



ADUR & WORTHING  
COUNCILS

Joint Strategic Committee  
30 March 2021  
Agenda Item 7

Ward(s) Affected: All

**Strategic Property Investment Fund 2021  
Annual Commercial Property Investment Strategy 2021/22**

**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 provides an update on the recent investment activities and current position of the Strategic Property Investment Fund as of January 2021. This covers:

- The current overall fund structures and completions within the current financial year to date.
- Review of impact due to the Covid-19 Pandemic and changes to the 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 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 capital preservation and growth.
- Outline the future strategy to re-focus investment within the Council's area of functional economic activity, including seeking more opportunistic acquisitions in area where the Council can add commercial and social value to assets through repositioning, repurposing or redevelopment.

A comprehensive review has been undertaken of the current Investment Strategy. This has been updated following the fundamental shift of PWLB funding and the significant impact of the Covid-19 Pandemic. The updated version is attached to this report as an Appendix.

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 2021/2022.

## **1. Purpose**

- 1.1 To update and confirm the Councils' CPIS to support the Councils' medium term financial strategy.
- 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, particularly where investments have a value add opportunity.

## **2. Recommendations**

- 2.1. It is recommended that the 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 CPIS.
  - ii. Note that at the end of the 2020-2021 financial year an annual asset

review will be undertaken by an external consultancy for the Strategic Property Investment Fund (SPIF), with officer input, to detail specific performance of assets and potential future risks and opportunities, and updated asset plans for each individual asset moving forward. This will be reported to the JSC at its September meeting.

- iii. Approves that the average lot size be decreased from £10m - £20m to £2m - £10m.
- iv. Recommends to Adur District Council and Worthing Borough Council to adopt the Commercial Property Investment Strategy for 2021-2022.
- v. 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.
- vi. 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.
- vii. 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.

### **3. Report Context**

- 3.1. 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.
- 3.2. Over the period 2010-11 to 2019-20 the Local Authority sector experienced a 28.7% real-terms reduction in spending power (Central Government funding plus Council tax).
- 3.3. Demand in key service areas has increased, including a 14.3% increase in the estimated population of older adults in need of care between 2010-11 and 2016-17, a 33.9% increase over the same period in the number of households accepted as unintentionally homeless and in priority need, and a 15.1% increase in the number of looked-after children from 2010-11 to 2017-18.
- 3.4. Adur and Worthing Councils have to make further savings of £1.6m and £4.5m over the next 4 years respectively. This is detailed in the Councils'

updated medium term financial plans which set out the scale of the financial challenge and detail the Council's approach in delivering the required level of savings. The most recent plan was considered by each Council as part of the budget papers presented to the Councils in February.

- 3.5. 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.
- 3.6. 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 the maintenance of direct labour and service organisations, such as civic halls, retail markets and industrial estates, and commercial activity).
- 3.7. Up to 2018-19 a cumulative total of 105 Local Authorities (29.8%) had spent at least £10 million on commercial property since 2016-17 with over half of these being district Councils and a further 25% being unitary authorities.
- 3.8. Direct property investment is commonly undertaken by Local authorities who have acquired assets both within their administrative boundaries and nationally (47.9% out of area).
- 3.9. Local Authority spend on commercial property was £2.2bn in 2018-19, and during 2019-20, spending was estimated at £7.6bn. In 2020-21, investment volumes from Local Authorities fell significantly due to the impact of the PWLB changes, and a reduced sentiment following the impact of Covid-19 Pandemic on the market generally. This is reflected in the total Local Authority investment during this period, which is estimated at circa £700m, a significant reduction from previous years.
- 3.10. Typically these investments have been funded through Public Works Loan Board (PWLB) long term lending which is at rates of circa 1%-2.5%. 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.
- 3.11. Members will be aware that in 2019 the PWLB increased borrowing rates by 1%, nevertheless the rates still represented good value.

