Joint Strategic Committee
10 March 2020
Agenda Item 8

ADUR & WORTHING
COUNCILS

Ward(s) Affected: All

Strategic Property Investment Fund 2020 and the Annual Commercial Property Investment Strategy 2020/21

Report by the Director for the Economy

Executive Summary

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 seeks to provide an update on the recent investment activities and current position of the Strategic Property Investment Fund as of January 2020. This covers:

- The current overall fund structures and completions within the current financial year to date.
- Updates to processes to support the ongoing structured and measured approach to property income generations and pro-active risk management inherent in any property investment.
- Update mechanisms to support the ongoing development of a balanced portfolio with a move from initial income generation to total return approach as the fund matures, with an increasing focus on strategic asset management and long term growth approach.
- Outline the future strategy to increase the respective Councils' funds by a further £50 million per Council from £125m per Council to £175m per Council, increasing capital reserve allocations and ensuring ongoing resourcing of the pro-active management of the funds

A review has also been undertaken of the current Investment Strategy has been undertaken and updated version is attached to this report as an Appendix to this report.

The primary objective of the CPIS is to build a strong and resilient portfolio generating consistent revenue for the benefit of 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 2020/2021.

1. Purpose

1.1 To update and confirm the Councils' robust Commercial Property Investment Strategy (CPIS) to support the Councils' strategic income generation objective.

1.2 To meet the Councils' statutory obligation to prepare an annual investment strategy to be approved in advance of the relevant financial year by Full Council (or equivalent).

1.3 The report will support the Councils' medium term financial strategy and seeks to renew and refresh the current investment strategy in relation to the investment funds providing details on:

- Robust parameters to guide and support the development of an income generating property portfolio that seeks to manage and provide a financially resilient income stream for the Councils
- Update governance criteria to ensure diligent analysis and transparency to support the transparent decision making process

2. Recommendations

2.1 It is recommended that Joint Governance Committee considers the contents of this report, providing feedback and/or comments to the Joint Strategic Committee (JSC)

2.2 It is recommended that the Joint Strategic Committee:

i. Agree the suggested delivery and governance model as set out in the report which will be approved by full Council as part of the overall Commercial Property Investment Strategy

ii. Note that at the end of the 2019-2020 financial year a Commercial Property Investment Fund Annual Asset Review to be undertaken to detail specific performance of assets and potential future risks and opportunities along with proposals to manage these individual sites moving forward. This will be reported to the JSC by the end of September.

iii. Notes that as part of the 2020/21 capital strategy, consideration is given to increasing the overall investment size from £125m to £175m per Council which will be funded from borrowing.

iv. Approves that the average lot size be increased from £5m - £15m to £10m - £20m.

v. Recommends to Adur District Council and Worthing Borough Council to adopt the Commercial Property Investment Strategy for 2020-2021

vi. 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

3. Context

3.1. Due to continued reductions in central government grant funding, local authorities are increasing reliant upon income generating models to support the delivery of council services.

3.2. Adur and Worthing Councils have to make savings of £10m over the next 5 years. This is detailed in the Council's Outline Forecast and Budget strategy for 2020/21 which set out the initial challenge and detailed the Council's approach to delivering the required level of savings.

3.3. [1]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

3.4. According to the Ministry of Housing Communities and Local Government, local authority expenditure on trading services totalled £4.0bn in 2018-19, up £993m (33%) in real terms from the previous year. (Trading services include

[1] Local Authority Capital Expenditure and Receipts, England: 2018-19 Final Outturn

the maintenance of direct labour and service organisations, such as civic halls, retail markets and industrial estates, and commercial activity)

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

3.6. National local authority spend on commercial property this financial year to date has totalled circa £1.9bn, with a total of £2.2bn spent in 2019. According to the Estates Gazette Radius Exchange, Councils have invested £3.5bn into office assets and a further £2.4bn into retail and leisure stores and schemes with almost 30% of all transactions in commercial real estate outside of the council's administrative area as councils seek to provide financial resilience for their services.

3.7. Typically these investments have been funded through Public Works Loan Board (PWLB) long term lending which is at rates of circa 2%-3%. 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.

