Wednesday, 9 November 2016

INVESTMENT COMMITTEE

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

Thursday, 17 November 2016

commencing at **5.30 pm**

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

Members of the Committee

Councillor Pentney
Councillor Darling (S)
Councillor O'Dwyer
Councillor Robson
Councillor Thomas (D)
Councillor Tyerman

A prosperous and healthy Torbay

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. Election of Chairman/woman
To elect a Chairman/woman of the Investment Committee for the 2016/2017 Municipal Year.

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

3. Appointment of Vice-Chairman/woman
To consider appointing a Vice-Chairman/woman of the Investment Committee for the ensuing Municipal Year.

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

5. Investment Committee Way Forward (Pages 3 - 60)
To consider the submitted report on the above.

6. Investment Fund Communication (Pages 61 - 62)
To receive an update from the Torbay Development Agency on how they intend to communicate to businesses that the Council has an Investment Fund.

7. 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.

8. Investment Opportunities
To receive an update on potential investment opportunities.

TORBAY COUNCIL

Meeting: Investment Committee **Date:** 17 November 2016

Wards Affected: All Wards

Report Title: Investment Committee Way Forward

Is the decision a key decision? No

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 Council meeting held on 22 September 2016, Members approved the creation of an Investment Fund of £50 million, an Investment Strategy and an Investment Committee, comprising of 6 members (politically balanced and to receive mandatory training, including any substitutes) and with terms of reference as follows:

1. To review the Strategy and make recommendations to the Council for revision of the same.

2. To determine any investment or purchase using the Investment Fund up to the value of £5 million, in accordance with the Investment Strategy. All investments or purchases to be subject to a (documented) review by the S151 Officer, Monitoring Officer, Fund Manager and Executive Head of Business Services (with any investment decisions in excess of £5 million to be approved by the Council).

3. To receive performance reports on the Investment Fund on a quarterly basis.

1.2 This paper provides benchmarking information on other local authorities' Investment Funds in order to provide members with some information in order to facilitate a discussion as to whether the Strategy and Fund needs reviewing, how the Fund could be managed and the governance, reporting and training arrangements for members and reserve members of the Investment Committee. It also sets out proposals from the Torbay Development Agency on how they could help the Council deliver its Investment Fund Strategy.

2. Reason for Proposal

2.1 To ensure that the Investment Strategy and Fund is fit for purpose and to implement appropriate monitoring and governance arrangements for the Investment Committee.

3. Recommendation(s) / Proposed Decision

3.1 That the Committee reviews the current Investment Fund Strategy (set out at Appendix 3 to this report) together with the benchmarking information, report from the Torbay Development Agency and Investment Strategies from Portsmouth and Southampton Councils, and consider if there are any changes it would wish to recommend to the Council.

3.2 That the Chief Executive and Assistant Director of Corporate and Business Services to continue to work with other local authorities to determine if we can collaborate on the delivery of the Investment Fund utilising expertise and potentially sharing risks.

3.3 That meetings of the Investment Committee be scheduled fortnightly between 4.00 p.m. and 7.00 p.m. and cancelled if necessary.

3.4 That an Investment Fund statement - monitoring how investments are performing - be initially presented to the Investment Committee on a quarterly basis moving to monthly once more investments have been made.

3.5 That the Assistant Director of Corporate and Business Services continues to develop the training for the Investment Committee to be held on 5 December 2016.

Appendices

Appendix 1: Supporting Information and Impact Assessment
Appendix 2: Benchmarking other local authorities' Investment Funds
Appendix 3: Report from the Torbay Development Agency on how they can support delivery of the Investment Strategy
Appendix 4: Approved Investment Fund Strategy
Appendix 5: Portsmouth Property Investment Strategy 2015/16 – 2019/20
Appendix 6: Southampton CC Draft Business Case and Options Appraisal
Appendix 7: Investment Fund Business Case for Investment Pro Forma

Background Documents

http://www.torbay.gov.uk/DemocraticServices/ieListDocuments.aspx?CId=163&MId=6615&Ver=4 – Capital Investment Fund report and minutes from 22 September 2016 Council meeting

Appendix 1

Supporting Information and Impact Assessment

Service / Policy:	Investment Fund
Director / Assistant Director:	Anne-Marie Bond

Version:	1	Date:	4.11.16	Author:	Teresa Buckley

Section 1: Background Information	
1.	**What is the proposal / issue?** To provide Members' with information to facilitate a consideration of whether the Investment Strategy and level of the Fund needs reviewing, how the Fund should be managed and the governance, reporting and training arrangements for members and reserve members of the Investment Committee.
2.	**What is the current situation?** The Council established an Investment Fund of £50 million, an Investment Strategy and an Investment Committee on 22 September 2016. An informal briefing session was held on 1 November 2016 to discuss possible options on how the Investment Fund could be managed and taken forward and these are summarised in paragraph 3 below.
3.	**What options have been considered?** It is recognised that the Council has limited experience of operating such a significant investment fund and there will be a need to obtain appropriate professional guidance, however there are a number of options available including: a. Appointment of an individual fund manager (recruitment required). - Pro's - lower cost, closer relationship, direct control of resource. - Con's - might not have specialist knowledge thereby requiring additional input, will take time to recruit, more difficult to change once employed. - Opportunity - to provide expert advice to other authorities (income generation with possibility of JV to share risk). - Threats - resilience and availability, might be poached by others. b. Appointment of an Investment Fund Management Company to provide advice (tender required).

	- Pro's - variable resource, likely to offer specialist sector expertise and resilience, and will be able to demonstrate a track record. - Con's - will need to be procured, may be remote. - Opportunity - Possibility to share procurement and investment with other authorities. - Threats - none identified. c. Place money into an existing Property Investment Fund. d. To compliment any of the options (or combination of options above, an element of the fund could be used locally, with the Torbay Development Agency (TDA) being instructed to bring forward local investment opportunities for consideration. These might be on behalf of the Council, the TDA, local developers or businesses, initiatives arising from the Local Enterprise Partnership (LEP) and others, for example, South Devon College etc. - Pro's - local knowledge, benefits to local economy. - Con's - local investments may offer lower initial yields. - Opportunity - lack of suitable premises is the second highest barrier to growth and inward investment. Business rate growth is important to council viability. - Threats - significant investments in individual projects are likely to carry higher risks (which might be mitigated through JV's). Training, the Governance Support Team Leader has been working to identify appropriate training providers to give expert training on investments and risks with a view to the training taking place before the end of November. This has not been possible due to the lack of availability of suitable trainers and the number of meetings being held in November. It is therefore proposed that the training will take place on 5 December to enable the Committee to start making formal decisions on investments.
4.	**How does this proposal support the ambitions, principles and delivery of the Corporate Plan 2015-19?** Principles: • Use reducing resources to best effect Targeted actions: • Working towards a more prosperous Torbay

5.	**Who will be affected by this proposal and who do you need to consult with?** At this stage we have consulted with Aylesbury Vale, Barnet, Eastleigh, Fareham, Guildford, Luton, Portsmouth and Southampton Councils who have already made successful investments and/or created investment funds and the Local Enterprise Partnership to see if there is any interest in collaboration with Torbay in respect of a shared Investment Fund or Fund Manager and to assist in sharing their experiences as part of the training to members.
6.	**How will you propose to consult?** Via telephone conversations and email.

Section 2: Implications and Impact Assessment	
7.	**What are the financial and legal implications?** When determining which investments to make under the Investment Fund, Members will need to have regard to the advice of the Chief Finance Officer on the anticipated income to be achieved taking into account the Council's treasury management process and the most cost effective way of borrowing the money to fund the investment. **Treasury management and (property) Investment Fund are two separate issues both in terms of governance and purpose.** **1) Treasury Management:** This is the "management of the Councils' investments and cash flows". The key here is the management of **all** council investments, borrowing and cash flow linked to its **total** spending and income plans. This is governed by Local Government Act 2003, CIPFA Treasury Management Code of Practice and the Prudential Code. This is reflected in the Council's Treasury Management Strategy, Annual Investment Strategy and Minimum Revenue Provision (MRP) Policy. All these are scrutinised by Audit Committee and approved annually by Council. The Council's approved Investment Strategy for 2016/17 allows the investment in Property Funds up to £10m. All property funds apart from CCLA (which has a legal exemption) are classified as capital expenditure and therefore a MRP would apply. DCLG guidance is clear that "while speculative nature of **borrowing purely to invest is unlawful**, there appears to be no legal obstacle to the temporary investment of funds borrowing for the purpose of expenditure in the reasonably near future".

	2) (**Property) Investment Fund:** This was established for the purchase of property within and outside Torbay. Loans and co-investment in property in property are also permitted. Any borrowing and cash flow implications, as a result of decisions made for spending the fund, would be dealt with under the Council's overall Treasury Management Strategy as above. Purchase of property is classified as capital expenditure and therefore a MRP would apply. The investment in a property fund would appear to be both a treasury management activity and unlawful if borrowed for. **Notes:** **Local Government Act 2003** allows Councils to: Power to borrow - A local authority may borrow money— (a) for any purpose relevant to its functions under any enactment, or (b) for the purposes of the prudent management of its financial affairs. Power to invest - A local authority may invest— (a) for any purpose relevant to its functions under any enactment, or (b) for the purposes of the prudent management of its financial affairs. **Local Government Act 1972** allows Councils to: Acquisition of land by agreement by principal councils. (1)For the purposes of— (a)any of their functions under this or any other enactment, or (b)the benefit, improvement or development of their area, a principal council may acquire by agreement any land, whether situated inside or outside their area.
8.	**What are the risks?** Members will receive professional training to help them understand the risks of the different types of property investment which may be used for the Investment Fund. It is likely that the Council will develop a portfolio of different investments some with higher yields to ensure that the income generated is maximised and that the risks are spread over a number of investments rather than all in one high risk proposal.

