Waverley
BOROUGH COUNCIL

Annexe 7

Capital Strategy

Non Treasury Management Strategies

Property Investment Strategy 2020/2021

General Fund

Owned by:	*Vicki Basley*
Council Approval date:	*February 2020*
Date for review:	*February 2021*

1. Introduction

1.1 The Council holds property assets for two reasons:
1. Service delivery (operational assets)
2. Investment to support corporate priorities

1.2 The General Fund Property Investment Strategy relates to 2. above and sets out the basis on which the Council intends to:
- Make property investments (through purchase or development)
- Provide on-going management of the investment property portfolio
- Report portfolio performance to officers and Members

1.3 All land and property will be acquired and held for a clearly defined purpose within clearly defined legal powers and in accordance with the corporate priorities.

1.4 This Strategy will be subject to review by the Property Investment Advisory Board (PIAB) and form part of the suite of documents under the Capital Strategy. Any material changes in year will be referred to the Executive for approval.

2. Elements of the Investment Strategy

3. Key Objectives

3.1 The key objectives are to:

Returns

- Acquire or develop properties or land that provide long term investment
- Obtain yield at least in line with Treasury Management targets
- Maximise return whilst minimizing risk through asset management plans
- Prioritise investments that yield optimal rent growth and stable income
- Consider proportionality of income from commercial property on the Council's revenue budget

Risk

- Build a risk/return balanced property portfolio
- Diversify through class and location
- Protect capital invested in property acquisitions
- Obtain stable growth

Governance

- Develop a governance framework that facilitates working in the open market

4. Link to Corporate Strategy and other Strategies

4.1 The Council will only consider property investments that support the Corporate Strategy and the Medium Term Finance Plan (MTFP).

4.2 The MTFP includes a target for net new income from commercial investment property of £1.2million across the next four years from 2020/2021. The Council will set an upper limit on the proportion of commercial property income to net service expenditure of 20%.

5. Investment Principles

5.1 The Council will consider residential and commercial property investment opportunities in accordance with legal advice both inside and outside the Borough.

5.2 Investments inside the Borough are most likely to be able to support the Corporate Strategy.

5.3 Opportunities for investment outside the Borough will be considered in accordance with legal advice and will be prioritised within the Council's area of economic influence. The area of economic influence is defined as areas where the residents of the Borough flow through for employment, social, environmental reasons as well as those areas defined in the Local Enterprise Partnerships (LEPs).

5.4 Property considered for investment will be assessed against the following criteria:

	Criteria	Excellent	Very good	Acceptable
General	Yield (will be assessed with reference to the Treasury Management Strategy)	5-6%	4-5%	Net rate of return after borrowing costs not less than the required rate set out in the TMS
	Lot size (cost)	£5m plus	£1-5M	Less than £1m
Commercial	Tenure	Freehold	125+ year lease	50-125 year lease
	Occupiers lease length	Greater than 10 years	5-10 years	Less than 5 years (with business case)
	Location	Major prime	Micro prime	Major secondary
	Repair terms	FRI	IRI (remainder 100% recoverable)	IRI (remainder partially recoverable)
	Tenancy Strength (if occupied)	Single tenant with strong financial covenant	Single tenant with strong financial covenant or, where multi-let, a suitable spread of risk across tenants commensurate with the type of property	Multiple tenants with strong financial covenants
Residential		Assured short-term tenancies in accordance with legal requirements	Assured short-term tenancies in accordance with legal requirements	Assured short-term tenancies in accordance with legal requirements

5.5 Investments requiring initial capital expenditure for re-instatement or refurbishment may be considered if the equivalent yield on the resulting total investment meets the required level for the improved property.

5.6 An investment may be considered which meets all other criteria but does not generate an adequate immediate gross rental income or net rate of return provided that it is reasonably expected to generate an adequate average gross rental income and average net rate of return over the first five years of ownership.

5.7 Consideration may also be given to acquisitions that focus on growth and provide opportunities for future development potential.

