Monday, 10 April 2017

INVESTMENT COMMITTEE

A meeting of **Investment Committee** will be held on

Thursday, 20 April 2017

commencing at **5.00 pm**

The meeting will be held in the Meadfoot Room, Town Hall, Castle Circus, Torquay, TQ1 3DR

Members of the Committee

Councillor Tyerman (Chairman)

Councillor Doggett	Councillor Robson
Councillor O'Dwyer	Councillor Thomas (D)
Councillor Pentney	

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For information relating to this meeting or to request a copy in another format or language please contact:
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INVESTMENT COMMITTEE
AGENDA

1. **Apologies**
To receive any apologies for absence including any changes to the membership of the Committee.

2. **Minutes** (Page 3)
To confirm as a correct record the Minutes of the meeting of this Committee held on 21 March 2017.

3. **Declarations of interest**

(a) To receive declarations of non pecuniary interests in respect of items on this agenda

For reference: Having declared their non pecuniary interest members may remain in the meeting and speak and, vote on the matter in question. A completed disclosure of interests form should be returned to the Clerk before the conclusion of the meeting.

(b) To receive declarations of disclosable pecuniary interests in respect of items on this agenda

For reference: Where a Member has a disclosable pecuniary interest he/she must leave the meeting during consideration of the item. However, the Member may remain in the meeting to make representations, answer questions or give evidence if the public have a right to do so, but having done so the Member must then immediately leave the meeting, may not vote and must not improperly seek to influence the outcome of the matter. A completed disclosure of interests form should be returned to the Clerk before the conclusion of the meeting.

(**Please Note:** If Members and Officers wish to seek advice on any potential interests they may have, they should contact Governance Support or Legal Services prior to the meeting.)

4. **Urgent Items**
To consider any items that the Chairman decides are urgent.

5. **Review of Investment and Regeneration Strategy** (Pages 4 - 17)
To consider the submitted report on a review of the Investment Strategy to cover regeneration investments.

6. **Exclusion of Press and Public**
To consider passing a resolution to exclude the press and public from the meeting prior to consideration of the following item on the agenda on the grounds that exempt information (as defined in Paragraph 3 of Schedule 12A of the Local Government Act 1972 (as amended) is likely to be disclosed.

7. **Investment Opportunities** (To Follow)

Minutes of the Investment Committee

21 March 2017

-: Present :-

Councillor Tyerman (Chairman)

Councillors Darling (S), O'Dwyer, Pentney, Robson and Thomas (D)

(Also in attendance: Councillors Lewis (C) and Morey)

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25. Minutes

The Minutes of the meeting of the Investment Committee held on 7 March 2017 were confirmed as a correct record and signed by the Chairman.

It was noted that future reference to the Torbay Development Agency will recorded as TDA as this is the wish of the Board.

26. Exclusion of Press and Public

Prior to consideration of the item in Minute 27 the press and public were formally excluded from the meeting on the grounds that the item involved the likely disclosure of exempt information as defined in paragraph 3 of Part 1 of Schedule 12A of the Local Government Act 1972 (as amended).

27. Investment Opportunities

David White, TDA provided an overview of an investment opportunity in Brixham as set out in the submitted exempt report circulated on 17 March 2017 and four opportunities in Torquay as set out in the submitted exempt report circulated on 20 March 2017.

Resolved:

(i) that the Council does not wish to make a bid at this stage off market on the Brixham investment opportunity but that the TDA be requested to continue to monitor this investment; and

(ii) that the TDA be requested to explore further the two larger investment opportunities in Torquay Town Centre.

Chairman

Meeting: Investment Committee **Date:** 20 April 2017

Wards Affected: All Wards

Report Title: Review of Investment and Regeneration Fund Strategy

Is the decision a key decision? Yes

When does the decision need to be implemented? As soon as possible

Supporting Officer Contact Details: Anne-Marie Bond, Assistant Director Corporate and Business Services, anne-marie.bond@torbay.gov.uk

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1. Proposal and Introduction

1.1 At the meeting of Council held on 6 April 2017 Members approved a revised Investment Fund Strategy and Terms of Reference of the Investment Committee. This was to ensure that there was the greatest opportunity to maximise benefits income, diversify investments and spread risks.