9.	**Public Services Value (Social Value) Act 2012** It is proposed that some of the investments will be within Torbay and consideration will be given to ensure that they improve the economic well-being in the area and they will also generate additional business rates which will be used to fund the Council in the future. Investments outside of Torbay will be assessed to ensure that they maximise income at appropriate levels of risk.
10.	**What evidence / data / research have you gathered in relation to this proposal?** See Appendix 2
11.	**What are key findings from the consultation you have carried out?** **n/a**
12.	**Amendments to Proposal / Mitigating Actions** n/a

Equality Impacts

13	**Identify the potential positive and negative impacts on specific groups**		
	Positive Impact	**Negative Impact & Mitigating Actions**	**Neutral Impact**
Older or younger people			There is no differential impact.
People with caring Responsibilities			There is no differential impact.
People with a disability	If the Council invests in local properties it will ensure that the buildings are DDA complaint.		
Women or men			There is no differential impact.
People who are black or from a minority ethnic background (BME) *(Please note Gypsies / Roma are within this community)*			There is no differential impact.
Religion or belief (including lack of belief)			There is no differential impact.
People who are lesbian, gay or bisexual			There is no differential impact.
People who are transgendered			There is no differential impact.
People who are in a marriage or civil			There is no differential impact.

	partnership			
	Women who are pregnant / on maternity leave			There is no differential impact.
	Socio-economic impacts (Including impact on child poverty issues and deprivation)			There is no differential impact.
	Public Health impacts (How will your proposal impact on the general health of the population of Torbay)			**If the Council invests in local properties it will ensure that the buildings are DDA complaint.**
14	**Cumulative Impacts – Council wide** (proposed changes elsewhere which might worsen the impacts identified above)	N/A		
15	**Cumulative Impacts – Other public services** (proposed changes elsewhere which might worsen the impacts identified above)	N/A		

Benchmarking other local authorities' Investment Funds

Authority	**How is their Investment Fund managed?** **How do they procure their investment advice?**	**How much is in the Investment Fund?**	**What sort of returns do they get on their investments**
Aylesbury Vale	They have built several town centre developments and leased out the properties and put together a team to work to develop the business case and to deliver the development, procure external services such as cost consultant, design co-ordinator etc. This has been funded through prudential and capital borrowing. They also have a private and public sector partnership with 100 properties mainly multi-let industrial estates which is managed by an Asset Management Company. They are looking at formally creating an Investment Fund to help accelerate future development and acquisitions.	£110m investment in town centre development but no formal Investment Fund	7-8% minimum Up to 12%
Barnet	They just have an investment reserve which they use to spend on infrastructure to unlock growth and then pay Community Infrastructure Levy/New Homes Bonus (CIL/NHB) back in to, in order to fund the next wave of investments.		
Eastleigh	Awaiting information		4% to 10%
Fareham	Awaiting information	£8m	
Guildford	In-house asset development team manage the Fund and contract out some of the leasing on an individual property basis. They have in-house surveyors and a framework contract where they need external support with local agents and a strategic property contract for strategic property advice.	Only invest in the borough £57m over 3 years Have not had to borrow this, funding has been taken out of cash held by	6% average achieved Target 8% internal rate of return (2013)

Authority	How is their Investment Fund managed? How do they procure their investment advice?	How much is in the Investment Fund?	What sort of returns do they get on their investments
	They took on an assistant £30-£40k to assist in management of leases. Most are on fully insuring and repairing long leases so don't require much management. Property Review Group Councillor/Officer review group monitors all investments. Already had significant amount of property investments on their books - £70m already owned shopping centres and majority of business parks in the area. Bought back leaseholds where they held freehold and the bought new leases. They are now looking at town centre masterplans and developing sites which are owned or partially owned by the Council for regeneration and housing – looking at this as a separate scheme outside Investment Scheme.	authority.	
Luton	They do not have a specific fund or a cap for their funding. They target commercial property and also manage three other local authorities' investment funds. They have an agreed strategy to work within and would seek member approval to go outside of those parameters. Investments include a Business Centre purchased from the Chamber of Commerce, an investment at a reduced yield with potential economic benefit and four speculative investments. They have a dedicated in house fixed asset team to deliver this and sell services to other organisations. Work with agents who find them property but carry out all analysis work in house.	Invested around £100m which includes Luton Airport	8.5% yield

Authority	How is their Investment Fund managed? How do they procure their investment advice?	How much is in the Investment Fund?	What sort of returns do they get on their investments
Portsmouth	They appointed their own Fund Manger to find investment opportunities. They use an external surveyor for building surveying and formal valuations at the end of the process and an external solicitor for legal transactions (e.g. conveyancing). They have a large property department who manage the existing properties and are looking at options on how to manage the new property investments as they are UK wide and may be better run by external specialists. Their overall budget is approved by the Council and then individual funding opportunities are recommended by the Fund Manager to an Investment Board (comprising the Section 151 Officer, Head of Property, Director and Leader of the Council who approve the investments. They have mainly invested in property outside of Portsmouth e.g. Waitrose, distribution point, storage warehouse. They recommend that the Fund should be higher e.g. £100m to enable investment in approximately 20 lots to spread the risk across the portfolio.	£20m year 1 £50m year 2 £60m year 3 Now a total of £110m	5 to 6% initial yield Internal return of rate around 6.5%
Southampton	Awaiting information		

Property/Land Examples of Good Practice Provided by the Local Government Association

Renting office space, Wyre Forest District Council - A review of WFDC’s future space requirements demonstrated capacity to rent out office space in the council’s new HQ building, Wyre Forest House. Following the review it took just under 12 months to generate income of £161,000 from tenants. We now have 7 Private Sector Tenants and 2 Public Sector tenants and generate income in excess of £250,000 per annum. The majority of our tenancy agreements are for 5 years so we are on target to achieve more than £1m of income over the next five years. There is no doubt the establishment of WFH and its commercial approach has had a hugely positive financial impact on Wyre Forest District Council and there are many more benefits for employees, businesses and residents. Feedback from private and public sector tenants demonstrates how this has helped them attract top candidates.

Commercial property, Sutton - the council agreed a new Asset Management Strategy in 2015 which included a different approach towards the management of the council's stock of commercially let property portfolio which had built up over the years in a largely unplanned fashion. The council separated properties into an Investment Property Portfolio for properties which it would hold solely for investment reasons and agreed a set of guidelines for managing the portfolio, including the acquisition of new properties to add to the portfolio. A target has been set to increase gross income from commercial property by 50% by 2019/20 from a baseline of £3.2m in October 2015. To date the council has acquired two properties in Sutton that both provide an income of about £600,000, and has reviewed over 90 different property investment opportunities over the last 12 months.

Property Estate, St Albans City and District Council - St Albans is using astute commercial management and development of our property estate to drive local development and regeneration, save money and create new revenue streams. Rather than a narrow focus on commercial property as more traditionally defined, ours is a whole council approach. We are embedding commercially shrewd and rigorous business planning into our decision making across the Council, and nurturing a growing entrepreneurial culture in our teams. We are promoting active and healthy living through a complete renewal of our leisure estate, a sea change in the use of museum and heritage assets. We are bringing derelict land back into use as affordable housing. Since 2012 we have invested over £35m on new leisure facilities. This investment has been on a revenue neutral basis, achieving £1.5m in annual revenue savings.

Council as property developer, Aylesbury Vale District Council Teresa Lane - We had identified two prime sites for development in the town centre. We engaged with two developers on mixed-use schemes, and both fell through: one due to a takeover and one due to financial collapse. We finally decided to become masters of our own destiny and manage the regeneration ourselves. One of the developments was what is now the Aylesbury Waterside Theatre. It generates £2m per annum and a 12% yield to the council for an investment of £32m overall; with all risks devolved to the theatre's tenants, the Ambassador Group. The council also targeted Bucks New University's Aylesbury Vale Campus. With a local campus, we are taking rent, but also feeding local employers' talent needs, keeping skills in the area, creating a new generation of postgraduate professionals who will put down roots here. Today the council is extending its property development portfolio with Waterside North. It's currently a car park, but a multi-phase masterplan will see the site improved during 2016/17.

Property, Medway – We invest surplus cash reserves in tenanted property, both commercial and residential for a minimum 5% return. This began in 2016 and we project annual income in the region of £140,000 target pa.

Business Hub, South Staffordshire - in 2015 the council created its Efficiency and Income plan addressing how it would become not only financially self-sufficient by 2020, but also income generating, turning over profit. This equates to generating £2.2m a year from 2020 onwards, 18.3% of the council's annual cost of services. One of these strands is the Business Hub which commercialises the councils assets for SME's by accommodating growing businesses with new affordable packages , connecting businesses with bespoke training, events, advice and marketing and providing council services to businesses for example through advertising, Good Life Deals App and Call Management services. This is generating profit for the council by making best use of its assets. By 2020 this will be over £300,000 cumulatively, averaging £75k per annum and in profit already after the first 14 months of trading with £63,000 generated.

Property, Nottinghamshire CC – the council has developed a Joint Venture with Scape Group to provide Property Design and Operations services on the premise that a commercial partner will drive a more cost effective procurement supply chain as well as developing income opportunities from other areas including Academies and schools, other public sector bodies such as health, fire and police, other local authorities and the private sector.

The Joint Venture is a 'Teckal Company' which means it is controlled by the local authority and can trade by up to just under 20% of its turnover. Scape hold the majority of shares (80:20) and the Board of the Joint Venture has representatives of both shareholders as both need to demonstrate control for the purposes of the 'Teckal' test. Efficiency savings generated by the joint venture (or surplus) from the work it does for NCC or Scape or returns generated from work undertaken for third parties, is shared 50:50.

Property, Reigate & Banstead – we have recently established a property investment company to seek opportunities beyond the borough. This has included looking to acquire an old Sainsbury's site in Redhill to redevelop including a new hotel. We joined with Sainsbury's to guarantee the funding for the hotel and in discussion with Travelodge to develop the site. The council has invested £3m to generate around £300,000 income pa and the capital value for the site has also significantly increased. We are now looking at other sites including land including a car park and looking to finalise a new leisure/restaurant site – total value £40m, council financed the development through borrowing. Sale of some of the residential element will leave a net debt of £10m, but annual income of around £1m pa (coming on stream 2019/20).

Investment strategy, Braintree District Council – the council has an investment strategy of £28m. This includes investment in health facilities, housing growth/new settlements and local infrastructure. The return on investment is in the region of 6% on average for new investments. The council have invested £8m in equity funds, generating between 3.1% and 7.6% pa. This has resulted in increased income by £815k in 2015/16 from previous year and anticipating further increase of £520k in 2016/17.

Commercial property, Runnymede Borough Council – the council funded the construction of the Addlestone ONE site. Income will be obtained from the commercial tenants plus the differential between the cost of borrowing by the council and the OJEU loan interest rate. This includes 10 residential and a further 100 will be added by Addlestone ONE. The development has a community heat network which will supply approx. £40k of electricity to the grid via the Feed In Tariff arrangement and supply all the heat and hot water to the 213 residential tenants and the key anchor tenants. In addition to the above the council has been proactively acquiring commercial properties using low cost borrowing to fund. The combined income from Addlestone ONE and the acquisitions to date exceeds £7.7m of new income, but after the cost of capital is deducted, a conservative £4.3m. By April 2017, the council expect the income generation to have exceeded £10m through the solid plans that I have in place.