- 3.12. The most recent change to PWLB funding arrangements announced during the November spending review, 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.
- 3.13. Members should also be aware that the CIPFA is currently consulting on changes to the Prudential Code which will further strengthen the prohibitions on investing solely for yield.
- 3.14. 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 2020) have built upon and developed this workstream following the introduction of the Strategic Property Investment Fund and have increased the current fund size (capital spend) to £125m per Council.
- 3.15. 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 given the wider economic impact of the Covid-19 Pandemic but 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.
- 3.16. This investment strategy was significantly curtailed by the global Covid-19 Pandemic, with officers re-focusing their efforts on rent collection and tenant engagement, seeking to preserve the Councils investment value and revenue position in these unprecedented times. Very little of the planned allocation for the year was spent by either authority reflecting the prudent and cautious management approach that has underpinned the development and management of the fund since its inception.
- 3.17. As a result, rent collection data (% of all rents collected in advance) for the last financial year is as follows:

	Mar 2020	June 2020	Sept 2020	Dec 2020
Adur	94.24%	96.22%	99.78%	90.23%
Worthing	90.57%	90.22%	90.62%	90.98%

- 3.18. The above figures take into account all rent collection data for all assets currently managed under the SPIF.
- 3.19. Against the backdrop of the Covid-19 Pandemic, the portfolios have performed very positively during the 2020-21 financial year, above industry benchmarks. 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.
- 3.20. This year's investment strategy reflects on the changes in the market over the last 12 months as a result of the profound impact arising from both changes to the PWLB lending criteria and the fundamental changes in the commercial property market as a result of the Covid-19 Pandemic. This strategy looks ahead to the future providing context for considering and change in the approach to include opportunistic and value add opportunities within the functional economic areas of the Councils (defined as the Greater Brighton City Region and Northern West Sussex Functional Economic Market Area) to better support out local economies whilst retaining the context of Council revenue requirements and general market regulations on this activity.

#### **4. Points for Consideration**

##### **4.1. Financial Position**

- 4.1.1. Please note that the total spend below per Council is based upon gross purchase price including purchaser's costs and includes all purchases made under the SPIF, including those purchased for operational, local economy and regeneration purposes, specifically for the Worthing fund.

	Number of purchases	Total Gross Spend
Adur	7	£81.5m
Worthing	16	£103.3m

- 4.1.2. For the Worthing fund, the number of purchases reduces to nine, and the total gross spend reduces to circa £75m, when those assets and additional funding acquired for local economy and regeneration purposes are excluded.

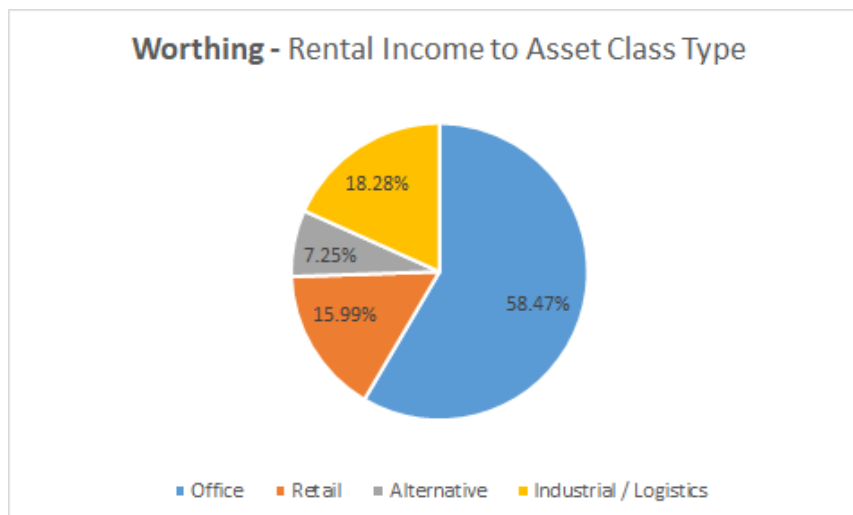
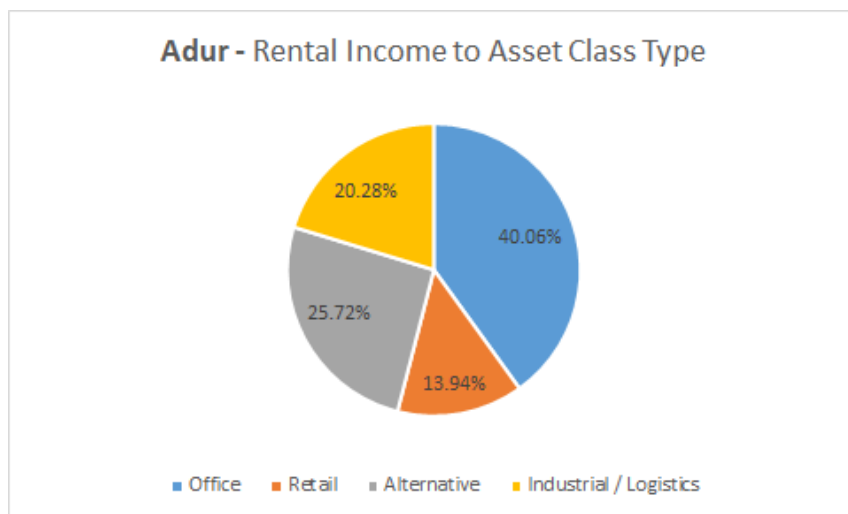
## 4.2. **New Acquisitions**

