Fit for the future

creating a prosperous and healthy Torba

September 2018

Investment and Regeneration Fund Strategy

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Torbay Council

Investment and Regeneration Fund Strategy

1. Introduction

The Council's efficiency plan and transformation programme is supporting the development of new ideas and approaches to enhance the financial resilience of the Council and reducing demand for Council services.

The Council needs to commit resources within Torbay and within the wider functional economic area, so as to generate income, stimulate growth and support the local economy, with all of the associated positive impacts for our communities.

The Council is committed to promoting development and investment in Torbay, particularly within our Town Centres in order to deliver the step-change needed to make Torbay an attractive, safe and successful place. The required step-change in our Town Centres can be achieved if the Council, local community and future investors work together, with the aim of providing quality, mixed-use offers capable of drawing the local population in and creating vibrant, viable and sustainable places, which deliver job creation throughout Torbay. This Policy Framework document sets out the strategy for the management of the Investment and Regeneration Fund. The strategy reflects a suitable balance between the risks inherent in the types of investments to be made and the financial rewards or wider regeneration outcomes obtainable whilst limiting risks appropriately. It has regard to the Statutory Guidance issued by the Ministry of Housing, Communities and Local Government (MHCLG).

2. Objective and Scope

The overall objective of the strategy is to improve the financial resilience of the Council and reduce demand for Council services for the benefit, improvement or development of the area through the acquisition, retention and management of good quality investments and the granting of loans. The Council will determine from time to time the overall amount of the Investment and Regeneration Fund, including any sub-division of the fund.

The Investment and Regeneration Fund Strategy supports the Council's Economic Strategy by delivering economic growth, tackling inequality and creating change in the area that benefits everyone. By creating such positive change, this will in turn reduce demand for Council services.

It is important that the Council has a balanced portfolio of investments in order to appropriately spread risk. The strategy envisages diversification across the geographical location, it recognises that Torbay has a small geographical location and investment of its fund solely in Torbay would not provide sufficient diversification in order to spread risk. It also recognises that diversification can be achieved through different use types of investments held, investing in existing assets as well as new assets.

3. Governance

This Policy Framework sets out that decisions to allocate monies in accordance with this policy are not Executive decisions, and the Council has previously delegated this to the Investment and Regeneration Committee who shall make all decisions up to £25m in respect of all proposals. The maximum individual investment to be approved by Investment and Regeneration Committee shall be £25m including any estimated purchasing costs, however Council approval is not restricted in terms of value.

The Strategy envisages proposals in two categories:

1. investment opportunities that meet the criteria set out in section 4 and deliver both a financial return to the Council and a benefit, improvement or development of the area, which includes loans – 'Investment Opportunities,'

2. regeneration investment opportunities that meet the criteria set out in section 5 and deliver significant regeneration benefits to the area, including Town Centre proposals – 'Regeneration Investment Opportunities.'

The Committee will consider investments in two distinct parts, dealing with Investment and Regeneration opportunities separately and where investments meet the criteria for both Investment and Regeneration will determine which category the investment falls into.

For Regeneration Investment Opportunities, these will always be within the boundaries of Torbay. For such opportunities it is anticipated that there will be two stages of consideration;

Stage 1 : Approval of the concept; and

Stage 2 : Agreement to proceed based upon a detailed business plan.

For Investment Opportunities, the improvement or development of the area will not be constrained by the boundaries of Torbay as there is an evidence base that demonstrates that wider investment has a positive impact on Torbay's economy. Specifically there is evidence that demonstrates that the South West Local Enterprise Partnership (LEP) Zone area has a positive impact on Torbay's economy. LEPs were established around functional economic boundaries which reflects both labour market and wider economic interdependence. This can be evidenced through the Heart of the South West Strategic Economic Plan (see http://heartofswlep.co.uk/wp-content/uploads/2016/09/SEP-Final-draft-31-03-14-website-1.pdf) and the Torbay Economic Strategy http://www.torbay.gov.uk/DemocraticServices/documents/s35783/Torbay%20Economic%20Strategy.pdf.

However opportunities in any geographic location will be considered where it can be objectively demonstrated that there are multiple benefits, including the improvement or development of Torbay, if supported by the Monitoring Officer and the Head of Finance.

4. Investment Opportunities - focus

To make investments for the benefit, improvement or development of the area, through a balanced investment of acquisition, retention and management of good quality investments, (including loans) whilst also delivering an income return to the Council.