Better use of office accommodation, Craven District Council – Skipton Town Hall is of significant historical importance occupying a prominent position on Skipton High Street. Having previously been used as office accommodation for the district council much of the space became vacant and was costing the Council around £300,000 per annum. In 2013 we embarked on a project to restore the building and create an Arts and Community destination to secure the buildings future whilst also improving the economic and social vitality of the area. Using a combination of Council funds, external funding and commercial income generated by letting parts of the Hall the project is on track to be make a significant contribution to the local economy and become self-financing by 2018/19.

Rental income, Wyre Council - we have made available part of the Civic Centre in Poulton to accommodate a local doctor's surgery and NHS Extensive Service. Investment by doctors/NHS £800K generating us £45K yearly rental income http://www.lockwoodavenuesurgery.co.uk/ and provided opportunity for integration of health and District Council services.

Rental income, Wyre Council - We have invested £30K into renovating a two storey building within the grounds of the Civic Centre in Poulton and tenant takes up occupation this month providing extended educational services generating a rental income for us of approximately £25K per year. http://www.mckee.lancs.sch.uk/.

Rental income, Burnley Borough Council - £1.7m of LEP funding was used to create 25,000 sq. ft. of managed workspace incubator plus 12,000 sq. ft. grow on units at Vision Park in Burnley. Here the council is taking on the role of an investor taking ownership and management responsibility for the completed units.

Property and land, Darlington Council – A land swap deal was used to remove a loss making golf course and generate about £6m in receipts from land disposal. Land swap revenue saving is in the region of £200k pa.

Rental income, Forest Heath District Council - The council acquired the factory site in May 2012 securing 130 local jobs that had been at risk. It then leased the site to a new business – Omar Group. This deal cost the council £1.456m, but secured £200k per annum in rent. The company grew to employ 367 people but needed more factory space to increase production. A new deal saw the Council invest more than £500,000 into the building of a factory extension – with the business paying the other 50 per cent of the construction costs. This extension is expected to create a further 80 new jobs in our local economy. In return Omar Group signed up to a new 15 year lease with an increase annual rent, representing a further 10% return on the new investment. The Council will also own the building at the end of the current lease. The factory extension was opened in August this year.

Land investment, Wychavon DC - The Evesham town centre project is our next big venture and will see a new fire station opening this year and a new Waitrose store, opening in March 2018. We will invest £10m moving the fire station to release land and then the Waitrose store will follow on the land. A rental stream of £500,000 per year to us and will represent a 5% return, significantly more than could be achieved on the money markets. Whilst this is great news for our financial challenges, the main aim of the project is to attract more big names, grow confidence in the town and stimulate the local economy.

Facilities management, Medway – We have a joint venture with Norse Commercial Services to create a local subsidiary. It is a ten-year arrangement. We have a local authority controlled company with the Teckal exemption providing facilities management services, grounds and greenspace management and special educational needs transport for other councils and private sector clients. This turns over £11m and we have generated £260,000 pa through a profit share arrangement.

Property management, Kent CC – GEN^2 this is a new wholly owned company set up to deliver Property Management Services to both KCC and other public sector clients. GEN^2 was established in May 2016 and work is underway to develop the newly formed company's business pipeline and client base. Similarly to Commercial Services, GEN^2 has been set a dividend target to return to the local authority.

Commercial property, Breckland Council - the council has invested in diverse portfolio of commercial properties that bring an annual income of approximately £2m back into the council.

Property, Hertsmere District Council - we own Elstree Film Studios. We have set up a Property Development Company to provide properties for rent; we have built good quality temporary accommodation and homes for rent prior to setting up this company on a small scale to meet housing demand and provide a revenue stream; our engineering services are a resource for the private sector as are our trading standards team; we along with other local authorities in the region have established a Building Control Company that has just been launched as an independent company; we are developing a hotel and retail outlet utilising council funds and at our own risk so that we maximise the return to the council based around strong leases with leading providers- this is a £10m investment; we are likely to borrow around £30m for our property development company and are in the process of transferring assets to it and getting a business plan together so it can start developing.

Property Investment, South Norfolk District Council – we develop houses for market sale, market rent, including affordables as well as commercial sites. Our Big Sky Developments Company will drive the development of houses and commercial sites across the district. The first sites in Poringland and Long Stratton will see the development of 102 residential dwellings and 3,170sq metres of commercial units. Whilst providing ongoing revenue income to help our aim of moving closer to financial independence, we are also attracting more businesses into the area and building much needed houses for burgeoning communities. We are aiming for an income of £120,000 rent pa from our rented homes (once portfolio is completed), £400,000 annual return on our existing commercial property portfolio (6.% return) Crafton House and Maple Park commercial developments will increase the income once completed and let. Overall, an estimated profit on the whole development of £2.5m.

Report on How the Torbay Development Agency can Support the Delivery of the Investment Fund Strategy

Supporting Officer Contact Details: Liam Montgomery, Head of Asset Management and Housing, 01803 208720 and liam.montgomery@tedcltd.com

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1. Purpose and Introduction

1.1 This report sets out proposals on how the Torbay Development Agency (TDA) can support the delivery of the Council's Investment Fund Strategy.

2. Proposed Decision

2.1 To instruct the TDA to inspect, monitor and liaise with the market and seek investment opportunities in accordance with the investment criteria for consideration by the Investment Committee.

3. Reason for Decision

3.1 To ensure sufficient resources are available to implement the investment fund in accordance with the proposal approved by Council on the 22nd October.

3.2 The decision is required to ensure that the available resources are directed in the right areas and to give clear instructions on the delivery strategy.

Supporting Information

4. Position

4.1 The Capital Investment Fund report is available at Annex 1 to this report and sets out the objectives of the fund and the parameters in which the fund will operate.

4.2 To support the Investment Committee a significant range of information will be required before any decisions can be made and this report sets out how the TDA will support the Council in this area.

5. Possibilities and Options

5.1 Assessing opportunities

The Council has already established a pro forma to assist with decision making (Appendix 7) although we would recommend that this is tailored for each sector and investment type. The investment criteria should be coherent and clearly defined and in a way that the market can understand.

In addition it will be important to have a list of external expertise in specific areas to provide additional information as part of the due diligence that can be called upon so not to delay the decision making. This may be required in specialist sectors or in locations where local market knowledge is key.

Appendix 6 provides the draft business case for Southampton City Council along with an example options appraisal which highlights investing in direct property carries the second lowest risk (after bonds).

6. Risks

6.1 There are numerous risks with all investments and this has been covered in the September Council report.

7. Resources

7.1 Torbay Council currently has 2 FTE development Surveyor resource within the contract fee of which there has been an ask for 1 to be dedicated delivery of the Town Centre Masterplans for 2 years. The other resource is currently delivering a number of high profile projects.

7.2 It would be recommend that an additional 2 x development surveyors for a 2 year period to exclusively work on and deliver the investment programme. This will break down as 8 days per week of development surveyor and 1 day per week of Director involvement and 1 day per week of admin and marketing support.

7.3 This will deliver and implement the marketing strategy, undertake constant reviews of the market, liaising with agents and the market place, visiting and assessing opportunities and then providing detailed appraisals for consideration by the committee. In addition to this they will be able to bring forward a number of direct delivery projects – the number of these will vary dependent on the size and complexity. The surveyors will then be supported by specialist advice where necessary in sectors that are not within our expertise (hotels, loan financing, Bonds etc).

7.4 As projects are delivered then additional support will be required to realise the potential. For example an acquisition of a retail park or units will require additional

Estates support to review lease terms, market the space and ensure they are let as soon as possible.

7.5 There are a number of different ways you could fund this resource, one way could be a % of the capital spent on investments or alternatively on a cost recovery basis – this service/resource would equate to a direct cost of £112,996 p.a.

Meeting: Council Date: 22 September 2016

Wards Affected: All Wards in Torbay

Report Title: Capital Investment Fund

Is the decision a key decision? Yes

When does the decision need to be implemented? Immediately

Executive Lead Contact Details: Mayor Gordon Oliver, 01803 207001, gordon.oliver@torbay.gov.uk

Supporting Officer Contact Details: Martin Phillips, Chief Accountant, 01803 207285, martin.phillips@torbay.gov.uk

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1. Proposal and Introduction

1.1 Building on the Council approval of a £10m investment fund in February 2016 and linking to the Efficiency Plan and the Transformation Programme, this report expands the fund proposal by £40m and provides criteria for both the investments made by the fund and details the proposed governance arrangements around the management of the investment fund. In addition the report proposes investment to increase future NNDR revenues within Torbay.

1.2 Examples of good practice used by other local authorities with similar funds have been incorporated into this document.

2. Reason for Proposal

2.1 To make investments in property (within and outside Torbay) in order to increase revenue streams, this report sets out an appropriate strategy for acquiring properties and setting up and managing a portfolio.

2.2 To make investments in Torbay to increase its revenue stream from NNDR, this report sets out an appropriate strategy for acquiring properties, making investments and capital loans.

3. Recommendation(s) / Proposed Decision

3.1 That the Investment Fund be increased by £40 million to a total of £50 million to be initially funded by prudential borrowing, with the revenue costs associated with that borrowing (MRP and interest costs) to be funded from the investment returns or higher NNDR income.

3.2 That the Investment Strategy for the fund as detailed within Appendix 1 be approved.

3.3 That the Council considers the options for the governance of fund as detailed within paragraph 7.4 or the Overview and Scrutiny Board's proposal as set out at Appendix 3.

3.4 That the Chief Executive be delegated authority to set up a delivery team including sourcing external support if required, to be funded from the investment returns.

3.5 That the Chief Executive be delegated authority to make any changes to the Strategy, in consultation with the Mayor, Group Leaders, Section 151 Officer and Executive Head of Business Services.

4. **Background Information**

4.1 Council approved prudential borrowing of £10 million to enable acquisition of properties (both within and outside Torbay), with the borrowing costs to be funded from future rental income in February 2016.

4.2 In addition, as part of its efficiency plan and transformation programme, the Council intends to use this Investment Fund to increase its future NNDR taxbase income 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.

4.3 For the sake of clarity 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 the Council with another investor provides finance or jointly purchases a property.

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

4.4 To provide a significant boost, show clear leadership and ambition for growth, and to achieve a greater scale of return it is proposed to increase the fund value by £40 million to £50 million.