- 4.2.1. During the current financial year, the Councils have not been active as in previous years, but have taken a reactive approach to opportunities as they have presented themselves.
- 4.2.2. Three purchases were made by Worthing Borough Council at a total of £4.57m and all assets are located within the East Worthing industrial estate area. The Borough Council already has significant land holdings in this area including Decoy Farm.
- 4.2.3. This includes two separate industrial assets located on Dominion Way, predominantly let to Allergy Therapeutics, an important strategic local employer. The properties were acquired for £2.77m, reflecting a 6.5% net initial yield, and presented an attractive income return against a strong financial covenant, in a buoyant asset class. As an illustration of a value add purchase, since the purchase. Officers have renegotiated the main tenant leases for an additional five years term certain and as a result the purchase price sits comfortably below current market values should the Council choose to sell.
- 4.2.4. Worthing Borough Council also purchased a longer term redevelopment site for £1.8m, known as the former EDF Car Park, where it intends to directly deliver new employment space to the area. Officers are currently progressing a redesign of the scheme and the existing planning consent. Overall, members have approved a budget of £5.8m for the acquisition and development of the site from the Commercial Property Fund.
- 4.2.5. Adur District Council made no acquisitions during the 2020/21 financial year.

## 4.3. **Current Fund Structure**

- 4.3.1. 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.
- 4.3.2. 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.

- 4.3.3. 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.
- 4.3.4. 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:



These funds have been targeting the following asset class weightings:



Office	Retail & Supermarkets	Industrial & Logistics	Alternative
30%	20%	25%	25%

- 4.3.5. The above pie charts does not include any purchases made which have been acquired for either operational purposes or regeneration and local economy purposes.
- 4.3.6. 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). The office sector makes up a significant proportion of the commercial real estate value in the UK in terms of value.
- 4.3.7. The balanced diversification within the portfolios, and an asset allocation focused on strong underpinning fundamentals, has resulted in a resilient performance overall given the pressure of the Covid-19 Pandemic. The funds low exposure to traditional retail and greater allocation to food store retailing, and industrial and logistic sectors, has been helpful to the funds performance. These specific sectors have seen significant investor demand and yield compression since the start of the Covid-19 Pandemic which is anticipated to continue in the short term.
- 4.3.8. 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. 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. 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.
- 4.3.9. Purchases will now solely focus on the functional economic area of the Councils, specifically targeting opportunities locally, where there is significant regeneration 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.
- 4.3.10. The key considerations underpinning the recent acquisitions have been around supporting our local economy and employment opportunities and

value add opportunities within area however, a market commentary and a key update is provided below on the main high level commercial property asset classes:

### **Offices**

Office markets remain subdued due to the impact of the Covid-19 Pandemic, national and regional lockdowns and the shift to home working. 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. A review of occupier office requirements and potential 'hub and spoke' models mean that there are opportunities more regionally for office demand, although this is yet to present it-self as an established trend. Investment yields have moved out in non-core offices and volumes are lower due to the Covid-19 Pandemic. Offices have typically been considered to be the least volatile commercial property asset class and it is not unexpected that both Councils remain heavily weighted towards the offices within the portfolios.

Looking to 2021 office occupier markets are likely to continue to perform well for high quality stock however there remains some uncertainty around structural changes in this sector as occupiers are expected to forensically examine how they use their office space with a move to more flexible working. It is likely that this will result in an acceleration of secondary office stock being repurposed where they face economic and physical obsolescence.

### **Retail**

The decline in 'bricks and mortar' retail has been exacerbated by the Covid-19 Pandemic which has in effect accelerated the move to digital trading. There have been a number of notable administrations, Debenhams, Arcadia Group, Bon Marche, TM Lewin, Monsoon amongst others and it is anticipated that this decline will continue.

Retail properties will continue to present high volatility rates until a sustainable model for traditional retail is established. Other than food store retail, 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 2021. Repurposing of assets will be the key trend in 2021, with 'right-sizing' and 're-centralising' as converting excess retail

space to create mixed-use destination schemes, which is supported by proposals for reform within the planning system.

### **Industrial**

Industrial and logistics investments remain highly sought after, both prime and secondary stock, with net yields often reflecting sub 5%. The Councils have invested into this asset class and will look to increase its allocation to this sector where pricing permits.

It is expected that rental and capital growth will continue although at a lower rate than we have seen recently. Industrial investments will remain competitively 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.

### **Alternatives**

The Councils have sought to add alternative investments such as hotels, car parking or sustainability investments such as solar farms to the funds, acquiring long index linked income to strong investment grade covenants. These have typically been in sectors that have been profoundly impacted in the short term by the Covid-19 Pandemic and lockdown restrictions. It is anticipated this sector will recover strongly 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, supported by alternative long term opportunities at these sites within Adur District and Worthing Borough. The Councils should also look to partnering and forward funding opportunities to deliver both regeneration, social, and economic return and there may be opportunities such as Teville Gate and Union Place amongst others to meet a mixture of these aims.

#### **4.4. Fund Size**

- 4.4.1. The decision to increase the fund size in the 2019 CPIS strategy provided means that the current un-allocated capital after all costs of acquisitions, including assets purchased for operational and regeneration purposes, are taken into account is as follows:

**Adur: Circa £43.5m**

### **Worthing:** Circa £24.7m

- 4.4.2. 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. 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.
- 4.4.3. 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.
- 4.4.4. 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 - £10m.
- 4.4.5. This will enable the Councils to operate in a window of opportunity below that of typical institutional investors (pension funds and private equity) in order for the Council to remain competitive in the market.
- 4.4.6. 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.
- 4.4.7. 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.
- 4.4.8. Proposals to alter the average lot size will not change the Council's acquisition and risk management process other than for redevelopment opportunities.
- 4.4.9. Where an acquisition presents as a value add and opportunistic opportunity, 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 for the redevelopment prior to acquisition, and that a full business case be required in order to release the funds for development.

- 4.4.10. This will enable the Councils to proactively seek more opportunities such as the proposed multi-let industrial development on Southdownview Road at the former EDF Car Park, Worthing, where the Council is working on plans to directly deliver circa 30,000ft<sup>2</sup> of new employment space.
- 4.4.11. 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.