1.2 The Investment Fund Strategy is a Policy Framework Document and requires Council approval.

1.3 The Investment Committee's Terms of Reference includes them making recommendations for the revision of the Strategy. As Council is looking at ways to enable regeneration projects to be brought forward, this report sets out proposals for the Investment Committee's consideration as to how this could be funded and proposes the expansion of the Investment Fund Strategy and Investment Committee’s role to cover regeneration proposals.

1.4 The Investment Committee is requested to review the documents set out in Appendices 1 and 2 to this report and make recommendations to Council on the proposals.

2. Reason for Proposal

2.1 To review the Investment Fund Strategy, to consider creating a separate fund for regeneration projects, reviewing the level of the General Investment Fund and the remit of the Investment Committee to enable regeneration projects pursued.

3. Recommendation(s) / Proposed Decision

3.1 That the Council be recommended to approve the revised Investment and Regeneration Fund Strategy, including the additional £50m for the General Investment Fund (making it a total of £100m) and £50m for the Regeneration Fund to be funded from prudential borrowing (when required), set out in Appendix 1 to the submitted report.

3.2 That the Council be recommended to rename the Investment Committee to the Investment and Regeneration Committee and approve the membership and Terms of Reference for the Investment and Regeneration Committee set out in Appendix 2 to the submitted report.

Appendices

Appendix 1: Revised Investment and Regeneration Fund Strategy
Appendix 2: Revised Membership Terms of Reference of Investment and Regeneration Committee

Background Documents

Revised Torbay Council Investment Fund Strategy – Council meeting 6 April 2017

Supporting Information

4. Regeneration Fund Proposal

4.1 The Council is in the process of reviewing its Torbay Economic Strategy and developing a number of regeneration proposals through the Transformation Project – Town Centre Regeneration in order to support regeneration across Torquay, Paignton and Brixham.

4.2 It is proposed that the Council establishes a Regeneration Fund of £50m which will be funded from prudential borrowing and will be used to fund and co-ordinate all regeneration capital projects. This will also help to generate NNDR (National Non-Domestic Rates – e.g. Business Rates) from 2019 linked to the new 100% NNDR Retention Scheme, which will be used to fund the Council from 2019. It is therefore proposed that this Fund will be spent over the next two years with a view to requesting the Council to increase this Fund if deemed necessary.

4.3 All capital regeneration projects will be funded from this Fund to include Claylands, Graphics and other new town centre regeneration projects and Torbay Economic Strategy projects which will leave other investments being funded from the General Investment Fund pot.

4.4 As the Regeneration Fund is aimed at enabling unfunded regeneration schemes to progress, any surplus income after operating, borrowing and MRP (Minimum Revenue Provision) costs will be ring-fenced to support future regeneration schemes. Assets purchased from this Fund must be valued in excess of the level of borrowing but will not be expected to achieve the same yields as other investments but must be cost neutral. MRP will be applicable over the life of the asset. Where the asset is subsequently sold the capital receipt will be allocated corporately following the recommendation of the Head of Finance.

4.5 The Council has successfully purchased two large investments and it is requested that the General Investment Fund pot be increased by £50m to £100m to enable the Council to make further investments from this fund.

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May 2017

Investment and Regeneration Fund Strategy

DRAFT Version 4

TORBAY COUNCIL

Investment and Regeneration Fund Strategy

1.1 Background

As part of its efficiency plan and transformation programme the Council needs to increase its future local taxbase income (Council tax and NNDR) by investing capital resources within Torbay to stimulate growth. Capital resources could be a combination of asset purchase, co investment in projects or capital loans.

As clarification the following descriptions have been used:

"Investments – Yield". These are property purchases where the objective is to increase rental income to the Council.

"Investments – Taxbase". These are property purchases where the objective is to increase NNDR or Council tax income to the Council.

"Investments – Loans or Co Investment". These are loans to business for capital expenditure where the objective is to increase rental income to the Council or to increase NNDR or Council tax income to the Council. Co Investment is where Council with another investor provides finance or jointly purchases.

"Property Purchase" – property to include purchase of land and/or buildings.

"Regeneration Fund Investments." These are property or land purchases where the objective is to enable regeneration projects to progress.