4.5 A detailed Business Case will be required for every investment/acquisition, setting out the potential future performance of the investment/asset together with projected disposal price or capital value at the end of the borrowing period. An example template shown is attached at Appendix Two. Internal Rate of Return calculations will be carried out to model expected cash flows over the term.

4.6 The Council will have to borrow to fund this strategy. Currently (July 2016) Public Works Loan Board (PWLB) rates are at historic lows. If borrowing is taken at the current low rates in advance of cash flow requirements there will be a short term "cost of carry" as the borrowing rates are approx 1.5% above current money market investment returns, however in the long term this provides a greater opportunity for significant return on investments

4.7 Any investments arising from "Masterplan" delivery will be approved and funded outside of this Fund. In addition any investments made under the Treasury Management Strategy (such as money markets, property funds etc) are outside of this Fund.

4.8 It will be essential to realise future income that sufficient capacity is allocated to manage this Investment Fund as soon as Council approval is given. The net returns assume that the ongoing costs of the fund management will be met from future returns. In the short term there will be some initial management costs which will be funded from the Invest for Income reserve, up to a value of £50,000.

4.9 This report sets out the proposed investment strategy (appendix 1) and covers the following:

- Background
- Objective
- Scope
- Strategy
- Yield
- Sector spread
- Locations
- Target Assets
- Assessment of Risks

4.10 Inevitably the Strategy will be subject to revision as the Council's knowledge and experience of operating such a fund increases. It is proposed that the Chief Executive is given delegated authority by Council to revise the Strategy if it is in the best interests of the Council in consultation with Mayor, s.151 Officer and Group Leaders.

4.11 A summary table of the key considerations for the Fund is set out in the table below:

	Investment - Yield	**Investment - Taxbase**	**Investment- loans & co investment**
Objective	Increase revenue streams	Increase NNDR & Council Tax income	Increase revenue streams Increase NNDR & Council Tax income
Governance			
Business case (see appendix two for example)	Yes	Yes	Yes
Review by S151 & Fund Manager	Yes	Yes	Yes
Legal Due Diligence	Yes	Yes	Yes
Decision maker	Chief Executive	Chief Executive	Chief Executive
Consultees	S151, Mayor, Group Leaders	S151, Mayor, Group Leaders	S151, Mayor, Group Leaders
Informed	OSB Chair	OSB Chair	OSB Chair
Reporting Performance	Quarterly to SLT, MEG, OSB & Investment Board (Audit Committee)	Quarterly to SLT, MEG & OSB & Investment Board (Audit Committee)	Quarterly to SLT, MEG & OSB & Investment Board (Audit Committee)
Criteria			
Scope	Maximum £50m in total		
Maximum individual Purchase	£5m	£5m	£2m
Valuation of asset	Yes	Yes	If applicable
Condition Survey	Yes	Yes	If applicable
Assessment of Asset Life	Yes	Yes	If applicable
Independent Assessment of Residual value	Yes	Yes	If applicable
Security required	-	-	Yes – minimum 75% of investment/loan
Target Assets for Acquisition	Yes – in strategy	-	-

Yield	Rental	NNDR	Loan repayments or rental
Minimum Yield Required (before costs)	6.5% of purchase price (or 2% above estimated borrowing costs)	Increased NNDR income (after multiplier) and/or rental yield equivalent to 6.5% of purchase price	6.5% of investment value (or 2% above estimated borrowing costs) If capital loan prevailing borrowing rates + 2%
Benchmarked Yield (linked to rate/size)	Yes	Yes	Yes
Sector Diversification – retail, leisure, office & industrial	Yes - retail, leisure, office and industrial	Yes - retail, leisure, office & industrial	Yes - retail, leisure, office and industrial
Risk Appetite	Risk averse	Moderate risk – linked to NNDR yield	Risk averse – linked to security
Lease	Tenants of strong financial standing and minimum 5 year unexpired lease term	Tenants of strong financial standing and minimum 5 year unexpired lease term	If applicable
Location	National (UK)	Torbay	Torbay
Location – Diversity	25% in any one Council area	100% Torbay	100% Torbay
Reputational Issues	No “sin” assets or tenants	No “sin” assets or tenants	No “sin” assets or tenants
Financial Assumptions			
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
Interest Costs used in appraisal	New Borrowing Rates	New Borrowing Rates	New Borrowing Rates
SDLT & other purchase costs	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

"Green Book" Financial profile over life of asset (IRR)	Yes	Yes	Yes

5.0 Other Councils

5.1 Other Councils have started similar investment funds including Luton and Harrow Councils. Details of Harrow's Fund and Investment Strategy are available on their website:

http://www.harrow.gov.uk/www2/documents/s131517/Invest%20Property%20Strategy%20-%20Main%20Report.pdf

5.2 Analysis of Investment Funds already set up by other Local Authorities has been used in preparing this report. For illustration, the figures declared for one such fund over a two year period are given below:

New purchases (gross, 5 properties)	**£19,900,000**
Rental Income per annum	£1,650,000
Gross Income yield	8.30%
Assumed financing costs (4% interest; 2.5% MRP)	£1,290,800
Net Income	**£359,200** (1.8% on capital)

5.3 Eastleigh Council has been used as a LGA case study. The LGA summary stated the following:

"Eastleigh Borough Council's main area of commercialisation has been in respect of property. They have actively been pursuing the purchase of a range of property assets which generate a high investment yield. By 2015, expenditure (financed principally by borrowing) will have reached over £100 million and includes a range of assets such as shops, banks, pubs and offices (one of which, following refurbishment, is now their headquarters).

Its innovative to property management now means the Council is landlord to a high profile mix of businesses including B&Q, Lloyds Bank, Wetherspoons, Matalan, Halfords, Pets at Home, Costa Coffee and Travelodge as a result of the freehold purchase of land and buildings over the last five years .

The most ambitious acquisition has been the Ageas Bowl, home of Hampshire Cricket, where the council is investing £40 million, including the construction of a 4 Hilton Hotel.*

Assets owned by Council have risen, according to the latest valuation, from £55 million to £188 million. Revenue surplus after borrowing and other costs is almost £2.5 million per annum. The assets contribute to regeneration, economic and employment objectives. For example, the Ageas Bowl alone is forecast to generate £55 million in direct and indirect economic benefits annually and 500 additional jobs".

6 Existing Investment Properties

6.1 The Council already holds a portfolio of non-operational properties within Torbay for investment purposes, managed on its behalf by the Torbay Economic Development Company (TDA) with the client function undertaken by the Executive Head of Business Services.

7. **Staffing, Management and Delegation**

7.1 Existing expertise within the TDA (and/or expertise to be recruited to by the TDA) is best placed to provide management of the Investment Fund (subject to an agreement between the two parties) supported where required by the Council's Finance and Legal sections with the client function undertaken by the Executive Head of Business Services.

7.2 It is proposed that a valuation be obtained for each property purchase and consideration needs to be given to further obtaining specialist expertise to actively manage market presence, acquisition & disposal and portfolio mix for this larger investment.

7.3 The above costs and any other associated purchase costs such as legal fees, property searches etc will be met by applying a 1% (of purchase price) one off cost, to be funded from the estimated return.

7.4 The following decision making process is proposed:

a) The Chief Executive is given delegated authority by Council to approve any investment or purchase within the fund in consultation with Mayor, S151 Officer, Group Leaders and Executive Head of Business Services. The Overview and Scrutiny Co-ordinator will be informed prior to any investment/purchase.

b) Any use of the Investment Fund is to be in line with approved criteria as outlined in the Investment Strategy. (Appendix 1)

c) Audit Committee and the Mayor (as Executive Lead for Finance) be requested to meet as an Investment Board to review the performance of the Investment Fund on a quarterly basis.

d) All investments or purchases to be subject to a (documented) review by S151 Officer, Monitoring Officer, Fund Manager and Executive Head of Business Services.

e) The Chief Executive is given delegated authority by Council to revise the Strategy if it is in the best interests of the Council in consultation with Mayor, S151 Officer, Group Leaders and Executive Head of Business Services.

7.5 The Overview and Scrutiny Board at its meeting on 14 September 2016, recommended alternative governance arrangements for the Investment Fund. The Assistant Director of Corporate and Business Services has prepared a supplementary report setting out the Board's proposals (attached at Appendix 3 to this report).

8. **Legal**

8.1 Local authorities have broadly drawn powers allowing them to invest and to borrow, in each case either for purposes relevant to the performance of any of their functions or generally for the prudent management of their financial affairs (s1 and s12 of the Local Government Act 2003).

8.2 They may also acquire property by agreement located either inside or outside of their borough for the purposes of any of their functions, including their investment functions, or otherwise for the benefit, improvement or development of their area (s120 of the Local Government Act 1972).

8.3 Furthermore, they may also take any action (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, which would again include their investment functions (s111 of the Local Government Act 1972).

8.4 The council will need to ensure that in exercising its investment and borrowing functions to expand its property portfolio, any actions are reasonable and proportionate and for proper purposes consistent with the Council's prudential regime and its investment strategy. Investment decisions also need to be taken mindful at all times the council’s fiduciary duties to ensure the sound management of the public finances.

8.5 Legal due diligence will be required on all property acquisitions, to include a review of title and ownership, and searches and enquiries of the vendor, in order to ascertain relevant liabilities and restrictions connected with the subject property. The results of the legal enquiries, and any associated risks, should be considered prior to any decision to enter into contract.

8.6 On any sale of an investment property the Council will be required to obtain best consideration in accordance with s123 of the Local Government Act 1972. Usually this will be achieved by placing the property onto the open market or otherwise, in respect of a sale agreed off market, demonstrating by way of professional valuation that it is achieving no less than market value for the property.

8.7 In all purchases, in particular on any loans, State Aid implications will need to be assessed.

9 Financial Implications

9.1 The potential income from this investment Fund has been estimated as follows. These figures will be included in the Efficiency Plan and as applicable included in future year budget proposals.

Year	Investments In year £m	Income Return @ 1.5% over costs £000’s	Cumulative Income Return £000’s
2016/17	5	75	75
2017/18	10	150	225
2018/19	15	225	450

2019/20	20	300	750
Total	**50**		

9.2 The 1.5% return above costs is considered to be a prudent target, although returns above this level will be aimed for.

9.3 It is proposed to allocate a sum of £50m (an increase of £40m) to be available for the purchase of an Investment Fund which will be added to the capital budget and will be funded from prudential borrowing with the ongoing revenue costs funded from future income.