#### **4.5. Resources and Capacity**

- 4.5.1. During 2020-21 the Property and Investment Team has consolidated a strong team to lead on both acquisitions and management of this portfolio to support the delivery of the CPIS.
- 4.5.2. Officers are supported on rent collection and service charge management by Savills who continue to undertake the 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.
- 4.5.3. The Property and Investment team has expanded with the further recruitment of a Principal Surveyor. There are now two Principal Surveyors within the team who split responsibility for both the strategic investment portfolio and the historic estate. This was in lieu of recruiting a post under the 'Commercial Property Investment Officer' post that was approved in last year's strategy.
- 4.5.4. As part of the development of the 2020-21 revenue budget, an additional role of Asset Portfolio Manager was recommended for approval. Following a review of the tasks and requirements of the role, it is now recommended that this role not be progressed, but the Councils procure a specialist consultancy firm to provide an investment management and fund administration service reporting on a regular basis and to produce an annual review of the individual assets, their financial performance since acquisition and a future management strategy for these assets within the respective portfolios.
- 4.5.5. A full specification of the requirements of this is being drafted by officers, in consultation with the Chief Financial Officer and will be procured in due course.

4.5.6. 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.

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

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

4.6.1. 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.

4.6.2. 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.

4.6.3. Due to the restrictions on PWLB funding, officers will be seeking 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.

4.6.4. The Councils should 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.

- 4.6.5. 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.
- 4.6.6. Owing to market uncertainties and the impact of the Covid-19 Pandemic coupled with 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 until the wider structural impact of Covid-19 Pandemic is known. This will enable the Councils to remain competitive and agile particularly when exploring investments that present strategic opportunities.
- 4.6.7. 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.
- 4.6.8. 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.
- 4.6.9. Councils continue to seek a mixture of 'Core', 'Added Value' and 'Opportunistic' acquisitions.
- 4.6.10. 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.

#### 4.7. **Statutory Guidance**

- 4.7.1. 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.

4.7.2. 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.

4.7.3. 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.

4.7.4. 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.

- 4.7.5. 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.
- 4.7.6. 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.
- 4.7.7. 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.
- 4.7.8. The annual Treasury Management Investment Strategy has already been approved by the Councils in February. This Treasury Management Investment Strategy and the Commercial Property Investment Strategy 2021/22, 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.

#### **4.8. Investment Evaluation Process**

- 4.8.1. Prospective investment opportunities are reported by suitably qualified and experienced in-house MRICS (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.
- 4.8.2. 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.

- 4.8.3. 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).
- 4.8.4. 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.
- 4.8.5. 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.
- 4.8.6. 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.
- 4.8.7. 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.
- 4.8.8. 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.

- 4.8.9. 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.
- 4.8.10. 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.
- 4.8.11. 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.
- 4.8.12. 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.

#### **4.9. Property Investment Governance**

- 4.9.1. 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.

- 4.9.2. 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.
- 4.9.3. It is proposed that a formalised staged governance approach is adopted in relation to SPIF purchases, as follows:

**Stage 1**

Officers identify suitable opportunities 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/s<sup>151</sup> 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 Head of Major Projects and Investment. In making any decision to purchase, the Head of Major Projects and Investment will carry out a consultation, as provided for in the Scheme of Officer Delegations, with the relevant Council Leader, Executive Member for Resources and Chief Financial Officer.

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

Subject to approval, written authority to proceed, will be provided by the Head of Major Projects and Investment to the 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.

### **4.10. Risk Management**

- 4.10.1. 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.
- 4.10.2. 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.

- 4.10.3. 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.
- 4.10.4. Whilst risk is a natural, necessary, part of investment that cannot be eliminated, it can be proactively managed.
- 4.10.5. 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.
- 4.10.6. 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.”***
- 4.10.7. 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.
- 4.10.8. 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.
- 4.10.9. 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.

- 4.10.10. 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.
- 4.10.11. 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.
- 4.10.12. 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.
- 4.10.13. 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 asset's current use is facing economic, physical or functional obsolescence and requires regeneration, economic support and placemaking more generally.
- 4.10.14. 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.
- 4.10.15. Investments should still focus on a diverse mix of single and multi let tenanted properties to spread the income security.
- 4.10.16. 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.