6. Legal Powers

6.1 The Council has powers to:

i) Invest, pursuant to Section 12 of the Local Government Act 2003 (LGA 2003) and an Investment Strategy; for any purpose relevant to its functions under any enactment and for the process of the prudent management of its financial affairs.
ii) Borrow, pursuant to Sections 1-6 inclusive of LGA 2003.

In both cases this is subject to Section 15 of LGA 2003: a duty to "have regard to" Guidance from CIPFA and MHCLG.

6.2 The Council also has other relevant powers. These include:

(1) Section 120 of LGA 1972: a power to acquire land; and
(2) General Power of Competence (GOPC), pursuant to Section 1of LA 2011.

6.3 The powers enable the Council to invest in:-

- Commercial property; and
- Residential property.

6.4 When making investments the Council will consider, amongst other things, the type of property and the location.

6.5 Every proposal submitted to the PIAB shall identify the legal powers under which the Council will invest having regard to legal opinion taken and supplementary legal advice where appropriate.

7. Funding

7.1 The Council will fund property investments from:

- General Fund revenue reserves and Capital receipts
- External borrowing (in accordance with the Treasury Management Strategy)
- Internal borrowing (in accordance with the Treasury Management Strategy)

7.2 Borrowing to fund or part-fund a property investment will comply with the Prudential Code issued by the Chartered Institute of Public Finance and Accountancy. This requires borrowing to be affordable, sustainable and provide value for money as reasonably determined by the Council.

7.3 The Council's approved Treasury Management Strategy includes property investment within its scope. The Council will comply with the requirement for all local authority investments whilst recognising the inherent lack of liquidity of property investments.

7.4 The proportion of overall borrowing to the Council's Capital Financing Requirement will be in line with the Prudential Indicators contained in the Treasury Management Strategy.

7.5 Minimum Revenue Provision (MRP) will be charged annually as a revenue cost to the General Fund in accordance with the MRP policy contained in the Treasury Management Framework. MRP will form part of the annual financing cost used to calculate the net return on each investment funded or part-funded by borrowed funds (external and internal).

8. Acquisitions Process

8.1 Acquisitions will be sourced from:

- Property searches
- Direct approach to or from vendor (off market deals)
- Third party agents
- Unsolicited introductions from agents
- Joint ventures with another local authority, developer or investor

8.2 The Asset Manager will undertake the initial consideration of an investment opportunity, employing an appropriate investment appraisal in line with this strategy.

8.3 Suitable investment opportunities will undergo qualitative and quantitative appraisal (Financial modelling) in order to establish its acceptability as an investment.

8.4 External professional advice will be sought where necessary, in accordance with the Council's Contract Procurement Rules.

8.5 For tenanted acquisitions each property and its tenant(s) will be fully appraised both physically and financially using industry standard techniques to ensure the yield offered is acceptable for the level of overall risk involved. An example risk spreadsheet is shown at Appendix 1.

8.6 A business case will be produced and supported by financial modelling which will include, where appropriate:

i) Yield calculations (Initial, equivalent and reversionary)
ii) Financing costs
iii) Life cycle costs to be borne by the Council
iv) Net rate of return calculation
v) Discounted cash flow analysis
vi) Sensitivity analysis of cash flow
vii) Exit Strategy, including trigger points
viii) Financial implications of exit strategy
ix) General Fund impact

8.7 Residential schemes will be subject to assessment through the ProVal system for residential development to determine financial viability.

8.8 All suitable opportunities will be referred to the IAB for consideration. The IAB will review each proposal in accordance with its Terms of Reference.

8.9 Decisions will be undertaken in accordance with the Scheme of Delegation and referred to the Executive or Full Council for approval as appropriate.

8.10 Following approval the Asset Manager will be instructed to express an interest in the property. If successful due diligence will be activated.