9.4 It is likely that the source of funds will be the Public Works Loans Board where Interest rates for periods of 45 years are currently in the range around 2.0% (2.5% used as prudent). Where possible the TDA will support the Council in using LEP support to gain access to the lower PWLB rate (by 0.2%) for projects that meet certain criteria. Any capital expenditure incurred by the Council necessitates a minimum revenue provision (MRP) of 2% if the principal repayment is spread equally over 50 years. If asset life is assessed as lower, then the MRP period will be adjusted accordingly.

9.5 As a guide if £50m is borrowed and expended the additional annual costs to the revenue budget will be £2.250m (4.5%). If long term borrowing rates increase then the costs may rise accordingly.

9.6 The draft Investment Strategy states that a minimum gross yield of 6.5% (or 2% above borrowing costs) is required from an investment property to ensure an additional income stream for the authority after accounting for capital financing costs. 0.5% of the return will be allocated to an earmarked reserve to cover any “asset” costs associated with the purchase, ongoing portfolio management and legal, repair, void costs etc.

Cost	**% Rental**	**% NNDR**	**% Loan**	**Costs per annum for £1m Cost**
Minimum Target Return	6.5%	6.5%	4.5%	£65,000
Less:				
MRP	2%	2%	-	£20,000
Interest Costs	2.5%	2.5%	2.5%	£25,000
Asset Costs	0.5%	0.5%	0.5%	£5,000
Net Return	**1.5%**	**1.5%**	**1.5%**	**£15,000**

9.7 For loans, where there is a clear assumption that the loan will be repaid then no MRP will be applicable, therefore the minimum interest rate will be 2% above interest costs (subject to state aid compliance).

9.8 For purchases to increase NNDR, the target return is still 6.5% however this will need to be assessed for each purchase linked to the estimated increase in the Council's 49% share of NNDR collected. In addition, as DCLG is currently consulting on reforms to the NNDR retention scheme leading to the Council by end of Parliament retaining at least 98% of NNDR income, each scheme will need to be reviewed in light of any DCLG proposals.

9.9 In relation to tax; if the properties are to be held directly by the Council then there should be no Corporation Tax or Capital Gains issues arising.

9.10 VAT implications will be considered in all purchases to ensure that optimum arrangements are put in place.

9.11 Stamp Duty Land Tax (SDLT) will be payable on purchases which will be included in the purchase cost of the investment.

9.12 On all purchases financial due diligence will be undertaken with all partners, and tenants and where applicable appropriate security/guarantees will be obtained.

Appendices:

Appendix 1: Investment Strategy
Appendix 2: Business Case for Investment Template
Appendix 3: Alternative Governance Structure for the Investment Fund

Background Documents:

Capital Investment Plan – Council February 2016

Investment Fund Strategy:

September 2016 revision

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

This appendix sets out an appropriate strategy for the management of the Investment Fund including purchases/investments. The strategy adopted should reflect 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.

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.

Objective:

	Investment - Yield	**Investment - Taxbase**	**Investment- loans & co investment**
Objective	Increase revenue streams	Increase NNDR & Council Tax income	Increase revenue streams Increase NNDR & Council Tax income

To invest in commercial investment properties to provide income (rental or increased NNDR or a combination of both) from investments with a minimum income return over the medium-term of 6.5%

(or 2% above capital costs) on capital invested, through a balanced strategy of acquisition, retention and management of good quality property investments.

The objective is specifically to acquire income-producing property in order to enhance Council revenue streams in combination with investments in potential development sites and development schemes within Torbay. Long-term growth of capital values is also an objective where possible but not a key focus.

Scope:

	Investment - Yield	Investment - Taxbase	Investment- loans & co investment
Scope	Maximum £50m in total		

Strategy:

	Investment - Yield	Investment - Taxbase	Investment- loans & co investment
Maximum individual Purchase	£5m	£5m	£2m

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, will be adopted.

Properties will be acquired to hold rather than to dispose.

Minimum and maximum yield

	Investment - Yield	Investment - Taxbase	Investment- loans & co investment
Yield	Rental	NNDR	Loan repayments or rental
Minimum Yield Required (before costs)	6.5% of purchase price (or 2% above estimated borrowing costs)	Increased Council NNDR income (after multiplier) equivalent and/or rental yield to 6.5% of purchase price (or 2% above estimated borrowing costs)	6.5% of investment value (or 2% above estimated borrowing costs) If capital loan prevailing borrowing rates + 2%
Maximum Yield	10%	10%	10%

Benchmarked Yield (linked to rate/size)	Yes	Yes	Yes

Acquisitions of assets will be pursued at a target minimum yield (before costs) of 6.5% and, as a guide to potential risk, maximum yield of 10.0%. 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 are therefore to be avoided. 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.

Sector spread

	Investment - Yield	**Investment - Taxbase**	**Investment- loans & co investment**
Sector Diversification – retail, leisure, office & industrial	Yes - retail, leisure, office and industrial	Yes - retail, leisure, office and industrial	Yes - retail, leisure, office and industrial

Traditionally the highest returns come from the office and industrial sub-sectors. 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 Fund strategy.

Locations

	Investment - Yield	**Investment - Taxbase**	**Investment- loans & co investment**
Location	National (UK)	Torbay	Torbay
Location – Diversity	25% in any Council area	100% Torbay	100% Torbay

Torbay would be the preferred location for fresh acquisitions of investment properties, so that reinvestment is 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. A wider area should also be considered for fresh acquisitions. Taxbase investments, loans and co investments will be for investments only within the Torbay area.

Target assets

The following assets will be sought;

1. Retail investments with the following characteristics;
· Lot sizes between£1m and £5m
· Good locations in town centres or in good out-of-town retail clusters/parks
· Well let to sound tenants on leases with a minimum of five years unexpired terms
· Income yield range from 6.5% to 10.0%

2. Office investments with the following characteristics;
· Lot sizes between £1m and £5m
· Modern specification, likely to be built since 1990
· Good locations in commercially strong town/city centres or in good out-of-town business parks
· Well let to sound tenants on leases with a minimum of five years unexpired terms
· Multi-let properties to be considered with average unexpired lease terms of 3 years, subject to a spread of expiry dates
· Income yield range from 6.5% to 10.0%

3. Industrial/Warehouse investments with the following characteristics;
· Lot sizes between £1m and £5m
· Modern specification with flexible standard layout, built since 1980
· Good locations on major road routes and good access to motorways
· Well let to sound tenants on leases with a minimum of five years unexpired terms
· Multi-let properties to be considered with average unexpired lease terms of 3 years, subject to a spread of expiry dates
· Income yield range from 6.5% to 10.0%

4. Leisure investments, such as public houses, restaurants and health & fitness centres with similar characteristics as above will also be sought.

5. 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. Again, similar characteristics as set out above for office investments will apply.

6. 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 is proposed to be excluded from the strategy under the proposals set out in this report.

Assessment of risks

	Investment - Yield	Investment - Taxbase	Investment- loans & co investment
Independent Valuation of asset	Yes	Yes	If applicable
Condition Survey	Yes	Yes	If applicable
Independent Assessment of Asset Life	Yes	Yes	If applicable
Independent Assessment of Residual value	Yes	Yes	If applicable
Security required	-	-	Yes – minimum 75% of investment/loan
Risk Appetite	Risk averse	Moderate risk	Risk averse
“Green Book” Financial profile over life of asset (IRR)	Yes	Yes	Yes
Lease	Tenants of strong financial standing and minimum 5 year unexpired lease term	Tenants of strong financial standing and minimum 5 year unexpired lease term	If applicable
Reputational Issues	No “sin” assets or tenants	No “sin” assets or tenants	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 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.

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.

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.

Property Services Directorate

Property Investment Strategy

2015/16 - 2019/20

June 2015

Contents

1. Introduction

1.1 All City Council owned land and property is held as a corporate resource. Government advice recommends that all local authorities should have an agreed strategy and operation policy for developing, disposing and acquiring land and property.

1.2 All property will be held for a clearly defined purpose, whether that is to support and sustain services, provide revenue or to enhance the Council's strategic role as a place shaper. This strategy focuses **on the acquisition of property as an investment** and sits within the wider Corporate Asset Development strategy.

2. Background

2.1 The Property Investment Strategy aims to provide a viable and sustainable framework for the acquisition of property investments. The purpose of the strategy is to set out:

- The Council's objectives for acquiring property investments
- Criteria for investment acquisition
- Risks to the Council
- The acquisition & disposal process (governance arrangements)

2.2 The Local Government Act 1972 gives the Council powers to acquire any property or rights which facilitate, or is conducive or incidental to, the discharge of any of its functions.

2.3 As described in the budget report to Council on 13th November 2013, the mandate to become less dependent on Government grant was given. At paragraph 8.24, the report is explicit for Portsmouth City Council to become a more entrepreneurial council with one strategy being 'to exploit commercial property acquisition opportunities with a view to generating long term rental income streams to support the delivery of council services in the future.

2.4 The outline Medium Term Financial Strategy - 2104/15 & Beyond confirms that we should 'seek out commercial property opportunities to increase the Council's property portfolio'.

3. Objectives

A. Acquire properties that provide long term investment in accordance with corporate objectives

B. Maximise return whilst minimising risk through prudential management processes as described in this document

C. Prioritise properties that yield optimal rental growth and stable income

D. Protect capital invested in acquired properties

4. Portfolio Structure

4.1 To achieve the budget reports recommendations the acquisition strategy will create a balanced commercial property portfolio that provides long term rental returns and growth. A core portfolio of property assets will be sought with a view to diversification on individual assets by sector (industrial, offices and retail), location and risk. A direct investment Core and Core Plus approach has been adopted.

Portfolio Mix

4.2 Core & Core+ Opportunities 70 - 80% of total portfolio

4.2.1 Description of Core

"The best property for the sector in an ideal location with long term income to high quality tenants, yields will be equal to or slightly above prime for the sector"

Rental yield (financial return on the capital investment as a percentage) will be lower than the general market but capital and rental growth should be steady and medium-long term risk of void periods and tenant default reduced.

4.2.2 Description of Core-Plus

"Similar properties to Core but in slightly less favourable locations, perhaps with shorter leases and lesser tenant covenants returns will be appropriate for the sector and risk"

Rental yield will be higher reflecting the increase in risk.

The Core and Core Plus mix is essential in providing a balanced but diversified portfolio

4.3 Specialist Sector & Residential Opportunities 20 - 30% of total portfolio

4.3.1 Specialist sector investments such as hotels, public houses, student accommodation, and health care facilities may be considered on merit but do not form part of the "Core" search criteria.

