appendix 1) 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 sector failure.

2.8.12. Funds that are excessively concentrated in one particular sector or region increase risk, whilst a good spread of properties across asset classes, diversify systematic risk and varying the locality, reduces local market risk.

2.8.13. As a result of re-focusing investment within the functional economic area, the Council's risk profile to local market risk will be increased due to the reduction in geographical spread of investments and higher allocation to our functional economic area. However, where investments are local, the Council is able to take a longer term view with regards to future growth and opportunities, specifically where an assets current use is facing economic, physical or functional obsolescence and requires regeneration, economic support and placemaking more generally.

2.8.14. The average property size was typically 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 whilst maintaining an efficiency of management. Whilst the Funds have historically moved to increase the Fund size, targeting larger lot sizes in order to maintain the same level of net return to the Council, officers feel that due to the locational restrictions on lending and typical lot size for prospective assets within our economic functional area, the average lot size should be adjusted to between £2m - £10m but with scope to increase to over £20m for exceptional opportunities.

2.8.15. Investments should still focus on a diverse mix of single and multi let tenanted properties to spread the income security.

2.8.16. The Council's exposure to investment risk can also be profiled by defining the acceptable parameters. The CPIS (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 the risk versus return spectrum.

2.8.17. The ability to vary the distribution of purchases between each of the above three 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 and opportunities will continue to be evaluated on a case by case basis.

2.8.18. This portfolio profile has favoured 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 which attract a different type of investor. If the portfolio expands into the value add and opportunistic spheres, investments will become less liquid so a greater level of scrutiny would be required through the business cases for individual opportunities to ensure proposals are financially robust and can be delivered within an appropriate timeframe. This is why officers have updated the acquisition process and further reporting to ensure that a robust risk management process is in place.

2.8.19. Officers have sought to ensure the Councils' robust risk management procedures are fit for purpose, in particular as a result of the 'stress test' applied to the portfolio as a result of the Covid-19 Pandemic. Whilst it is clear that the impact of the pandemic will continue to be felt and markets will flex and change to meet this, it is important that the Councils continue to adjust their risk management procedures in order to respond to this.

2.9. Annual Performance Monitoring

2.9.1. Active management of the portfolio is key to proactively maintain the buildings to maximise value, monitor occupiers and capitalise in favourable market conditions which maximise capital receipts. 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 (Savills) have been appointed and the portfolio is cliented by the Councils' in-house surveyor, a FRICS qualified professional with experience in institutional level commercial property investments.

2.9.2. Additional recommendations within last year's report were to expand the investment management Fund reporting to include total return outputs to measure the income and capital return from portfolio at inception to each future financial year showing accumulative and annual performance. In the event Officers have altered and enhanced the reporting tools for Members given we are income driven and focusing on that metric, i e actual cash returns.

2.9.3. Officers are instead working up appropriate metrics for the different types of investments arranged in 'Tiers'. This means a focus on reporting for the SPIFs, the second tier investments, then to community assets, as a more measured and appropriate basis of reporting and ultimately resource allocation for different property classes.

2.10. Corporate Implications

2.10.1. 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.

2.10.2. The capital value and income from the Funds assets will go down as well as up. There is no guarantee that the Fund will achieve its objectives and Council returns less than originally invested.

2.10.3. The additional income delivered from SPIF investments has contributed to the delivery of the Revenue Budget for 2023/24 and is a core element of future budgets. It supports the delivery of the budget strategy, helping to manage pressures arising in-year due to unforeseen circumstances.

2.10.4. As part of this initiative, the Councils will inevitably be taking on more risk. Consequently, a robust risk management strategy has been adopted to cover both 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 the Councils' financial health.

3. Engagement and Communication

3.1. This report builds upon the previous CPIS 2020-21, taken to JSC in March 2020.

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

4. Financial Implications

4.1. The Councils have, over the past few years, addressed significant budget shortfalls. The investment in commercial property has enabled the Councils to protect front line services, address falling income from Central Government grant Funding, and increase the level of spend in areas such as housing need through generating net additional income.

4.2. Looking ahead, this investment continues to be an important strand of the budget strategy, helping balance the budget as the Councils continue to address significant financial challenges.

4.3. The Councils approved an overall investment of £125m per Council which was has been spent or allocated as follows:

	Adur	Worthing
	£'000	£'000
2016/17 Actual	0	0
2017/18 Actual	11,579	0
2018/19 Actual	26,532	26,697
2019/20 Actual	44,298	45,047
2020/21 Actual	0	0
2021/22 Actual	0	0
2022/2023 Actual	0	22,483
2023/2024 Actual		
- Allocated to projects	0	0
- Unallocated	43,488	3,075
Virements to other invest to save schemes outside SPIF	0	28,771
Total investments	125,897	126,073

**Figures include purchase costs*

4.4. 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.