3.8. Members will be aware that earlier in the year the PWLB increased borrowing rates by 1%, nevertheless the rates still represent good value.

3.9. Adur District and Worthing Borough Councils have an established Strategic Property Investment Fund following a report to JSC in July 2015. Since this time, subsequent reports (the most recent being March 2019) have built upon and developed this workstream following the successful introduction of the Strategic Property Investment Fund and have increased the current fund size to £125m per Council

3.10. The approval of the 2019 Commercial Property Investment Strategy (CPIS) provided mechanisms to grow the portfolio and monitor performance through improved asset management, continued annual reviews and KPI monitoring. This report reinforces the continued need to monitor performance but moves to take a longer term total return approach to growing the portfolio. The investment strategy as part of this year's report follows the same format as previously.

3.11. This year's investment strategy reflects on the changes in the market over the last 12 months and looks ahead to the future providing context for considering the expansion of the fund size and continued investment within commercial property both in the context of council revenue requirements and general market regulations on this activity.

4. Issues for consideration

4.1. Financial position

4.1.1. Please note that all capital values quoted in the report are based upon initial purchase price excluding purchaser's costs. The two portfolios properties are subject to annual market valuations. This shows that overall the Worthing fund has increased in capital value by circa £800,000 and the Adur fund has shown a modest increase of circa £600,000 as at 1 April 2019. These are accounting valuations and do not include in year revaluations or on this financial year's acquisitions.

Year 2019-2020 position

	Number of purchases	Total Spend	Net return after borrowing
Adur	3	£40.85m	£747,187
Worthing	6	£51.73m	£831,688*

Year 2018-2019 position

	Number of purchases	Total Spend	Net return after borrowing
Adur	3	£24.98m	£521,730
Worthing	3	£25.14m	£522,210

Overall Fund position

	Number of purchases	Total Spend	Total Net return after borrowing
Adur	7	£76.76m	£1.55m
Worthing	13	£85.17m	£1.70m*

*This figure attributes nil income to Cannon House, Chatsworth Road - purchased with vacant possession and currently on the market available to let at £104,000 pa.

This figure does not include the uplift in income from the Liverpool Gardens Car Park acquisition should the Council seek to operate this car park directly, estimated at an additional £70,000pa.

4.1.2. Based on the current purchases, the Council will over-achieve it's income targets for 2019/20 as follows:

Total income for 2019/20

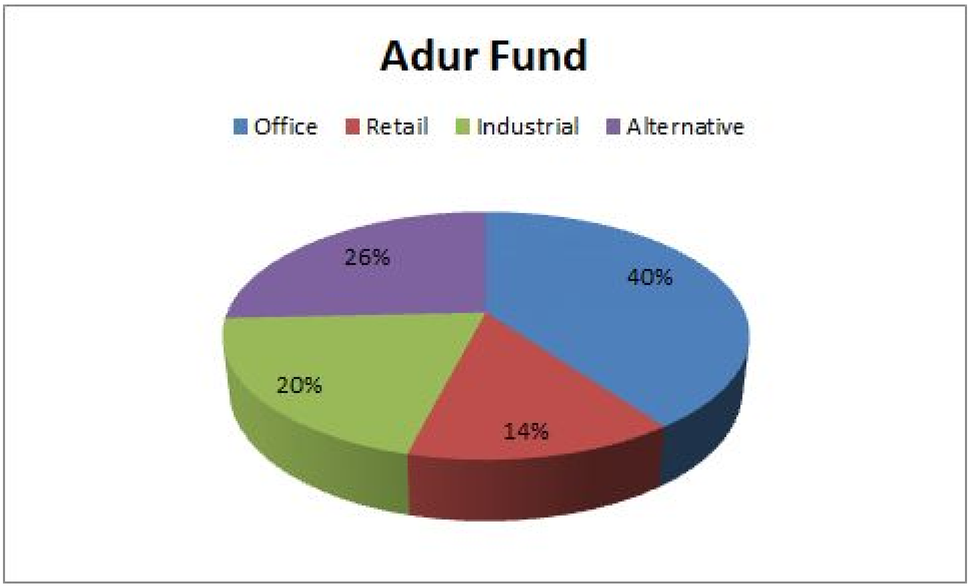
	Budget	Forecast outturn	Over achievement
	£	£	£
Adur	-2,728,010	-3,543,017	815,007
Worthing	-3,229,040	-3,882,659	653,619