4.3.2 Given the depreciating specialist infrastructure and changes in trends such assets may require substantial future capital expenditure in order to maintain the value of the interest; the risk from this should be fully explored and understood before purchase.

4.3.3 Residential provides a good income diversifier given its limited correlation to commercial property. Returns have been stable over the long term although the level of tenant and property management needs to be carefully considered and allowed for in all appraisals.

4.3.4 The returns on this element of the portfolio will be varied but should in principle be at the upper level or above those of the Core properties.

4.4 Value Add

4.4.1 Value add (vacant or short leases), re-development opportunity or distressed property requiring extensive capital expenditure can reap high capital and yield returns but do not form part of this strategy.

4.5 Holding Period

4.5.1 It is usual for an investment "holding period" before sale to be defined from purchase; this is to counter any significant depreciation eroding value or before the need for re-development arises. The holding period will be determined for each individual property at the appraisal stage.

5 Investment Portfolio Principles & Decision Making Criteria

5.1 Given the varied sector dynamics the criteria of each asset whether core specialised or residential will vary although should follow first principles in that;

5.2 All investments considered must initially provide income (yield) equal to or above the councils required rate of return (RRR) defined by the cost of capital borrowing for purchase.

5.3 Individual properties will be fully financially and physically appraised using industry standard techniques to ensure the return is acceptable for the level of overall risk. This will be specific to each and every property proposed for purchase.

5.4 Further performance measure, portfolio analysis and valuation will be undertaken during the holding period to allow for buy/sell/hold decision making.

5.5 To minimise management and risk; preference will be for single occupancy investments although multi-let properties or multi-unit schemes may be considered.

5.6 Location will be dictated by opportunity to acquire investments that meet the strategy, proximity to the city of Portsmouth will be a deciding factor when all other attributes are equal.

5.7 Only Investments with full 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 will be considered.

5.8 Lease length will be determined by market sector forces but the premise will be to maximise.

5.9 Market rent (MR) should be equal to or above passing rent.

5.10 Market sectors and locations with rental growth and good letting prospects will be actively sought.

5.11 Buildings should have sound structure and designed for use, with good transport links and accessibility.

5.12 Lot size (price paid) should account for the volume of time, labour and cost of individual acquisitions, the level of financial return, the funds overall size, the existing portfolio mix, market dynamics (competition and volume of buyers), sector dynamics and asset/portfolio management decisions.

5.13 The core initial lot size target is £2 million+ for any one individual property. This may change as time progresses and the portfolio grows.

5.14 Market exit (sale) will be intrinsic to the assessment of risk for each individual property.

5.15 The decision to sell stock during the holding period may be triggered by a variety of factors and is not limited to lease events, market forces, portfolio mix, or changes in strategy. The portfolio will be open to continued appraisal and active management with a view to minimising risk and increasing returns.

5.16 The strength of tenant covenant will be concurrent with the overall balance of risk for any given property and in line with the key objectives.

5.17 Minimum acceptable financial strength for any given tenant will be determined through financial appraisal of company accounts and the use of appropriate methods of risk assessment and credit scoring.

5.18 The choice of investment will take into account non-financial; ethical and legal considerations in particular relating to the intended use of the building and its current or future occupants.

Appendix 1 - Risks and their Management

Market forces

To limit risk the criteria for purchase and due diligence will be followed for all transactions; however fluctuations in demand and supply of the individual market and the wider economy will see the value of the investment and the income rise and fall, the council may not recoup the original amount invested in full.

Liquidity

The process of buying and selling commercial property, in relation to some other forms of investment, is complex and can result in transactional delay and uncertainty which carries risk from market shift, abortive transactional costs and in-ability to realise "sale" capital quickly.

This can be managed and improved through good portfolio management and where possible by adopting the IPF's best practice "Readiness for sale - A guide for streamlining commercial property transactions".

Opportunity

The availability of stock is generally limited; there will be times where lack of or lost opportunities through negotiation and competition will frustrate the process. This is often exacerbated by a general lack of transparency and openness in the market creating barriers to entry. It is therefore a possibility that a proportion of the fund remains un-invested during these periods.

To counter this; the role of the "Investment Acquisitions Manager " will be to seek out as many appropriate opportunities as possible, build relationships and communicate to the market the council's requirement and ability to perform.

Management

The portfolio will have the risk of void periods in occupation or tenants may default on payment of rent. The loss of income is a direct result however voids create further holding (and re-letting) costs which if vacant for a prolonged period of time can be substantial. Active portfolio management will be undertaken during the holding period to reduce such risks where possible.

Appendix 2 - Portfolio Acquisition Methodology

Acquisitions will be made in accordance with the guiding principles (principle 4 - acquisitions) within the Asset Development strategy.

Identification, consideration and recommendation of assets suitable for acquisition will be Undertaken by a suitably qualified and experienced 'Investment Acquisition Manager' working within the Corporate Assets Team.

As property acquisitions require timely decisive decision making, it is recommended that the Corporate Asset Development Board review, challenge and recommend or reject the purchase of investments identified to include the sanctioning of formal offers and counter offers which will be guided by the Council's Required Rate of Return.

All investments considered for purchase will undergo qualitative and quantitative appraisal to establish portfolio suitability which will consider rental levels, location, property type, rent review and lease expiry pattern, tenant(s), industry sector, tenure, lease covenants, market exit constraints and physical and environmental factors. In addition 3rd party advice may be called upon where specialist market knowledge is required.

The "Investment Acquisition Manager" will undertake a search of the market which will include approaches and introductions of opportunities direct from the sellers their agents and third parties.

Introductions from third party agents will be accepted on a first come first serve basis by verbal or written communication to the "Investment Acquisition Manager". If after the introduction the council wish to pursue the purchase further written agreement on the "basis of engagement" and fees will be required.

Portfolio Acquisition & Disposal flow

Selling		Buying
• Instruct advisors formulate asking terms and marketing strategy • Review property information anticipate issues devise strategy • Procure energy performance certificate	Offer to market - Heads of Terms	• Appraise property • Offers & counter offers • Agree HOTs • Secure source of funds
• Consider carrying out and providing searches • Make available pre contract legal pack and access to data • Negotiate contract	Pre - Contract	• Instruct legal team • Investigate title • Conduct surveys and reports • Negotiate contract
	Exchange	• Pay deposit
	Parties committed to purchase	
• Continue to manage property (in accordance with contract) • Preparation of completion statement • Prepare requisitions on title	Pre - Completion	• Pre completion searches • Finalise mechanics for drawdown/transfer of completion monies
• Discharge borrowing liability	Completion	• Pay completion monies • Assume liability for property
	Post - Completion	• SDLT / Land registration • Collation of property information • Portfolio management

Southampton City Council – Property Investment Fund

Draft Business Plan 2016 - 2020

Introduction

The financial objective of the Property Investment Fund is to achieve a 6% income return. Different types of investment will provide different levels of return, income and capital.

Historic data shows that a 6% income return from property is achievable over the longer term and through a full economic cycle.

Various factors will affect the level of income return a property investment strategy will deliver over time including;

the **general economic environment** (driving rent growth or reductions)

interest rates (low rates drive prices up and property yields down)

investment demand (high liquidity drives prices up and property yields down)

The Investment Property Database (IPD) 2015 analysis of global property performance, reflecting different methods of investing in property (direct, unlisted funds and listed property company shares) and analyses the returns and risks associated with each over various time periods. In addition comparable return and risk analysis is provided for other types of investments – bonds and general equities.

This shows:

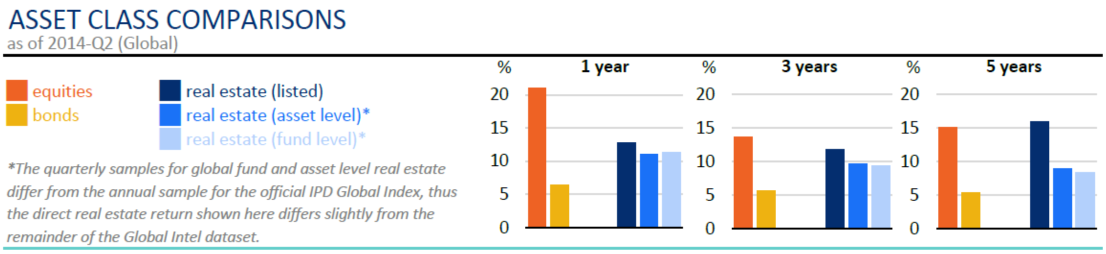
a) investing in direct property has the second lowest risk (after bonds) as measured by volatility (standard deviation)

b) for property investment options:

higher returns can be earned from investing in listed property shares and property funds

over a five year period listed real estate gave materially the highest absolute and risk adjusted returns

over a 10 year period listed real estate gave the highest absolute return (just) but as a result of high volatility direct property gave materially the highest risk adjusted returns



Investment Objectives

PIF requirement	Reason for requirement	Potential approach taken to inform PIF and impact on performance
Low risk initially moving to higher risk over time	Recognising that benefits will need to be evidenced to demonstrate value to stakeholders and the wider community	Identify potential lower risk sources of revenue initially, moving to a more balanced risked portfolio over time Levels of return initially may be low
Focus on revenue (rather than capital)	To meet revenue funding gap	Consideration for investing in existing property funds Acquire to hold, rather than to dispose Re-invest any capital receipts
Short term revenue generation	To meet short term funding requirements	Seek to invest initially in current revenue generating assets or property funds in the short term In the medium term, identify opportunities for greater return on investment (ROI) by taking a longer term approach e.g. acquisition of vacant properties or development to realise a revenue stream
Ability to make quick decisions	The Council's current governance structure does not allow the Council to react quickly to investment opportunities	Consideration of amendments to the levels of delegated decision making
Stakeholder buy-in	Recognising that the PIF needs long term stability and cross political support to be successful	Consultation and engagement throughout the development of the PIF Communications Strategy Regular reports and reviews of PIF performance
Transparency	Meets the Council's audit and scrutiny requirements	Business cases required to support all investment decisions

	Demonstrates basis of investment decisions and value for money	Independent appraisal and evaluation Regular reporting and review of PIF performance
Commercial and political sensitivity	Recognising that the set up and operation of the PIF may create conflicts of interest As a public body, there are reputational risks that may impact upon the nature and type of investments	Review governance structure for the PIF to mitigate any obvious conflicts of interest Consider the reputational risks for the Council within any investment opportunities

Investment Criteria

The objectives of the Property Investment Fund will be met in accordance with the following Investment Criteria: -

- The Council will invest in a balanced portfolio of property assets with a focus on traditional, lower risk sectors including offices, retail, industrial and residential with a focus on Freehold (or Long Leasehold) property in lot sizes of between £2 and £10 million.
- The portfolio will be developed through a range of means including acquisition of existing investments, development and investment in property funds and shares.
- Development opportunities that exploit existing Council assets and the Council's knowledge of the City to maximise competitive advantage will be prioritised.
- Investments will achieve an overall target yield of 6% although a balance of lower and higher yielding investments will be considered on their merits to ensure an appropriate balance between risk and return.