4.5. It is recommended where possible the Councils continue to seek to retain an average of 20% of the rental income towards future expenditure on repairs, refurbishment, lettings incentives, and void periods. To achieve this the Council has three measures in place:

i) A regular contribution to earmarked reserves is budgeted with the intention of building a balance that equates to 10 - 20% of annual rental income over 5-10 years;

ii) Any over-achievement against the commercial income budget set will be placed into earmarked reserves at the year end where affordable within the overall outturn position for the council;

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 investment requirements. In the short term, this reflects the need to build reserves to support the management of risks associated with the portfolios. In the medium term, it is envisaged these Funds could also be released for reinvestment into the portfolios.

4.6. Currently the annual provision for the management of voids and future maintenance is £750k for Adur and £550k for Worthing, and it is intended to increase this provision by at least £100k per annum until the 20% annual set aside has been reached. For 2024/25 the annual provision will be:

- Adur £850,000
- Worthing £650,000

The earmarked property risk reserve balances as at 31st March 2023 were £375k in Adur and £450k in Worthing. The first call on the provision is to mitigate any in year income shortfalls due to void or rent free periods and expenditure required on the properties. Thereafter a transfer to reserves is only possible if affordable within the overall outturn for the council.

Legal Implications

4.7. S.111 Local Government Act 1972 provides 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.”

4.8. Section 120 (1) Local Government Act 1972 provides the Council with the power to acquire land, whether inside their area or not, for the benefit, improvement or development of their area. Section 1 Local Government Act 2003 enables the Councils to borrow money for the purpose of the prudent management of its financial affairs. Section 12 Local Government Act 2003 empowers the Councils to invest for the purposes of the prudent management of its financial affairs.

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

4.10. 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).

4.11. The Officer Decision Making Protocol in each Council’s Constitution 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.

4.12. 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.

Background Papers

- March 2020 JSC report
  - Strategic Property investment Fund 2020 (SPIF)
  - The Commercial Property Investment Strategy (CPIS 2020-2021) ● Platforms for our places
- 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 Finances In Local Authorities ● The Chartered Institute of Public Finance and Accountancy: Prudential Property Investment
- National Audit Office: Ministry of Housing, Communities & Local Government Local authority investment in commercial property
- Costar Insight - Local Authority Investment

Sustainability & Risk Assessment

1. Economic

- This proposal continues the implementation of the Council's capital and Medium Term Financial Strategy to generate additional revenue for the Funding of Council services.

2. Social

2.1 Social Value

- Matter Considered, no issues identified.

2.2 Equality Issues

- Matter Considered, no issues identified.

2.3 Community Safety Issues (Section 17)

- Matter Considered, no issues identified.

2.4 Human Rights Issues

- Matter Considered, no issues identified.

3. Environmental

- Matter Considered, no issues identified.

4. Governance

- This aligns with the Council's capital strategy. Investment in good quality commercial property to produce additional revenue is part of a combined strategy in the Councils' approved budget strategy.

Appendix

1 Commercial Property

Investment Strategy:

THE COMMERCIAL PROPERTY INVESTMENT STRATEGY 2023-2024

(written 2015)

Contents

The Property Investment Strategy

Objectives

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."***

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

- To invest in commercial or other property to generate a sustainable income, or capital receipt, with clear margins exceeding the cost of capital and borrowing.

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

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

- Supporting economic growth within Worthing and Adur, where suitable opportunities arise, provided the return covers the costs of an associated financing but lower returns or greater risk can be justified.

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

- Retain the existing properties, as appropriate to maximise long term revenue generation.

Fund Policy

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

- Review the possibility of alternative uses for in Borough property where alternative user need is identified.

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

- Capital receipts from the sale of Strategic Property Investment Fund (SPIF), or other Council properties, to be considered for:

- Reinvestment in SPIF, to sustain income generation and maximise opportunities.
- Repayment of capital borrowing to improve the return on existing assets.

- Allocation of new purchases or disinvestment between the Adur and Worthing portfolios, to be recommended in consideration of Fund diversification risk management.