- 4.10.17. 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.
- 4.10.18. 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. As the portfolio expands into the value add and opportunistic spheres, investments will become less liquid so a greater level of scrutiny is 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 are recommending an update to the acquisition process and further reporting to ensure that a robust risk management process is in place.
- 4.10.19. 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.

#### 4.11. **Annual Performance Monitoring**

- 4.11.1. 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 MRICS qualified professional with experience in institutional level commercial property investments.



- 4.11.2. Additional recommendations within this report is to expand the investment management fund reporting to include total return outputs which will measure the income and capital return from portfolio at inception to each future financial year showing accumulative and annual performance. These outputs will be further benchmarked against a comparator index. This will enhance the performance reporting mechanisms and enable officers to recommend asset management initiatives in the future, either investment, repositioning and disinvestment. This further includes new updated asset plans for each asset, and a portfolio composition review. This work is being scoped currently, and will be procured in due course.
- 4.11.3. The cost of this additional reporting and recommendations will be met from the budget already allocated from the Asset Portfolio Manager post.
- 4.11.4. This additional third party reporting is in addition to ongoing monitoring, the CPIS (Appendix 1) which 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 performance and strategic direction that are undertaken internally and in consultation with relevant officers and members.

#### 4.12. **Corporate Implications**

- 4.13. 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.
- 4.14. 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.
- 4.15. The additional income delivered from SPIF investments, has contributed to the delivery of a more robust and sustainable Revenue Budget for 2021/22 and the delivery of the budget strategy, helping to manage pressures arising in year due to unforeseen circumstances, including the Covid-19 Pandemic.
- 4.16. 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 CPIS 2020-21, taken to JSC in March 2020.
- 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 Central Government grant funding, and increase the level of spend in areas such as Housing need through generating net additional income. Below is a breakdown of the contribution to balancing the budgets made by the acquisitions since the introduction of the initiative in 2017:

	Adur	Worthing
Level of savings required to balance the budget 2017/18 - 2021/2022	£5.119m	£8.521m
Net new income from the investment in commercial property	£1.043m	£1.270m
% of savings from commercial property income	20.43%	14.90%

- 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 has been spent or allocated as follows:

	Adur £'000	Worthing £'000
2016/17 Actual	0	3,222
2017/18 Actual	11,579	9,464
2018/19 Actual	26,366	26,973
2019/20 Actual	43,507	51,549
2020/21 Actual	0	4,799
2021/22		
- Allocated to projects	80	4,272
- Unallocated	43,468	24,721
Total investments	<u>125,000</u>	<u>125,000</u>

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. 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 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.

6.6. Currently the annual provision for the management of voids and future maintenance is £200k for Adur and £250k 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 2021-21 the annual provision will be:

- Adur                    £550,000
- Worthing            £350,000

In 2020-21 this provision was used to offset all losses within the property portfolio due to the impact of the Covid-19 Pandemic.

## **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 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.
- 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 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

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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 2021-2022**



# Contents

1. Objectives
2. Fund Policy
3. Financial Resilience
4. Fund Structure
5. Purchase Guidelines
6. Annual Review

# The Property Investment Strategy

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## 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 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 property portfolio, where appropriate to maximise long term revenue generation.

## The Property Investment Strategy

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### 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 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

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### 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, except for in borough investments with a social, economic or environmental benefit.	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. Restrictions to PWLB funding mean that this is relevant to non-PWLB funded acquisitions through alternative finance or from capital reinvestment following asset sales.
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 medium term. The fund has avoided 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.£2-10m	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. 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