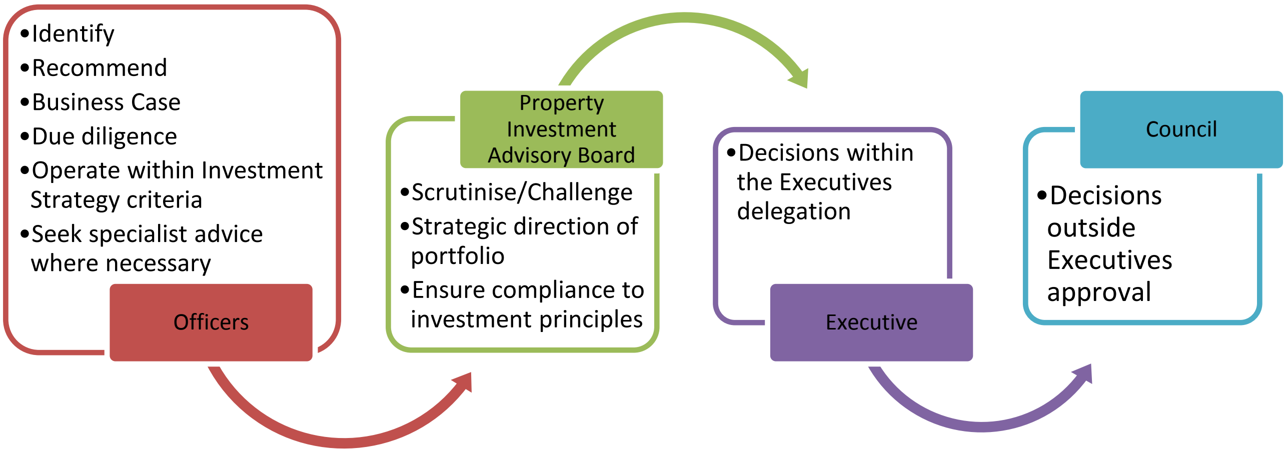
9. Governance and Due Diligence

9.1 Prior to any investments the Council makes it will first determine:

- The reason for the investment
- The powers under which the investment is made
- The extent to which the capital invested is placed at risk
- The impact of any potential losses on financial sustainability

The governance process will be reviewed on a regular basis to take account of changes in legal powers, the market and other conditions to ensure it is robust.

9.2 The Governance framework will comprise:



9.3 Due diligence will include:

Evaluation:

- Compliance to Investment Principles
- Legal power under which the Council will invest
- Assessment of legal issues in relation to property

Risk Analysis

- Risk appetite
- Assessment of sector risk and asset risk
- Reputational issues

Property Analysis

- Independent valuation of property from external agent
- Land Registry title checks
- Formal building condition survey
- Independent assessment of asset life
- Any necessary environmental and flood risk investigations

Financial Analysis

- Financial assessment of tenant(s)
- Assessment of the impact of any potential abortive costs and how they will be funded
- Assessment of impact of default or significant loss in value and how it will be funded
- Allowance for future costs, income shortfall and management of assets
- Formal estimate of any re-instatement costs

Risk

9.4 Risk will be assessed in line with the Council's Risk Management Framework and Risk Appetite Statement. The Business Case for the investment will assess each risk domain documented in the Risk Management Framework.

9.5 Risk will be minimised through:

- Compliance to the investment criteria
- Completion of due diligence
- Having management strategies in place for each property
- Having an exit strategy for each property, including trigger points and operating parameters

9.6 Once approval is in place, subject to a satisfactory outcome to the due diligence and after liaison with the Portfolio Holder for Property and Finance, Legal Services will be instructed to proceed to completion.

10. Property Development

10.1 The Council will consider opportunities for development, either buy or build, for:

- Residential property
- Commercial property
- Land assembly
- Conversion of assets

10.2 Delivery options will include:

- Partnership working and Joint Ventures
- Self build
- Contract development with a Developer

10.3 Residential development will be undertaken within the General Fund under Section 12 of the Local Government Act 2003 to achieve market rent or sale.