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

The Property Investment Strategy

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, except for in borough investments with a social, economic or environmental benefit.	The initial Funds, were concentrated on outer London and the wider South East area, but restrictions to PWLB Funding mean that this investment is now within The Functional Economic Area or in Boroughs only.
Asset Class/Sector Mix	Industrial/Warehouses 25% Offices 35% Retail 15% Alternatives 25% (e.g. car parking, leisure, quasi retail spaces)	To ensure a spread of risks, acquisition across sectors shown. As the Fund grows, 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 medium term. The Fund has

		avoided large scale retail, but where food retail opportunities or those with value add or opportunistic opportunities, this level has been retained.
Average Property Size	Guide Size c.£2-20m	This provides flexibility for the Councils to operate in an optimal place in the market, tailored to the extent of competition and likely asset availability within the functional economic area/boroughs. Acquisitions outside the guide sizes will be considered where they offer a good return, support diversity and do not create over exposure to a large single tenant/asset but also facilitate larger multi-let properties or strategic purchases.
Leases Expiring within 5 years	Maximum 30%	Spread and diversity sought in future lease expiries across acquisitions to protect revenue streams unless value add or opportunistic acquisitions.
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 or for lower risk investments but not lower than 1%.
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 Expenditure Allowance	20% of the rental income	Held in a Fund to support future management and capital expenditure for the portfolio, such as voids, maintenance and/or refurbishment. Surplus income will be set aside into a revenue account and capacity within the annual revenue

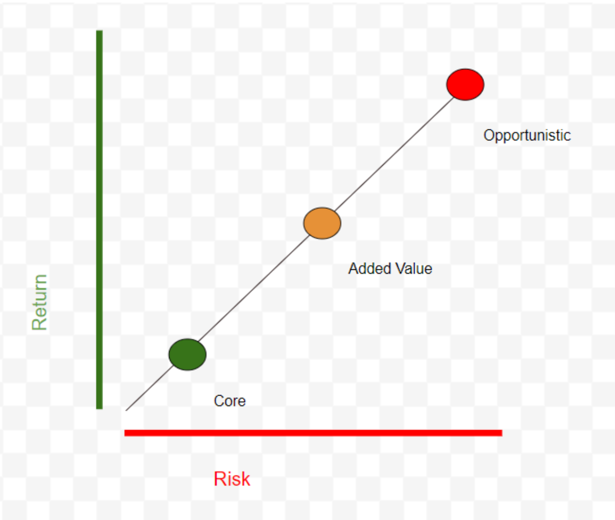
	budget to support this will be built over the next 3 financial years, notwithstanding unforeseen stress tests such as Covid-19

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

The Property Investment Strategy

1. **Fund Structure**

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



These segments can be defined as follows: -

Core investments: - comprise the bedrock of a diversified portfolio and present minimum risk, being the least risky investment segment. Typically they comprise fully leased, secure investments to strong covenant tenants, in urban locations/markets that tend towards strong demand.

Attractive for the lower level of risk they provide compared to other investment types, which is reflected in the lower yield when compared to riskier property investments.

Typical property characteristics: -

- subject to long leases to strong covenant tenants on fully repairing terms.
- buildings are typically modern, in good repair and condition.

- the buildings have reduced depreciation and obsolescence, providing a stable relatively predictable income.

This type of investment suits investors who seek capital preservation and long hold periods. This type of investment is typically the most liquid, on the basis they are generally attractive, marketable assets when compared to the following segments.

Added Value: - More risky investments reflected in the potential for higher return by increasing property value.

Typical Property Characteristics: -

- single let, or multi let, with varying tenant covenants
- Opportunities to improve buildings.
- Fairly liquid in a stable market.

Potentially vacant, partially vacant, or close to lease expiries, creating opportunities to make improvements.

Opportunities to increase value could include physical improvements, such as refurbishment, or re-development, letting vacant space to stronger covenant tenants on more investor attractive terms, lowering operating expenses.

These properties carry more risk due to the property not operating to its full potential when acquired, commonly with less secure income. If the business plan to increase value does not succeed, a tenant fails, or vacates, there is potential for reduced return, or losses.

Opportunistic: - similar approach to value add, with additional risk due to property typically requiring substantive work to increase value.

Typical property characteristics: -

- Part or fully vacant when acquired.
- No income when acquired, with ongoing vacant running costs.
- Typically distressed property, requiring substantial investment.
- These properties are considered high risk, with failure of a business plan typically resulting in financial losses.

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

	%	
Core	65% (+/- 10%)	Modern, or extensively refurbished buildings, fully let on long leases to good covenant tenants in major core markets.
Value Add	Max 25% (+/- 10%)	Single or multi-let buildings, with various lease lengths and tenant covenants. Opportunity to add value.

Opportunistic	Max 10%	an be repurposed to generate income.