This Policy Framework document sets out the strategy for the management of the **General** Investment Fund **and the Regeneration Fund** including purchases/investments. The strategy reflects a suitable balance between the risks inherent in the types of property/investments to be acquired and the financial rewards obtainable whilst limiting risks appropriately. In addition, the portfolio of investments being acquired should be diversified in order to spread risks via a balanced portfolio, such diversification principally being across geographical location and the use type of properties held. Existing investments that fall within the remit of the Investment **and Regeneration** Fund Strategy shall be included in the portfolio to assist in creating a balanced portfolio, as well as other suitable assets held by the Council.

The risks of investing in property may be mitigated through the acquisition of assets with secure, long income streams. This needs to be balanced against the requirement for a given level of income yield on capital invested in a careful and controlled manner, with specific analysis of risk criteria carried out in the 'due diligence' stage prior to the completion of each purchase.

1.2 Objective – General Investment Fund

To invest in commercial investment properties for the benefit, improvement or development of the area whilst also delivering a significant income return over the medium-term of at least 2% above capital costs on capital invested, through a balanced strategy of acquisition, retention and management of good quality property investments, with that income being used to support wider Council services.

The improvement or development of the area will not be constrained by the boundaries of Torbay as there is an evidence base that demonstrates that investment within the South West Local Enterprise Partnership (LEP) Zone area has a positive impact on Torbay's economy. LEPs were established around functional economic boundaries which reflects both labour market and wider economic interdependence. This can be evidenced through the Heart of the South West Strategic Economic Plan (see http://heartofswlep.co.uk/wpcontent/uploads/2016/09/SEP-Final-draft-31-03-14-website-1.pdf **)** and the Torbay Economic Strategy (see http://www.torbay.gov.uk/DemocraticServices/documents/s35783/Torbay%20Economic%20Strategy.pdf **).** However opportunities in any geographic location will be considered where it can be demonstrated that there is a benefit to, or improvement or development of Torbay. **This will not prevent the Council investing in national opportunities which have a sufficient yield through a wholly owned company of the Council, if supported by the Monitoring Officer and the Head of Finance.**

1.3 Objective – Regeneration Fund

To invest in properties or land to support the Torbay Economic Strategy and town centre regeneration which will enable regeneration projects to be progressed within Torbay on a cost neutral basis and help to generate NNDR, whilst delivering economic growth and regeneration.

1.4 Scope

The maximum total level of investment shall be **£100m for the General Investment Fund** ~~£50m~~ **and £50m for the Regeneration Fund** ~~to assist in diversifying the investment portfolio~~.

1.5 Strategy

This Policy Framework sets out that decisions to allocate monies in accordance with this policy are not Executive decisions, and the Council has previously delegated this to the Investment **and Regeneration** Committee **who** shall make all decisions up to £10m. The maximum individual investment to be approved by Investment **and Regeneration** Committee shall be £10m including estimated purchasing costs, however Full Council approval is not restricted in terms of value.

The Investment and Regeneration Committee will be held in two distinct parts, dealing with Investment and Regeneration opportunities separately.

Achieving a spread of risk across a greater number of assets and by acquiring properties across the range of different property asset classes, namely retail, leisure, office and industrial, is to be desired, however it has to be recognised that opportunities to do this may not arise, and ultimately if individual business cases are robust**,** groupings in any individual property class should not pose any increased risk to the Council.

The principle of being relatively risk-averse by limiting fresh investment to properties with minimum unexpired lease terms of five years at the date of acquisition, and with tenants of strong financial standing, should be adopted if possible. Clear consideration will need to be given to yields where investments do not have fully repairing and insuring (FRI) terms or FRI by way of service charge, meaning that all costs relating to occupation and repairs are borne by the occupier(s) during the lease term to ensure that these costs are recovered.

The investment portfolio will include acquiring some properties to hold and some properties to dispose of depending on the anticipated lifespan of the asset, so as to ensure that the Council has a rolling stock of investments in order to achieve maximum **benefit** ~~income~~ for the Council.