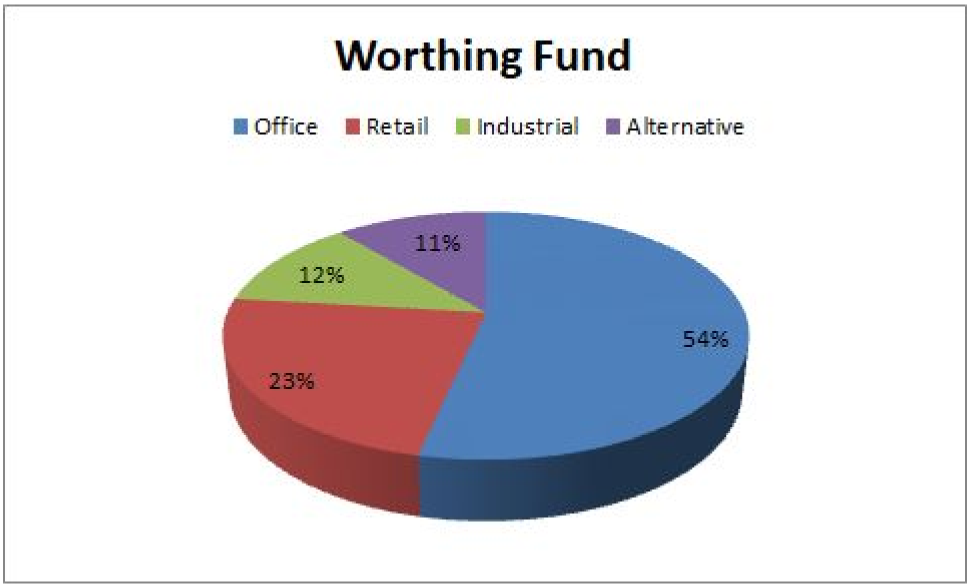
4.1.3. It is important to note that due to the timings of individual purchases throughout the financial year, the rent received will be reduced in the first year to reflect the time held. Overall, the total annual rental yield from the current portfolios is expected to be £4.59m per annum for Adur and £5.3m for Worthing from next year.

4.2. Current Fund Structure

4.2.1. During the current financial year, the Councils have sought to acquire properties with yields at circa 5% as the funds move to a lower risk return, seeking strong underpinning factors with the investment but with potential for long term stable income and growth opportunities. The Councils have sought to acquire investments with strong covenants and often index linked rental growth for greater security.

4.2.2. The pie charts below detail the current weighting of the funds considering all purchases to date





These funds have been targeting the following asset class weightings:

Office	Retail	Industrial	Alternative
30%	20%	25%	25%

Details of the 2019-2020 individual acquisitions are summarised at **Appendix 2**

4.2.3. The above charts show that the latest financial year still leaves both Councils weighted towards office investments as this has been driven by a combination of market opportunities and strong fundamentals within this sector.

4.2.4. Both funds have significantly increased their diversification into alternative and industrial asset classes, seeking to spread risk where opportunities with sufficiently strong fundamentals present.

4.2.5. It is important to note that this diversification will continue as the funds mature and seek a total return approach rather than immediate short term income.

4.2.6. Purchases continue to focus on the South East market, where market foundations remain strong. Acquisitions have been spread across regional centres.

4.2.7. The key considerations underpinning the recent acquisitions has been similar to the 2018-2019 market commentary and a key update is provided below on the relevant sectors:

1. **Offices**
   Office markets remain strong but investment volumes are lower than last year due to a shortage of stock, making office investments an attractive investment. Offices have been considered to be the least volatile investment sector so it is not unexpected that both Councils are heavily weighted towards office within the portfolios.

   Looking to 2020 office occupier markets are likely to continue to perform well across the UK despite ongoing political background noise. Demand will be driven by a wide range of sectors including professional services and the public sector. On the capital markets side, yield compression is possible during 2020 if uncertainty dissipates.