11. Property Management

11.1 The assets will be managed in accordance with the Strategic Asset Management Plans held under the Capital Strategy.

11.2 On acquisition, an Asset Management Plan will be drawn up for each asset in line with the characteristics of the type of asset. The plan will specify the timeframe over which performance will be assessed and the short, medium and long-term objectives of holding the asset.

12. Performance Reporting

12.1 A quarterly Performance Report for properties acquired under this Strategy will be submitted to the Value for Money Overview & Scrutiny Committee as part of the Council's performance reporting.

12.2 Performance measures will be set to check:

- Ongoing security of investment
- Ongoing yield
- Fair value against purchase price
- Lifecycle costs required to maintain the income potential

Underperformance on these measures may trigger the exit strategy.

12.3 Performance will be monitored to ensure results are being delivered and to consider if the portfolio meets the needs of the Council or if any rebalancing is required.

13. Exit Strategy

13.1 Each property within the portfolio will have an Exit Strategy to ensure that where there is a predicted risk of change in market/obsolescence or the required return on the property is not being achieved action can be taken to protect the Council's finances from further loss.

13.2 Options for consideration will include:

- Disposal – sell the asset and realise the investment cash
- Alternative uses – based on market demand
- Transfer to operational property for service delivery

13.3 An Exit Strategy may be triggered in the following circumstances:

- Long term void and unable to attract good quality replacement tenants at acceptable rent levels
- Maintenance liability of the building
- The age and specification of the building affects the ability to let the property
- The management costs of the property affect the yield
- The use or user changes
- The reaching of a specific time period for being void based on the property's normal void turnaround period of a comparable property

14. *Other considerations*

Skills and Expertise

14.1 The Council invests in its Asset Management Team through training to enable staff to:

- Identify investment opportunities
- Undertake property management
- Know when to divest the asset

14.2 External support will be sought where appropriate according to:

- Complexity of transaction
- Nature of acquisition
- Independence requirement
- Skills and capacity of internal team
- Time dependency of transaction

14.3 Management of property (commercial and residential) may be through an agent where the service charge gives best value or where multi-let properties favour external expertise.

Voids and rent arrears

14.4 The Council is exposed to the risk of void periods or tenants defaulting on payment of rent. Loss of income and holding and re-letting costs will be met from a void reserve and managed in line with each individual asset plan.

14.5 Void periods will be kept under review to determine at which point the exit strategy for the asset will be triggered in accordance with the asset management plan for that asset.

Subsidised Rent

14.6 Investment property yields must reflect market conditions and be in line with individual asset management strategies.

14.7 Investment properties will not be subject to Council determined rent subsidy or reduction for operational purposes. Such proposals will trigger the exit strategy for that specific asset including the capital and revenue budget implications of the transfer to operational.

14.8 Residential investment properties will be on assured short-term tenancies and will not be subject to Right to Buy.

Legacy portfolio

14.9 Assets held prior to 1 April 2018 are part of this Investment Strategy unless they qualify as operational assets.

14.10 This will be assessed for:

- Performance
- Risk
- Maintenance requirements
- Yield

14.11 Legacy properties will have their individual asset management plans, including exit strategies.

Environmental considerations

14.12 The Council has declared a Climate Change Emergency and made a commitment to becoming carbon neutral. In undertaking property investment the Council will honor these commitments by setting an example and excluding certain assets from being considered as potential investments if they are not in alignment with these commitments. Assets that will not be considered for investment therefore include, but are not limited to, petrol stations and airports and those that would require special consideration include, but are not limited to, car parks and depots.