1.6 Minimum and maximum yield

	Investment held for asset life	Investments/assets held for defined period (maximum 10 years)
Minimum Yield Required **for General Investment Fund** (before costs)	2% above estimated borrowing costs (interest and MPR or if capital loan prevailing borrowing rates + 2%)	2% above estimated borrowing costs (interest only or if capital loan prevailing borrowing rates + 2%)
Minimum Yield Required **for Regeneration Fund** (after costs)	**£0 – cost neutral after estimated borrowing costs (interest and MRP or if capital loan prevailing borrowing rates must be equal to the income due)**	**£0 – cost neutral after estimated borrowing costs (interest and MRP or if capital loan prevailing borrowing rates must be equal to the income due)**

Acquisitions of assets will be pursued at a target minimum yield (before costs) of 6.5% and, as a guide to potential risk, yields of 10.0% or more are unlikely to be appropriate for investment **in respect of the General Investment Fund purchases**. Assets producing initial yields in excess of 10.0% are likely to exhibit high risk characteristics, such as very short unexpired leases, or financially weak or insubstantial tenants, or obsolete buildings and would therefore require a higher level of due diligence to be carried out to assess the benefits and risks. Assets with a projected yield of over 10% will be discounted unless officers can demonstrate that risk characteristics are acceptable and avoid very short unexpired leases, financially weak tenants or obsolete buildings.

Acquisitions of assets in respect of the Regeneration Fund will be pursued where there is a clear business case for direct delivery of regeneration to support the Torbay Economic Strategy or town centre redevelopment. These assets will not be required to achieve the same level of yield as the General Investment Fund purchases and any surplus income after operating, borrowing and MRP costs will be ring-fenced to support future regeneration schemes. Assets purchased from the Regeneration Fund must be valued in excess of the level of borrowing and must be cost neutral. MRP will be applicable over the life of the asset. Where the asset is subsequently sold the capital receipt will be allocated corporately following the recommendation of the Head of Finance.

1.7 Sector spread

Traditionally the highest returns come from the office and industrial sub-sectors. Currently offices can provide an income return of 5.5% in quality in-town areas and between 7.5% and 8.5% for reasonable quality offices in regional and sub-regional centres. Industrial income yields can range from 6.0% up to 7.5% for acceptable quality assets. The retail sub-sector for prime retail property is lower than comparable office/industrial assets with typical yields ranging between 5% and 7% for high quality in-town properties. On this evidence it is likely that predominantly office and industrial/warehouse will be targeted for acquisition with a lesser emphasis on retail. Leisure and mixed use investments will also be eligible under the strategy.

Residential property tends to be management intensive and requires specialist expertise. It is therefore proposed that this sector is excluded from the Investment **and Regeneration** Fund strategy.

Sector spread will be applicable for General Investment Fund investments but not Regeneration Fund investments as these will be focussed on delivering regeneration within Torbay which will be site specific to meet the aspirations of the Torbay Economic Strategy and town centre regeneration.

1.8 Locations

Torbay would be the preferred location for fresh acquisitions of investment properties, so that reinvestment is directly retained within the local economy and any additional capital expenditure is made in the local area. However, there is a finite and limited supply of property within the local area, and of that supply only a small proportion may be available for purchase at any time. The wider South West Local Enterprise Partnership area should also be considered for fresh acquisitions as there is an evidence base that demonstrates that investment in this area has a positive impact on Torbay's economy. However opportunities in any geographic location will be considered where it can be demonstrated that there is a benefit to, or improvement or development of Torbay. **This will not prevent the Council investing in national opportunities which have a sufficient yield through a wholly owned company of the Council, if supported by the Monitoring Officer and the Head of Finance.**

We will consider opportunities for co investment with partner organisations of good financial and reputational standing. **Acquisitions using the Regeneration Fund will only be sought within Torbay.**

1.9 Target assets

Commercial assets will be sought with lot sizes of £500,000 plus with income yields of 2% or more above borrowing costs **in respect of the General Investment Fund and assets valued in excess of the cost of borrowing in respect of the Regeneration Fund**. However consideration will always need to be given to the number of smaller investments held by the Council, in pursuance of this Strategy and the burden of administering each investment before a decision is taken.

1. Leisure investments, such as public houses, restaurants and health & fitness centres will also be sought.

2. Mixed-use investments would also be potentially suitable additions to the portfolio. These may include a mixture of commercial uses or a mixture of retail and office use.

3. Residential investment – tends to be significantly more management intensive than the types of commercial property investment envisaged under this strategy and requires specialist residential management expertise, so are excluded from this strategy.