2. **Retail**
   Retail properties have continued to present high volatility rates and other than food retail acquisitions and those more historic retail acquisitions which benefit longer term regeneration aims of the Councils in borough, the Councils have typically sought to avoid retail due to the higher risk of these investments.

It is anticipated that there will be continued structural change in UK retail in 2020. Performance will be strongest in London and the surrounding key urban locations while polarisation of assets will see prime retail outperform the rest. Repurposing of assets will be the key trend in 2020, converting excess retail space to create mixed-use destination schemes.

3. **Industrial**
   Industrial investments remain highly sought after for strong stock, often pushing yields for prime assets significantly below 5%. The Councils have invested into this sector seeking to balance risk with return on stock close to this yield but in more regional centres where market fundamentals for the asset remain good.

   It is expected that rental growth will continue although at a lower rate than we have seen recently. Industrial investments will remain competitively priced due to continued demand for industrial space, particularly in relation to last mile distribution linked to online retail. The Councils will remain alert to opportunities, although these are expected to be relatively limited in comparison with office and retail.

4. **Alternatives**

   The Councils have added alternative investments to the funds, acquiring long index linked income to strong covenants. Owing to the attractiveness of such investments within the market, tighter yields reduce the net return for the Councils, but by seeking to purchase strong covenants, investments are de-risked significantly in comparison to retail/industrial.

   It is likely that 2020 will continue to present uncertainty so competition for such investments is likely to remain high. The Councils should seek further alternative sector investments to diversify risk across the funds.

4.3. Fund Size

4.3.1. The decision to increase the fund size in the 2019 strategy provided means that the current un-spent capital after all costs of acquisitions are taken into account is as follows:

Adur: Circa £37m

Worthing: £48m

4.3.2. The overall fund size of £125m per council is relatively small within the context of wider commercial property investment funds. Risks presented by smaller funds include lower diversity and increased volatility as they are inherently exposed across the total return to a smaller number of assets.

4.3.3. Proposals to increase this fund size beyond £250m would potentially provide greater flexibility from an asset management approach as the fund seeks a total return approach and provide capacity to protect revenue generation when seeking to re-evaluate and reposition existing purchases, maintaining essential income requirements.

4.3.4. Proposals to increase the fund size will provide greater resilience and market movements and risk, de-risking this from short term fluctuations.

4.3.5. The proposal to consider an increase in both funds to a total fund value of £350m will enable the Councils to not only increase overall net revenue returns to Council budgets annually, but also benefit from de-risking the fund exposure through increased diversification and economies of scale.

4.3.6. Proposals to increase the overall fund size do not impact the fundamental decision making process but in order to benefit from the increased fund size coupled with challenges presented within fluctuations within the Public Works Loan Board lending, it is recommended that the average lot size be increased from £5m-£15m to £10m-£20m.

4.3.7. With this being an average lot size, the Councils will continue to evaluate opportunities higher and lower than these costs in line with the evaluation criteria to ensure that opportunities of interest and benefit to the Councils are not unduly ruled out.

4.3.8. This will enable Councils to seek to invest in higher quality assets (lower yielding) but with a larger lot size will limit the impact of lower yielding assets on surplus revenue, maintaining income levels.

4.3.9. Considering an Increase to the overall fund size and increasing the average lot size will provide continued opportunity for the Councils to judiciously invest with commercial property to provide a continued revenue stream for the Councils’ services.

4.4. **Resources and Capacity**

4.4.1. During 2019-2020 there has been significant personnel change within the Property and Investment Team, but notwithstanding this excellent progress has been made on delivering the Commercial Property Investment Strategy.

4.4.2. Progress has also been made on the appointment of a firm of chartered surveyors to undertake the day-to-day 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.

4.4.3. Officers have also compiled a 'Commercial Property Investment Officer' Job Description which is just to be evaluated in February. This additional role was approved as part of the 2019/20 budget and will provide some of the additional capacity required to manage a portfolio of this size. This was following recommendations in the 2018 JSC report. To date this work has been undertaken by appointed specialist consultants to ensure appropriate resource levels have been provided for prudent management of the fund.