The Property Investment Strategy

Purchase Guidelines

- Target area Adur and Worthing municipal and functional economic areas.
- Commercial real estate.
- Freehold, or long leasehold nominal rent purchases. Forward Funding, income strips and other financial models considered subject to individual business cases.
- Income producing properties, leased on conventional terms, secured against good covenant tenants.
- Value Add and Opportunistic acquisitions to have an outline business case and clearly identify economic social or environmental value added if returns do not meet the benchmarks above.

Property Investment Strategy – Property Investment Portfolio Management

Reviews

To monitor performance and ensure proactive risk and opportunity management, a Quarterly review will consider:

- An update of quarterly rent performance, service charge, voids and insurance collection and arrears position.
- A review of retain, sale, repurpose or re-gear of each asset following on from the individual asset plan.
- Bi-annual valuations of the assets to look at portfolio total return.
- Advise on all critical lease matters including rent reviews, lease renewals, lease breaks and re- gearing opportunities.
- Upcoming cash flow issues and reactive asset management requirements, risk reporting from these.
- Tenant compliance with lease terms and any default, or issue.

An Annual review will consider:

- Market update on activity and forecasts to identify any re-purposing of any asset(s).
- Ongoing review of the current investment strategy.

- An external market valuation of the portfolio to monitor and benchmark performance, meeting financial requirements.

- An updated three -year cash flow forecast and capital expenditure forecast.

- An update or review of individual asset plans.

- A review of retain, sale, repurpose or re-gear of each asset.

- Review of the previous year's performance incl. any (Key Performance Indicators) KPIs.

- Review of the underlying lifecycle of the asset, holding period and refurbishment expectations.

- Rent collection rates, arrears and service charge reconciliation.

- Advise on all critical lease matters including rent reviews, lease renewals, lease breaks and re- gearing opportunities.

- Dilapidations, health and safety and insurance claims.

- Capital expenditure over the preceding 12-month period.

- Tenant covenant strength monitoring report.

- Tenant compliance with lease terms and any default, or issue.

Asset Management Functions

- Rent collection rates, arrears and service charge reconciliation.

- Advise on all critical lease matters including rent reviews, lease renewals, lease breaks and re- gearing opportunities.

- Driving asset management initiatives and delivering on asset management plans.

- Dilapidations, health and safety and insurance claims.

- Void and re-letting management.

- Capital expenditure over the preceding 12-month period.

- Tenant covenant strength monitoring report.

- Tenant compliance with lease terms and any default, or issue.

Appendix 2

Risk Matrix and SWOT example:

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	Weighting	Weighted Property Score	Excellent	Good	Acceptable	Marginal	Poor
LOCATION	Location: Macro	Quality of the location (town, city, area) with regard to the property use		3	0					
	Location: Micro	Quality of the individual situation of the property within the macro location, with regard to the property use		3	0					
	Building Quality	Quality of the building compared to the Industry standard Grade A for the property type		3	0					
OCCUPANCY	Tenant Covenant	Ability of the tenant/s to pay the rent for the duration of the lease. Credit rating of the tenant		3	0					
	Tenure	Freehold / Long Leasehold. Consideration of any ground rent obligations		2	0					
	Lease Term	Length of the secured income.		3	0					
	Lease Structure	Tenant repairing obligations, rent review mechanisms		3	0					
	Rental Growth Prospects	Opportunity / Likelihood to increase passing rent/ ERV		3	0					

	Occupational Demand	Anticipated level of demand from alternative occupiers if the tenant/s were to vacate		3	0					
STRATEGY	Management Intensity	Complexity and cost of managing the property		2	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.		2	0					
	Alternative Use / Underlying Value	The value of the land and the opportunity to explore a change of use should this be required		2	0					
	Asset Management Opportunities	Opportunities to add value to the property		1	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		4	0					
	Portfolio Strategy Context	The extent to which the property meets the strategy and contributes to the achievement of a diversified portfolio		3	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.	0	

Investment Decision Guide for filling in matrix

example considerations

Criteria	Criteria Description	Maximum Weighted Score	Excellent	Good	Acceptable	Marginal	Poor

Scoring numerically between 1 and 5 as detailed in this guide

SCORE TO APPLY TO EACH COLUMN	5	4	3	2	1

Shading denotes client to fill in

SCORING GUIDE

			SCORING CONTROLS	
Portfolio Strategy Context	The extent to which the property meets the strategy and contributes to the	15	Under-represented sector	Sector already heavily represented

	achievement of a diversified portfolio						
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				:ation with limited benefit
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
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
Lease Term	Length of the secured income.	15	eater 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
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	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
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%+)
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

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.

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