1.10 Assessment of risks

	Investment, Loans & Co Investment
Independent Valuation of asset	Yes (if applicable)
Condition Survey	Yes (if applicable)

	Investment, Loans & Co Investment
Independent Assessment of Asset Life	Yes (if applicable)
Independent Assessment of Residual value	Yes (if applicable)
Security required	Yes if loan
"Green Book" Financial profile over life of asset (IRR)	Yes (if applicable)
Reputational Issues	No "sin" assets or tenants

A rigorous assessment of all risks is required in each case of fresh investment in order firstly to value each property and then to check its suitability for inclusion in the portfolio. The risks fall into two categories, firstly economic and property market risks in specific property market sub-sectors and locations and secondly asset-specific risks (as set out below). These can be measured and an assessment made of the likely future performance of the investment carried out based on the ranges of likely future rental growth and voids of the property and also the projected disposal price or capital value at the end of the period over which the cash flow analysis is being measured.

Financial returns are modelled over a medium-term horizon of five years, based on proposed offer prices, to determine the acceptability of each investment, and can be compared against general market forecasts. Internal Rate of Return (IRR) calculations will be carried out to model the expected cash flows from each investment. The anticipated returns can be modelled on different bases to reflect the range of risks applicable in each case, to ensure that forecast returns properly reflect the measured risks. In this way a Business Case is put together to support each recommended property acquisition.

This modelling will be used to make an assessment on how long the asset should be retained for, taking into account the likely future value of the asset at the proposed time of disposal, any over-renting and potential voids in the leases. Where the value of the asset is likely to be less than the amount paid, including stamp duty and purchasing costs, Minimum Revenue Provision (MRP) will be applied to recover these costs. MRP will be assessed on a case by case basis by the Head of Finance in line with the Council's MRP Policy **for General Investment Fund investments**. **MRP will be applicable over the life of the asset for Regeneration Fund investments.**

The Head of Finance reserves the right to refer any proposed investment decision (irrespective of value) to the Council for consideration where he deems this is in the best interest of the Council.

Asset-specific risks

Income and capital returns for property will depend principally on the following five main characteristics;

• Location of property

• Building specification quality

• Length of lease unexpired

• Financial strength of tenant(s)

• Rental levels payable relative to current open market rental values

Location – this is the single most important factor in considering any property investment. In the retail sector prime or good secondary locations in major regional or sub-regional shopping centres are likely to provide good long-term prospects, or alternatively prime locations in sub-regional or market towns.

Industrial and warehouse property has a wider spectrum of acceptable locations with accessibility on good roads to the trunk road and motorway network being the key aspect.

Experienced knowledge will be required to ensure that good locations are selected where property will hold its value in the long term.

Building specification quality – In office property especially it is important to minimise the risk of obsolescence in building elements, notably mechanical and electrical plant. Modern, recently-built office and industrial property should be acquired to ensure longer-term income-production and awareness of the life-cycle of different building elements and costs of replacement is critical in assessing each property's merits. For town centre retail property trends have been towards larger standard retail units being in strongest demand from retailers.

Length of lease unexpired – At present capital values are highest for long-term leased property and values tend to reduce significantly when unexpired lease terms fall below five years, as owners expect significant capital expenditure to be necessary when leases expire and tenants may not renew leases and continue to occupy. Fresh investments should be made ensuring that diminishing lease terms will not either adversely affect capital value or that significant capital expenditure and voids are experienced. A strategy to dispose of investments before unexpired lease terms reach terms of shorter than three years should be adopted or the leases to be renegotiated before this time.

Financial strength of tenant(s) – assessment will be required of each tenant of potential acquisitions through analysis of their published accounts and management accounts where necessary. Risk of tenant default in rent payment is the main issue but the relative strength of a tenant's financial standing also impacts upon capital value of property which is let to that tenant and careful analysis of financial strength is a key part of due diligence prior to purchase of investments.

Rental levels – following the banking crash in 2007/8 rental levels fell across most occupier markets, particularly in office and retail markets. As a result rents payable on leases that were granted before 2007 may be at levels which are higher than current rental values. Rents in some sub-sectors have recovered back to pre-2007 levels but care is required in all purchases to assess market rents local to each property to check whether rents payable under leases are above or below current levels, as this will impact on whether growth in rents in the future will be fully reflected in the specific property being analysed.

Environmental and regulatory risks - Risks such as flooding and energy performance are taken into account during the due diligence process on every property purchase.