4.4.4. As part of the development of the 2020/21 Revenue budget, an additional role of Asset Portfolio Manager has been recommended for approval. Following the recruitment of the Commercial Property Investment Officer, a further Job Description will be compiled and recruited to for an 'Asset Portfolio Manager' to lead on asset management and strategy for the portfolios. This was recommended in the March 2019 report and work is ongoing on this.

4.4.5. 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 Commercial Property Investment strategy.

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

4.5. **Future Fund Direction and Update to Commercial Property Investment Strategy**

4.5.1. The current weighting of the portfolio into the varying asset classes has improved in diversification from previous years as the funds have started to mature with a larger number of assets within each fund. 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.

4.5.2. Owing to market uncertainties, it is unlikely that the funds will seek to meet their target percentage of retail stock as it is not clear if the retail investment market will meet the investment criteria of the Councils. The SPIF has therefore been updated to reduce the target retail percentage to 15% but to increase the office investment percentage to 35%.

4.5.3. This move away from retail within the strategy should be viewed in the light of exploring retail investments that present strategic opportunities or for foodstore investment.

4.5.4. The funds continue to invest within the office market but security of investment must continue to be balanced with fund diversity, consideration will need to be actively seeking to maintain the alternative investments within the funds (Hotels, Car Parks, Leisure etc) as a higher priority than previous years.

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

4.5.6. Acquisition 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.

4.5.7. The Councils move their funds to a total return fund rather than seeking immediate revenue return. A focus on both revenue return over costs should now be considered along with capital growth of the asset to take into account the capital appreciation. This may mean the council takes lower initial returns on more secure assets, de-risking the portfolio but also providing opportunity for capital growth. This will mean that the target return 2% after borrowing costs may need to be lowered, although the strategy already allows for lower returns on portfolio fit and viable business case.

4.5.8. As the Councils move to a total return approach to re-classify opportunities into 'Core', 'Added Value' and 'Opportunistic'.

4.5.9. That the funds seek to proactively seek value add opportunities with the portfolio but also undertake a risk review and engage tenants where appropriate to protect and grow revenue and capital values from the investments.

4.5.10. There is also scope due to the financial performance to adopt an appetite for assets with 7%-8% yields, perhaps where there are more regional opportunities that are well let that can improve flexibility within the fund but also to improve the running yield for asset management purposes within the opportunistic category above.

4.5.11. To undertake the whole portfolio review on an asset by asset basis and bring a further report back to members with the findings and with individual property recommendations to September JSC.

4.6. Statutory Guidance:

4.6.1. 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.

4.6.2. 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 the 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.

4.6.3. 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.

4.6.4. 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 is also being brought to the March Council. This Treasury Management Investment Strategy and the Commercial Property Investment Strategy 2020/21, 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.

4.7. Investment Evaluation Process

4.7.1. 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 3). 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.

4.7.2. 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 portfolio. A minimum score threshold is set, below which it is not recommended to proceed unless there are significant unforeseen factors that require consideration, to include additional regeneration opportunities for the Council, land assembly opportunities or other circumstances that can be suitably justified in the round consideration of potential acquisition.

4.7.3. The score threshold is not an absolute, but set to guide decisions, reflecting the Fund Structure objectives, as detailed in the Commercial Property Investment Strategy (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).

4.7.4. 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.

4.7.5. 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, including seeking additional information, where relevant.

4.7.6. 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.

4.7.7. 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 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.

ii) A Building Survey report, as part of the proposed purchase for investment purposes, including preparation of a Site Environmental Assessment and preparation of a Reinstatement Cost Assessment for insurance purposes.

iii) Environmental, services and any further surveys/Technical Due Diligence 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.

4.7.8. The above is reviewed by the Property and Investment 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.

4.7.9. 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.

4.7.10. A separate paper will be presented in due course, detailing a proposal for a disposals strategy if required, as part of the whole fund annual review after year end.

4.7.11. It is also anticipated that further papers to adopt an asset management plan for the general fund will be brought forward in the coming year which will inform the future of the councils' historic estate.

4.7.12.

4.7.13. 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.

4.8. Property Investment Governance

4.8.1. 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.

4.8.2. 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.

4.8.3. 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 Property and Investment Manager 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.