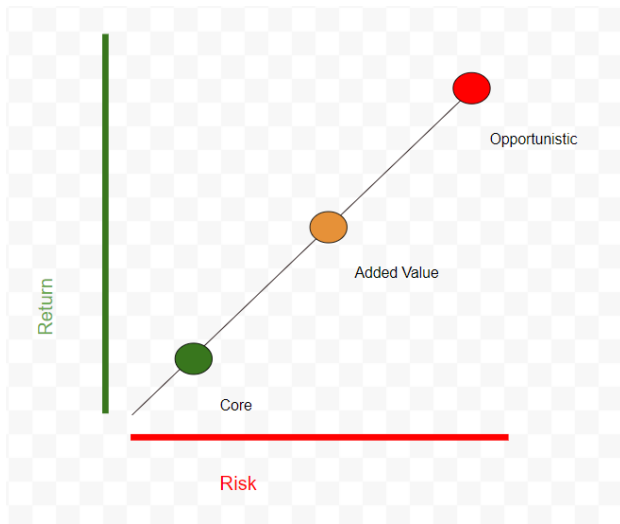
It is important to acknowledge that the above principles are ongoing long term objectives and attaining balance will progress as the fund matures.

# The Property Investment Strategy

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## 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.



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.

**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 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.

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. Where new acquisitions are PWLB funded, sites to be within the functional economic area.
- ❖ 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

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### 6. Quarterly and Annual Review

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

- ❖ An update of quarterly rent performance, service charge 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.

The 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.
- ❖ 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.
- ❖ 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.

## **7. Asset Management (on-going)**

- ❖ 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 to deliver 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:

INVESTMENT PROPOSAL

Property Name/Location:  
 vendor:  
 tenure:  
 Category:  
 Price:  
 Rent per annum:  
 Rent Free:  
 Initial Yield:  
 VAV 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 internal 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	
Under-represented sector	Sector already heavily represented
Major Prime	Prime      Major Secondary      Micro Secondary      Tertiary
Excellent transport / footfall	Location with limited benefit
Excellent financial covenant	Strong financial covenant      Good financial covenant      Poor but improving covenant      Poor financial covenant
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
Greater than 15 years	Between 10 and 15 years      Between 6 and 10 years      Between 2 and 5 years      Under 2 years / vacant
Full repairing and insuring-recoverable	Full repairing and insuring-partially recoverable      Internal repairing-recoverable      Internal repairing-partially recoverable      Landlord responsible
Fixed uplifts at frequent intervals	Significantly over-rented (tenant paying above the
In demand from many tenants	Reasonable prospect of securing new tenants      Niche with limited demand
Single Tenant	Multiple Tenants
Lot size & attractive to investors	Attractive to niche purchasers only
Favourable location / planning	No opportunity to change use
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%+)
Significant opportunity to add value	No opportunity
Return higher than expected for sector / the risk profile	Return lower than expected for sector / risk profile

Portfolio Strategy Context	The extent to which the property meets the strategy and contributes to the achievement of a diversified portfolio	15
Location: Macro	Quality of the location (town, city, area) with regard to the property use	15
Location: Micro	Quality of the individual situation of the property within the macro location, with regard to the property use	15
Tenant Covenant	Ability of the tenant/s to pay the rent for the duration of the lease. Credit rating of the tenant	15
Building Quality	Quality of the building compared to the Industry standard Grade A for the property type	15
Lease Term	Length of the secured income.	15
Lease Structure	Tenant repairing obligations, rent review mechanisms	15
Rental Growth Prospects	Opportunity / Likelihood to increase passing rent	15
Occupational Demand	Anticipated level of demand from alternative occupiers if the tenant/s were to vacate	15
Management Intensity	Complexity and cost of managing the property	10
Liquidity	The degree to which the property can be quickly sold in the market without affecting the price	10
Alternative Use / Underlying Value	The value of the land and the opportunity to explore a change of use should this be required	10
Tenure	Freehold / Long Leasehold. Consideration of any ground rent obligations	10
Asset Management Opportunities	Opportunities to add value to the property	5
Financial Return (risk v reward)	The forecast gross financial return considering the risk profile of the property and in accordance with the sector.	20

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.
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<b>Strengths</b>	<b>Weaknesses</b>
<b>Opportunities</b>	<b>Threats</b>