Reputational risks - A policy on specific types of commercial tenant which may not be acceptable to the Council such as tobacco, gambling or alcohol-related companies should be adopted. Properties tenanted by such companies would not then be considered for purchase. However, this would not necessarily protect the Council in the event of a future transfer of any tenancy to a prohibited company.

Risks in respect of assets purchased using the Regeneration Fund will be assessed in terms of their ability to enable regeneration of the area and subsequent use of the asset, details of which will be set out in the business case for investment.

1.11 Financial Assumptions

	Investment - Yield	**Investment - Taxbase**	**Investment- loans & co investment**	**Regeneration Fund Investments**
MRP	50 years land and 40 years buildings or life of asset	50 years land and 40 years buildings or life of asset	As applicable	**Life of asset**
Interest Costs used in appraisal	New Borrowing Rates	New Borrowing Rates	New Borrowing Rates	**New Borrowing Rates**
SDLT & other purchase costs	Part of purchase price	Part of purchase price	-	**Part of purchase price**
*Fund Management Costs & ongoing client costs	0.50% of purchase price	0.50% of purchase price	0.50% of loan or investment	**0.50% of loan or investment if asset is being retained**
"Green Book" Financial profile over life of asset (IRR)	Yes	Yes	Yes	**Yes**

*Normally for each investment an annual payment of 0.5 % of the purchase price or loan or investment, subject to a case by case evaluation and decision by the **Head of Finance** ~~Chief Finance Officer~~, will be held in a central fund to cover the following:

- external advice for future investments;
- known or expected one off future costs, such as costs associated with future negotiation or renegotiation of leases;
- void periods;
- bad debt provision;
- irrecoverable estate costs;
- management of assets; and
- maintenance or redevelopment costs associated with future leases.

Appendix 1

Investment and Regeneration Fund Business Case for Investment

1. Investment Name and Address

2. Strategy Objective

3. Compliance with Strategy Objective – Non-Financial:

- Sector and target assets
- Location
- Building specification
- Management and maintenance obligations
- Lease arrangements
- Quality of tenants
- **General Investment Fund or Regeneration Fund proposal**

4. Compliance With Strategy Objective – Financial (Completion of Appendix with commentary as below):

- Purchase price with an independent valuation
- Estimated exit value and proposed timescale for disposal
- Building survey results
- Rental income assessed over asset life linked to assessment of future market trends of both the asset sector and location
- Outgoings
- Estimated voids
- Cashflow
- Costs including stamp duty, legal fees, survey fees, letting costs
- Management and maintenance obligations
- Internal Rate of Return (IRR) Calculation
- Diversity – how this investment fits in with existing investments and loans by sector

5. Legal Issues (to Include):

- Review of title and ownership
- Liabilities and restrictions

6. Risk Assessment

- Economic and Property Market
- Asset-specific –e.g. location, building quality, length of lease, financial strength of tenant, rent payable
- Environmental and regulatory
- Reputational

7. Recommendation

8. REVIEW

- ~~Chief Finance officer~~ **Head of Finance**
- Monitoring officer

Investment and Regeneration Committee:

Proposed Revisions to Terms of Reference:

1. To review the Investment **and Regeneration** Strategy and make recommendations to the Council for revision of the same, when appropriate.

2. To determine any investment or purchase using the Investment **General** Fund **and Regeneration Fund** up to the value of £10 million, in accordance with the Investment **and Regeneration Fund** Strategy. All investments or purchases to be subject to a (documented) review by the **Head of Finance** ~~S151 Officer~~, Monitoring Officer and Executive Head of Business Services (any of whom may require the proposal to be referred to Council for approval).

3. To review with officer advice current and future investment opportunities.

4. To determine when to receive external advice on investment opportunities.

5. To receive performance reports on the Investment **General** Fund **and Regeneration Fund** on a quarterly basis.

Proposed Membership of the Investment and Regeneration Committee:

The Executive Lead for Regeneration/Executive Lead for Finance, plus 6 members of the Council (politically balanced and members to receive mandatory training, including any substitutes)

Executive Lead for Regeneration and Finance – Mayor Oliver (or his representative)

Conservative (4) – Councillors O'Dwyer, Robson, Thomas (D) and Tyerman

Liberal Democrat (2) – Councillors Darling and Pentney