4.8.4. 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.

4.8.5. Subject to approval, written authority to proceed, will be provided by the Head of Major Projects and Investment 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 pre-acquisition due diligence.

4.8.6. 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

4.8.7. Completed purchases will be reported as part of the Annual Review, or following year’s Commercial Property Investment Strategy to JSC.

4.8.8. Should any proposal to purchase prove abortive, this will also be reported to in line with 4.8.7 above.

4.9. Risk Management

4.9.1. Property investment will necessitate exposure to risk, 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.

4.9.2. 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.

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

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

4.9.5. 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."

4.9.6. 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.

4.9.7. 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.

4.9.8. 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.

4.9.9. The Commercial Property 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.

4.9.10. Funds that are excessively concentrated in one particular sector or region increase risk, whilst a good spread of properties across retail, office alternative and industrial diversify sector-specific risks and varying the locality, reduces local market risk.

4.9.11. 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. As the fund seeks to purchase more lower risk properties, to maintain the net revenue to the council after borrowing costs (as you would receive from higher risk properties) it has been recommended to increase the average lot size by £5m to account for this and for single lots where there is more than one tenant.

4.9.12. The Council's exposure to investment risk can also be profiled by defining the acceptable parameters. The Commercial Property 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.

4.9.13. 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 Commercial Property Investment Strategy distribution of purchases across the three categories (core, value add and opportunistic) is weighted heavily towards lower risk assets. This reflects the Commercial Property 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.

4.9.14. 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.

4.9.15. 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.

4.9.16. 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.

4.9.17. The Commercial Property Investment Fund Annual Asset Review will consider 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.

4.10. Annual Performance Monitoring

4.10.1. 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 (Savills) have been appointed and the proposed recruitment of the Property Investment Surveyor in underway and due to be advertised prior to year end. This post will support the Investment Strategy Annual Review and future asset management of the fund

4.10.2. In addition to ongoing monitoring, the Commercial Property 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.

4.11. **Scope of Investment**

4.12. 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: -

4.13. Retaining existing assets where appropriate, to generate income, investing where necessary to enhance returns.

4.14. Re-evaluate the existing property portfolio to identify opportunities to maximise the financial benefit through the implementation of a new Asset Management Plan and relevant portfolio review/disposal programme .

4.15. The Property and Investment 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.

4.16. The Property and Investment Manager/Investment Surveyor will review the existing Commercial Property Investment fund and report any of the existing investment property fund that do not fit the investment criteria, recommending transfer into the general Commercial Property Portfolio, whereby the sites can be managed in accordance with less strict KPIs on income generation and capital appreciation, but can be used to support a more tailored approach to economic regeneration, placemaking and other socio-economics drivers, that similarly apply to the existing estate.

4.17. Any capital return generated from the investment fund, will be ring fenced for future property investment, after deduction of financing costs and professional fees.

4.18. To undertake a Commercial Property Investment Fund Annual Asset Review and further reporting should this highlight opportunities to dispose of assets which will then be subject to a separate reporting process. This annual review will be presented to JSC in September 2020

4.19. **Corporate Implications**

4.20. 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.

4.21. The additional income delivered from SPIF investments, has contributed to the delivery of a more robust and sustainable Revenue Budget for 2020/21 and the delivery of the budget strategy.

4.22. 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.

5. Engagement and Communication

5.1. This report builds upon the previous Commercial Property Investment Strategy Report 2019/20, taken to JSC in March 2019.

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

6. Financial Implications

6.1. 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 Government Grants, and increase the level of spend in areas such as Housing Need.

	2017/18	2018/19	2019/20	2020/21
Adur				
Level of annual savings	£1,089,000	£1,333,000	£757,000	£1,379,000
Net new annual income from new commercial property	£100,000	£493,000	£200,000	£400,000
% of savings from commercial property income	9.18%	36.98%	26.42%	29.01%
Worthing				
Level of annual savings	£1,669,000	£1,853,000	£1,367,000	£2,483,000
Net new annual income from new commercial property	£200,000	£420,000	£150,000	£400,000
% of savings from commercial property income	11.98%	22.67%	10.97%	16.11%

6.2. 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.