Achieving Greater Return

SCC is planning for a growing shortfall in Central Government funding which may result in a desire to achieve greater than a 6% income return on its initial PIF investment over time. This can potentially be achieved in two ways.

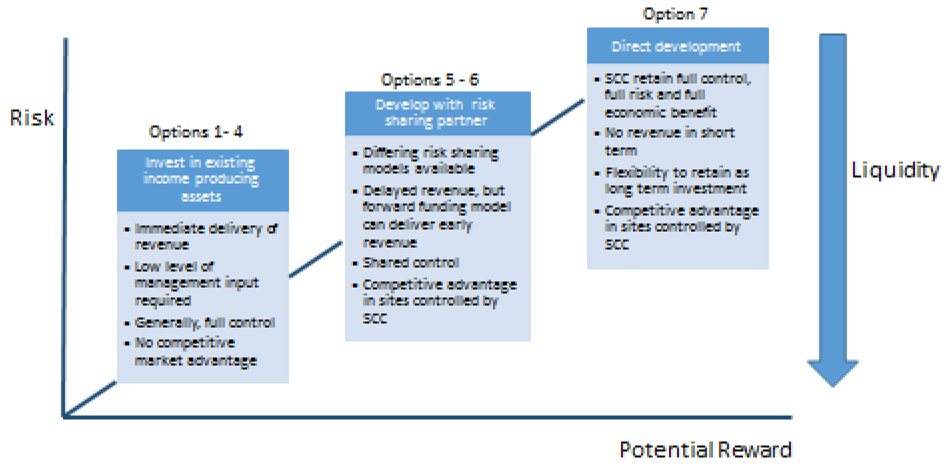
Firstly by increasing the amount of PIF investment while still achieving a target 6% income return, and

Secondly by taking greater risk in the investment strategy.

A potential model for taking progressively, and measured, increased risk over time is shown below. The intention is that a blend of risk profiles are employed and that the proceeds of higher risk (and shorter term) activities are partly redeployed back into the lower risk, long term sustainable "core" investment strategy.

It also envisages that additional funds can be made available after the first three year investment period.

There are a range of investment strategies with different financial, risk and timing profiles



Leveraging the Investment Pot

Whilst there are a number of potential constraints imposed upon the Council, which will result in the PIF operating in a slightly different way to a commercial property company, there are areas of competitive advantage over the private sector, which should be leveraged to enhance the performance of the PIF, or create/ identify opportunities that are not open to others.

1. Use of Prudential Borrowing – The Council can access funding at significant lower rates than the private sector. Comparatively, this results in better return on investment or improved development margin.

2. Tax Efficiencies – there may be opportunities where investment can be made directly through the Council which is potentially more tax efficient than private sector delivery vehicles.

3. Access to Public Sector Grants – whilst recognising potential State Aid issues, there is potential to use sources of public sector grant to support and benefit investment made through the PIF.

4. Use of existing assets – there will be opportunities to optimise the value of existing assets through acquisition of neighbouring sites using the PIF. The ‘marriage value’ of existing and acquired sites is likely to be greater than individual sites.

5. Strategic acquisitions – whilst mindful of potential conflicts of interest with the role of Local Planning Authority, the Council is in a unique position to make investments with the benefit of foresight of future development.

Resources

It is proposed that the Head of Capital Assets will manage the Investment Business Plan and programme delivery. This will be using resources and expertise primarily from within that team and the SSP, however, where specialist external advice is needed, this work will be commissioned on an ‘as required’ basis, funded from the income from the Leaders portfolio Property Management budget (PA120 and

PA130). This approach will be reviewed regularly as part of the Investment Business Plan.

The detailed market searches and acquisition process will be undertaken either by the Valuation and Estates Service in Capita, as this work is covered by the Strategic Services Partnership, or by use of external agents. After acquisition the new property will form part of the Council's Investment Property Portfolio, which is currently managed on a day-to-day basis by Capita.

Governance Arrangements

In considering the optimal governance arrangements for the Property Investment Fund the Council will need to decide what decisions are most appropriately made by Committee (through existing procedures) and under delegated authority. The following decision structure is proposed: -

Committee Decisions

Purpose – defining the purpose and criteria of the PIF

Capital structure – how much finance to put into the PIF and on what terms?

Distribution policy – is all income or development profit to be returned to the General Fund or is any retained for future investment and/or running capital?

Business plan – agreeing the general investment targets for the period and an associated budget.

Delegated Decisions

Specific investment transactions – acquisitions, sales, borrowing (if applicable) and other key transactions

Appointment of service providers – lawyers, valuers, due diligence advisors, property managers, etc.

Delegated decisions sit with the Council's Capital Board and Head of Capital Assets in consultation with the Service Director – Finance and Commercialisation and the Leader (as Portfolio Holder).

Monitoring and Review

The day-to-day responsibility for implementing and managing the performance of the portfolio will reside with the Head of Capital Assets. This will reviewed by the Service Director -Strategic Finance & Commercialisation and will periodically be scrutinised by the Council's Management Team.

A Portfolio Performance Report will also be published at least bi-annually for Member scrutiny and will inform future iterations of the Investment Business Plan.

Communications

A communications strategy will be developed to ensure that Portfolio Holders, ward Councillors and wider stakeholders are informed of decisions, acquisitions and disposals at appropriate times without compromising commercial confidentiality.

Delivery Options

Given the PIF objectives the recommendations are as follows:

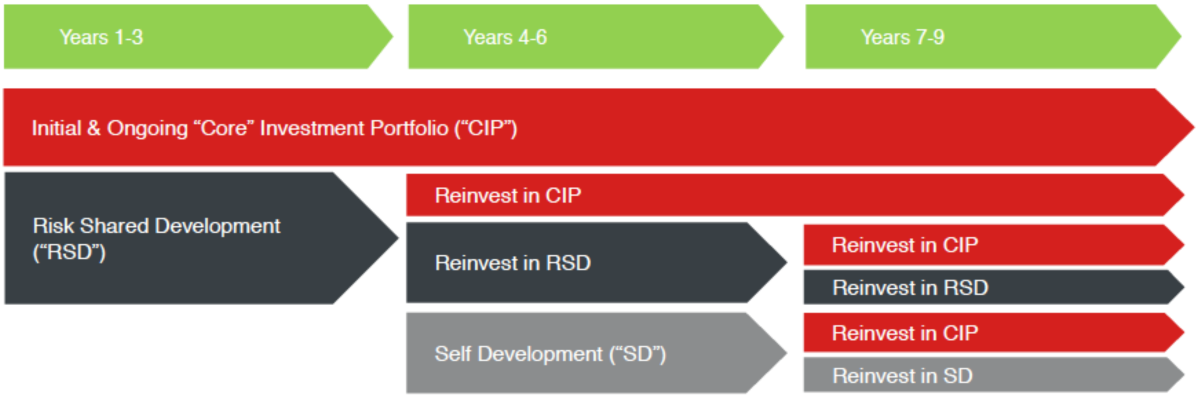
1. The PIF be flexible enough to allow all seven potential delivery methods as described in this report.

2. To generate immediate income, initial investment is proposed into the most liquid categories of delivery methods, namely 3 and 4 (property funds and shares). In this way, capital can be deployed quickly and flexibly. In the event

further allocations do not become available for future projects, these investments can be readily realised and redeployed.

3. As suitable opportunities arise investments will then be focussed on delivery methods 1 and 2 (direct property investment and joint ventures).

4. Higher value adding/risk activities (delivery methods 5 to 7) are focussed initially within the City. SCC's knowledge of the District creates a competitive advantage and allows it to better manage risk and deliver wider SDC objectives. A pipeline of opportunities is already under consideration.



Risks

This is a medium to long-term strategy for the Council.

Investment in property and the carrying out of development activities carries risks at both macro and micro levels. Property rentals, values and occupancy rates typically fluctuate broadly in line with the regional, national and increasingly, the global economy.

The timing of acquisitions and sales can thus have a significant impact on the rate of return as can complementary investment in lower risk or countercyclical investments such as Private Rental Residential property.

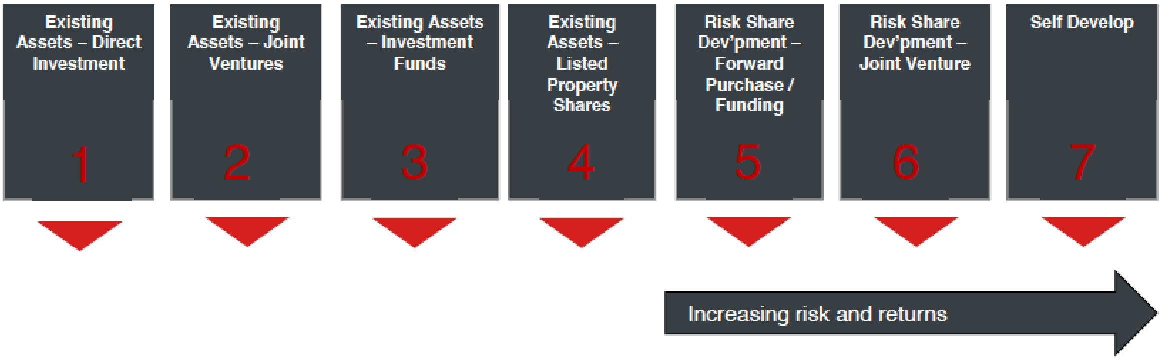
Historically, however, property rentals and capital returns have delivered growth and as it is the Council's intention to be a long term investor it is considered that these risks can be mitigated through a balanced portfolio approach.

Individual Investments will be the subject of pre-acquisition due diligence and risk assessments and regular updates to the Council's Capital Board.