15. Sector diversification

15.1 At 31 December 2019, the property portfolio is made up as follows:

Sector	Units	Fair Value £'000	Annual Rent £'000	Gross Yield %
Office	7	11,089	644	5.8
Supermarket	1	7,625	305	4.0
Industrial	30	6,196	295	4.8
Retail	1	641	71	11.0
Total	**39**	**25,551**	**1,315**	

Location	Units	Fair Value £'000	Annual Rent £'000	Gross Yield %
Cranleigh	0	0	0	0.0
Godalming	1	758	56	3.0
Haslemere	1	328	23	7.1
Farnham	37	24,465	1,236	5.0
Total	**39**	**25,551**	**1,315**	

16. Investment Checklist

16.1 The following check list will be used to determined decisions on whether proposed investments can be undertaken.

- **Can we acquire commercial and residential property?**
  - What are the legal powers to support the acquisition and, crucially, are they powers specifically to acquire property or to make investments?
  - Where borrowing is required, what are the powers available to support the taking out of loans?
- **Should we acquire commercial and residential property?**
  - Can the Council justify the exercise of the legal powers in the way proposed?
  - Does the Council's decisions have proper regard for the statutory guidance?
  - Does the Council's decisions have proper regard for the Prudential Code in terms of affordability, prudence and proportionality?
  - Is the acquisition defensible under the best value duty?
- **Will we acquire commercial and residential property?**
  - Is the proposal consistent with the Council's Corporate Strategy and Medium Term Financial Plan?
  - Can the proposal be accommodated within the Council's Treasury Management Strategy and Property Investment Strategy?
  - Does the Council have the necessary competence to take the proposed decision?
  - Does the Council have appropriate skills to manage the asset?

Appendix 1

Investment Analysis template

Source			
Property type			
Address			
Location			
Built			
Condition			
Area	sq ft		
Tenure			
Unexpired term			
Tenants(s) inc underlettings			
Use/alienation			
Repair			
Occupancy rate	%		
Rent	£		
OMV	£		
Management Costs %	%		
Net income after management fees	£		
Term	years		
Rent reviews			
Lease renewal			
Break option			
Asking price	£	£ CV/ sq ft	
Yield			
Net initial	%	% less management costs	
Net equivalent	%	% less management costs	
True equivalent			
Net reversionary	%	% less management costs	
Agents Intro fee	£		
Condition Report	£		
Due Diligence	£		
Legal	£		
SDLT	£		
Management costs	£		
Refurb costs	£		
Total	**£**		
Strengths	**Weakness**	**Opportunities**	**Threats**

eg • In Borough • Fully let • FRI • Location • Parking • Modern	eg • Tenants break • Years remain	eg • Rental growth • Restructure of lease • WBC could utilise	eg • Tenant may exercise break
Conclusion Pursue as potential acquisition/do not pursue			

Glossary

Due diligence: A process to ensure correct documents and searches are complete and that the proposed purchase is legally and financially viable.

Fair value: The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Freehold: The ownership of a property in perpetuity

FRI: Full repair and insurance; Usually a tenant's obligation under the terms of a lease.

IRI: Internal Repair & Insuring

Lease: Type of tenure, whereby rights to a property are granted for a fixed term.

Local Enterprise Partnerships (LEPs): Local business led partnerships between local authorities and businesses and play a central role in determining local economic priorities and undertaking activities to drive economic growth and the creation of local jobs.

Management Costs: Costs incurred to ensure both parties comply with their obligations, if done internally the costs will be absorbed by the council, or if externally, the charges will be deducted from the total income.

Minimum Revenue Provision (MRP): MRP is a statutory mechanism for allocating funds out of revenue income to repay debt (from borrowing or credit arrangements) for capital spend that is unfinanced.

PIAB: Property Investment Advisory Board

Rent Review: The period after which the annual rent for a property can be reviewed in accordance with the terms of the lease, allows for growth on the investment.

Yield: The earnings generated and realised on an investment over a period of time (generally annually). It is expressed as a percentage based on the invested amount, modified for MRP and any other appropriate adjustments, or on the current market value.

(Net) Equivalent yield: The weighted average income a property produces after allowing for voids and costs associated with buying the property.

Initial yield: The annualised rent of a property expressed as a percentage of the property value at the date of purchase.

Reversionary yield: Is the anticipated yield to which the initial yield will rise and fall.