6.3. The Councils have already approved an overall investment of £125m 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	26,532	49,868	37,020
Worthing	3,472	9,464	26,697	50,304	47,999
Total	3,472	21,043	53,229	100,172	85,019

6.4. 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.

6.5. Following successful investment activities this financial year and in order to continue to provide revenue support to meet the savings required under the MTFS, as well as to be able to react to opportunities within the market, this report recommends reviewing the overall fund size with the intention to increase the amount invested to £175m per council but retaining the annual limit of £50m per year. This will be addressed more fully in the capital strategy due to be considered in July 2020.

6.6. 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 will take three measures:

i) A regular contribution to earmarked reserves is to be created over the next 5 years to equate to 10 - 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 envisaged these funds could also be released for reinvestment into the portfolios.

7. Legal Implications

7.1. 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."

7.2. Section 120 (1) Local Government Act 1972 provides the Council with the power to aquire 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.

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

7.4. 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).

7.5. 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.

7.6. 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 2019 JSC report
  - Strategic Property investment Fund 2019 (SPIF)
  - The Commercial Property Investment Strategy (CPIS 2019-2020)
- 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

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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 2020-2021

Contents

The Property Investment Strategy

1. 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 property to generate a sustainable income, 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 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 an associated financing.
- Re-evaluate the existing property portfolio to maximise the financial benefit.
- Retain the existing property portfolio, where appropriate to maximise long term revenue generation.

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 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 between 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.

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 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/Warehouses 25% Offices 35% Retail 15% Alternatives 25% (e.g. car parking)	To ensure a spread of risks, acquisition across office, retail and industrial sectors. 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 longer term.
Average Property Size	Guide Size c.£10-20m	Assuming a combined fund size of £250M, this will support a spread of investments. Acquisition 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.
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 or for lower risk investments
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%. Potential increase this fund size to be considered in July Capital Strategy.
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.

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

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	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%	Higher risk assets that can be repurposed to generate income.

5. Purchase Guidelines

- Target area UK wide, with focus upon 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.

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)
- ❖ 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
- ❖ An update of three-year capital expenditure forecast
- ❖ A review of retain, sale, repurpose or re-gear of each asset
- ❖ Review of the previous year's performance including any (Key Performance Indicators) KPIs
- ❖ Review of the underlying lifecycle of the asset, holding period and refurbishment expectations.

Asset Management

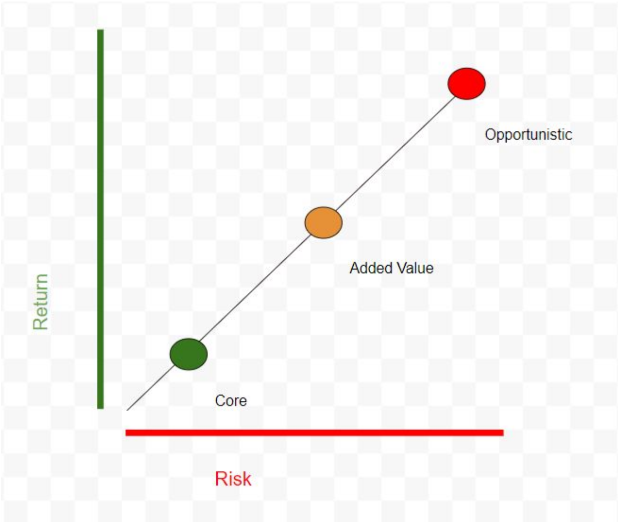
- ❖ Rent collection rates, arrears and service charge reconciliation.
- ❖ Advise on all critical lease matters including rent reviews, lease renewals, lease breaks and re-gearing opportunities.
- ❖ Dilapidations, health and safety and insurance claims.
- ❖ Capital expenditure over the preceding 12-month period.
- ❖ Tenant covenant strength monitoring report.
- ❖ Tenant compliance with lease terms and any default, or issue.

THE PROPERTY INVESTMENT

STRATEGY

<u>FUND STRUCTURE</u>

Different fund structure segments provide a basis for dividing commercial property investments, based upon their risk profile, as illustrated in the below table.



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 more risky 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.

<u>Added Value</u>: - 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.