Southampton City Council – Property Investment Fund

Options Appraisal

The Options Appraisal considers the relative benefits and limitations of seven investment options as follows:-



These are assessed against eight criteria

- Financial Objective
- Revenue Delivery
- Risk
- Control
- Liquidity
- Management Oversight
- Performance
- Diversification

Existing Assets – Direct Investment

What is it?

- The Council acquires and manages freehold or leasehold properties.

How does it work?

- The Council uses property professionals to identify market opportunities.
- After deciding on price and clearing appropriate internal approvals, bid for assets.
- Using appropriate advisors (legal, surveying, valuation) undertake due diligence and complete legal acquisition documentation.
- Establish on going management arrangements (internal or outsourced).
- Regular asset reviews to determine business plan and exit strategy.
- Process required on an asset by asset basis.

Benefits

Financial Objective	Depending on property type, is capable of delivering 6% annual return
Revenue Delivery	Generates revenue from the time of the property acquisitions
Risk	Low risk option
Control	High level of control
Liquidity	Reasonable liquidity, subject to usual property market timings
Management Oversight	Relatively light requirement – high involvement at key decision points (buying and selling)

Limitations

Performance	Low return option and no competitive market position
Diversification	Desired diversification unlikely to be achieved given current potential capital allocation

Existing Assets – Joint Ventures

What is it?

- The Council acquires and manages freehold or leasehold properties together with a partner.

How does it work?

- The options are to approach this on a case by case basis or create a strategic relationship with a trusted partner.
- The Council will wish to select a partner or partners on the basis of their demonstrated expertise and ability to co-invest with the Council (assume 50/50). The Partner will carry out much of the management role.
- The Partner will identify market opportunities.
- The JV will include governance allowing Council input on key decisions, including acquisitions and sales.
- The Partner is responsible for on going management arrangements.
- Council rights to review business plan and exit strategy.

Benefits

Financial Objective	Depending on property type, is capable of delivering 6% annual return
Revenue Delivery	Generates revenue from the time of the property acquisitions
Risk	Lower risk option – JV partner risk added
Control	Medium level of control
Liquidity	Reasonable liquidity, subject to usual property market timings and governance of JV
Management Oversight	Light requirement – JV partner undertakes most of the direct acquisition, management and sales work

Limitations

Performance	Low return option. Partner selected to bring track record and potentially competitive market position
Diversification	Diversification improved given additional Partner capital contribution but still unlikely to be at desired level

Existing Assets – Investment Funds

What is it?

- The Council invests in an unlisted property fund which owns a range of diversified property investments.

How does it work?

- The Council will undertake a process of reviewing available fund options and the track record of the fund managers.
- Once capital is invested the entire responsibility for acquiring and managing the investments is delegated to and the responsibility of the fund manager.
- The fund manager will report and pay distributions to the Council on a regular basis, usually quarterly.
- The fund documentation will set out the rights of the Council to redeem its investment and/or to sell it on the secondary market. The nature of these rights will vary depending on the type of fund.

Benefits

Financial Objective	Depending on fund type, is capable of delivering 6% annual return
Revenue Delivery	Generates revenue from the time of the fund investment – generally a shorter time than investing in direct property
Risk	Risk is determined by the nature of the fund. Additional risks relate to the fund structure, principally the performance of the fund manager
Performance	Returns are related to the specific investment strategy of the fund and manager performance.
Diversification	Fund investment can spread risk over a large number of underlying assets.
Control	High level of control of fund interest
Management Oversight	Very light requirement

Limitations

Liquidity	Unlisted investment funds generally have a low level of liquidity, particularly in market downturns.

Existing Assets – Listed Property Shares

What is it?

- The Council invests in listed property shares in a fund or a separate account mandate managed by a specialist fund manager.

How does it work?

- The Council will undertake a process of reviewing managers and available fund options and selecting an appropriate investment strategy.
- Once capital is invested the entire responsibility for acquiring and managing the investments is delegated to and the responsibility of the fund manager.
- The fund manager will report and pay distributions to the Council on a regular basis, usually quarterly.
- The mandate with the fund manager can be structured to allow an immediate liquidation of the investment portfolio if required.

Benefits

Revenue Delivery	Generates revenue from the day the property shares are acquired – share transactions can be effected in a short time period
Liquidity	The highest level of liquidity
Risk	The risk and return level is flexible and can be altered over time by reference to the agreed investment strategy
Diversification	Risk can be spread over a large number of underlying property companies/assets.
Control	High level of control
Management Oversight	Very light requirement

Limitations

Performance	Higher volatility than direct property. Longer term performance correlates to property but short term can correlate to general equity markets
Financial Objective	Dividend yields generally lower that direct property yields – to be investigated further.

Risk Share Development – Forward Purchase Funding

What is it?

- The Council enters into an agreement with a developer to fund part of the development cost and/or acquire a development on completion.

How does it work?

- The Developer will identify a market opportunity (although it may come from the Council) and carry out the development functions.
- The Council will be able to determine the risk profile it wishes to take on in entering the arrangement with the developer (e.g. after planning permission has been secured and construction packages have been tendered).
- During the construction stage the Council will likely require monitoring rights.
- Post development completion (as per direct investment):
  - Establish on going management arrangements (internal or outsourced).
  - Regular asset reviews to determine business plan and exit strategy.

Benefits

Financial Objective	Should deliver a premium to pure investment activity, so at least a 6% income return dependent on property type
Performance	A higher level of performance than investment activity
Risk	The risk of development is highly mitigated by the forward purchase/funding arrangements
Control	High level of control
Management Oversight	Moderate level once the transaction is agreed

Limitations

Revenue Generation	Revenue can accrue to the investment when funded, but this will only occur during or at the end of the development period
Diversification	Desired diversification unlikely to be achieved given currently contemplated level of investment
Liquidity	Low liquidity during the development period, thereafter as per the general property market

Risk Share Development – Joint Venture

What is it?

- The Council enters into a JV agreement with a developer to carry out a specific development.

How does it work?

- The Developer will identify a market opportunity (although it may come from the Council) and carry out the development functions.
- The risk of the development will be shared 50/50 between the Council and the Developer.
- The Council will be involved in key decisions during the development period.
- Post development completion (as per direct investment):
  - Establish on going management arrangements (internal or outsourced).
  - Regular asset reviews to determine business plan and exit strategy.

Benefits

Financial Objective	Should deliver a premium to pure investment and forward purchase/funding, so at least a 6% income return dependent on property type
Performance	A higher level of performance than investment and forward purchase/fund development activity
Risk	The risk of development is mitigated by careful partner selection and development stage oversight
Control	Strong level of control through JV documentation
Management Oversight	Meaningful level of oversight required

Limitations

Revenue Generation	Revenue will only accrue once the development is completed and leased (or sold).
Diversification	Diversification improved given Developer 50% capital contribution, but still unlikely to be at desired level
Liquidity	Low liquidity during the development period, thereafter as per the general property market

Self Development

What is it?

- The Council undertakes a development itself, appointing a development manager.

How does it work?

- The Development Manager will identify a market opportunity (although it may come from the Council) and carry out the development functions.
- The risk of the development will be taken 100% by the Council.
- The Council will be involved in key decisions during the development period.
- Post development completion (as per direct investment):
  - Establish on going management arrangements (internal or outsourced).
  - Regular asset reviews to determine business plan and exit strategy.

Benefits

Financial Objective	Should deliver a premium to pure investment and forward purchase/funding, so at least a 6% income return dependent on property type
Performance	The highest level of performance – the Council retains all development profit
Risk	The risk of development is mitigated by appointment of expert development manager and adoption of thorough risk management strategy
Control	Complete control with the Council

Limitations

Management Oversight	High level of oversight required
Revenue Generation	Revenue will only accrue once the development is completed and leased (or sold).
Diversification	Desired diversification unlikely to be achieved given the currently contemplated level of investment
Liquidity	Low liquidity during the development period, thereafter as per the general property market

INVESTMENT 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

4. COMPLIANCE WITH STRATEGY OBJECTIVE – FINANCIAL (Completion of Appendix with commentary as below)

· Purchase price

· Estimated exit value

· Building survey results

· Rental income

· Outgoings

· Estimated voids

· Cashflow

· Costs including stamp duty, legal fees, survey fees, letting costs

· Management and maintenance obligations

· IRR Calculation

5. LEGAL ISSUES (to include)

· Review of title and ownership

· Liabilities and restrictions

6. RISK ASSESSMENT

· Economic and Property Market

· Asset-specific –eg location, building quality, length of lease, financial strength of tenant, rent payable

· Environmental and regulatory

· Reputational

7. RECOMMENDATION

8. REVIEW

- Chief Finance officer
- Monitoring officer
- Investment Fund Manager

Meeting: Investment Committee **Date:** 17 November 2016

Wards Affected: All wards

Report Title: Investment Fund Communication

Is the decision a key decision? No (delete as appropriate)

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

Supporting Officer Contact Details: Liam Montgomery, Head of Asset Management and Housing, 01803 208720 and liam.montgomery@tedcltd.com

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1. Purpose and Introduction

1. Following the Capital Investment Fund report presented to Council on 22nd September whereby the investment fund was increased to £50 million an investment committee has been established to provide the necessary governance.

1.2 The Torbay Development Agency (TDA) have been requested to provide proposals on how they intend to communicate the fact that the Council has an investment fund outside of Torbay to encourage companies to come forward with new proposals.

2. Proposed Decision

2.1 To instruct the Torbay Development Agency (TDA) to publicise and market the investment fund as set out in the submitted report.

3. Reason for Decision

3.1 To ensure appropriate communication of the Council's investment fund.

Supporting Information

4.1 Publicising the fund:

a) The Torbay Development Agency (TDA) will write to and visit (where appropriate) all agents in our preferred markets.
b) Write to major landowners / public bodies.

c) Write to other people/organisations that will be aware of possible development or investment opportunities which will include, but not limited to architects, planners and various lenders and accountants.
d) Write to investment agents – regional and national.
e) Consider offering an introduction fee to non retained agents.
f) Place advertisements in the Estates Gazette and on the TDA's and the Council’s website - launching the fund.
g) Use new media, to provide editorials and social media to promote and inform the market.
h) Officially launch the fund with an invitation for agents to attend a launch in Torquay.

4.2 Agents and others will ask, “Why deal with Torbay Council as an investor?”

It will be imperative that we can give the market confidence in the Council as an investor. Quick decisions are absolutely key to this especially if we want to know about opportunities before they reach the market place. Unless we are fleet of foot we will miss off market opportunities and many market ones as well.

We will need to provide certainty on the size of the fund and information on the sectors Torbay are interested in.