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

Typical property characteristics: -

- Part of 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.

Appendix 2

Summary of April 2019 - Jan 2020 Purchases:

Investment Property
New Purchase Performance
2019-2020 Financial Year

	Adur	Worthing	Combined
Income Target			
Net Income Target	-£2,728,010	-£3,229,040	-£5,957,050
Net Income Target position	-£3,543,017	-£3,882,659	-£7,425,676
Target Delivered to date	**£815,007**	**£653,619**	**£1,468,626**
Purchases			
Completed excl Purchases costs as at Jan 2020	£40,850,000	£48,000,000	
Prev Years	£35,910,000	£37,170,999	
Sub Total			
Committed future expenditure (Under Offer)	nil	nil	
Committed future expenditure (Exchanged)	nil	nil	
Total	**£76,760,000**	**£85,170,999**	
NET INCOME (pa after finance costs)			
2019-2020	£741,187	£866,447	
Previous Years	£809,497	£868,304	
Total	**£1,550,684**	**£1,734,751**	

Adur

Address	Description	Tenure	Passing Rent PA	Purchase Price	Purchase Date	Gross Yield	Net Yield (purchase costs deducted @ 6.5%)	Net Income (PA after finance costs)	Tenant
Eskan Court, Milton Keynes	Multi Let offices in Milton Keynes circa 25,000 f	Freehold	£400,323	£5,600,000	Apr-19	7.15%	6.71%	£192,326	Konica Minolta Business Solutions UK Ltd 01132885 Alliance Automotive UK Ltd 03430230 Western Power Distribution (East Midlands) Plc 02366923
Photon Park, Wakefield	Office and Industrial unit with circa 9 acres	Freehold	£930,000	£15,100,000	Aug-19	6.16%	5.78%	£376,498	Aston Barclay Holdings Ltd Company Number: 0427312
Regent Street, Luton	Multi Let, Hotel, Gym and Car Park	Freehold	£1,029,710	£20,150,000	Dec-19	5.11%	4.80%	£172,363	Bannatyne Fitness Limited 03287770 National Car Parks Limited 00253240 Premier Inn Hotels Limited 05137608

Worthing

Address	Description	Tenure	Passing Rent PA	Purchase Price	Purchase Date	Gross Yield	Net Yield (purchase costs deducted @ 6.5%)	Net Income (PA after finance costs)	Tenant
Waitrose, Newton Mearns	36,000 ft2 food store plus 182 car parking spaces	Hertiable Interest (freehold)	£714,733	£12,200,000	Apr-19	5.86%	5.50%	£178,007	Waitrose 00099405
Decimal Place, Amersham	27,000ft2 office block with parking	Freehold	£710,065	£12,700,000	Sep-19	5.59%	5.25%	£240,701	Barnett Waddingham 0C374854
Interface House, Royal Wootton Bassett	35,000 ft2 office with 296 car parking spaces	Freehold	£468,000	£6,750,000	Sep-19	6.93%	6.51%	£206,112	Swindon Silicone Systems 01378199
Liverpool Gardens Car Park, Worthing *	Surface Car Park in within borough	Freehold	£260,000	£4,200,000	Nov-19	6.19%	5.81%	£60,353	CP Plus Limited 02595379
Cannon House, Worthing *	7,500 ft2 office in Worthing with parking	Freehold	£104,000	£1,300,000	Nov-19	8.00%	7.51%	£34,759	Vacant
Unit 11D South Marston Business Park, Swindon	90,000ft2 warehouse plus parking and service yard	Freehold	£630,000	£10,850,000	Dec-19	5.81%	5.45%	£146,515	Bleckmann Logistics UK Limited 10769673

* NB Liverpool Gardens Car park on profit share but income to increase by circa £70,000 pa if operated by the council
* NB Cannon House acquired with vacant possession, but estimated annual rent of £104,000 pa

Appendix 3

Risk Matrix:

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	Weighting	Weighted Property Score	Excellent	Good	Acceptable	Marginal	Poor
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					
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					
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

ıading 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 achievement of a diversified portfolio	15	Under-represente d sector				Sector already heavily represented
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
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 covenan t	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	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
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.

SWOT

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