Achieving a spread of risk across a greater number of property investments and by acquiring them 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 whilst maximising the return to the Council will be taken in respect of investment opportunities.

The investment portfolio will be kept under review on a regular basis by the Head of Finance and Executive Head of Assets and Business Services. All decisions to hold or dispose of properties will result from ongoing monitoring of the market opportunities for rental, capital growth or sale. Any proposal to dispose of an asset will be considered by the Investment and Regeneration Committee having regard to the implications on capital receipt, rental income, outstanding debt, capital loss or appreciation as part of a business case at the time of recommendation and in light of the Council's overall financial position, and they will make a recommendation to the appropriate decision maker.

Yield required for investment opportunities	Ordinarily a minimum of 1.25% return over forecast borrowing costs and any other relevant operating costs, taking in account the expected average return over 5 years. Opportunities providing less than 1.25% will only be considered in circumstances where the Committee are satisfied, acting reasonably, where any of the following apply; - tenant is of exceptionally good financial standing; - there is a long lease; - there is strong rental growth; and/or - there is a strong strategic reason for owning the site. A referral will be made to Council for any investment opportunities where, over the 5 year period, yields are less than 1% over borrowing costs and any other relevant operating costs.

Yield required for loan opportunities	A minimum of a 2% return over forecast borrowing costs and any other relevant operating costs with full asset security or satisfactory guarantees. Loans which fail to give full asset security or satisfactory guarantees will need to have a greater return over borrowing costs and any other relevant operating costs commensurate with the risk involved.

Torbay would be the preferred location for investment opportunities, so that reinvestment is directly retained within the local economy and any additional capital expenditure is made in the local area. However, there is a finite and limited supply of property within the local area, and of that supply only a small proportion may be available for purchase at any time that meet the requirements of the Investment and Regeneration Fund. The South West Local Enterprise Partnership (LEP) zone area will be considered for investment opportunities given the economic interdependence of the areas. However opportunities in any geographic location will be considered where it can be demonstrated that there is a benefit to, or improvement or development of Torbay.

The strategy does permit opportunities for co investment with partner organisations of good financial and reputational standing.

Only opportunities in excess of £500,000 (with the exception of loans, where no minimum level has been set) will be considered for this element of the Investment and Regeneration Fund Strategy, given the need to consider the number of smaller investments held by the Council, in pursuance of this Strategy and the burden of administering each investment before a decision is taken.

An assessment of all risks is required in each case of investment in order firstly to value it 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. These can be measured and an assessment made of the likely future performance of the investment carried out based on, for example, the ranges of likely future rental growth and voids of the property and also the projected disposal price or capital value at the end of the period over which the cash flow analysis is being measured.

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

5. Regeneration Investment Opportunities - focus

To make investments for the benefit, improvement or development of the area, through a balanced investment of acquisition, retention and management of good quality investments, whilst delivering regeneration outcomes for Torbay, inter alia through:

- Development in our Town Centres - successful regeneration of Torbay's Town Centres is crucial to improving the overall economic performance of Torbay's economy, and in driving future investment and development in Torbay;

- Job creation - successful creation of new jobs or retention of jobs within Torbay;
- Business rate growth;
- Preventing Local Market failure; and
- Opportunities that have strategic importance within Torbay, such as those that will improve key sectors, key locations or address issues such as deprivation and child poverty.

Ideas for regeneration schemes can be brought forward by the Elected Mayor, Councillors, officers and the wider community.

Yield required for Regeneration Investment opportunities	A 0% minimum return over forecast borrowing costs and any other relevant operating costs (including operational costs through any construction and operational phases), taking into account the expected average return over a 5 year period from the expected date of completion. It is imperative that such opportunities are subjected to a sensitivity analysis.

In respect of Regeneration Investments, opportunities will be pursued where there is a clear business case demonstrating how it will contribute to the regeneration of Torbay.

Sector spread will not be applicable for Regeneration Investment opportunities, as these will be focused on delivering regeneration within Torbay, which will be site specific so as to drive economic regeneration. Only proposals within Torbay will be considered for Regeneration Investment opportunities.

The strategy for Regeneration Investment opportunities does not exclude residential property, although it does envisage that any residential opportunities are more likely to come forward as part of enabling development or hybrid schemes, for wider regeneration purposes.

The Strategy does permit opportunities for co-investment with partner organisations of good financial and reputational standing.

Opportunities in excess of £50,000 will be considered for Regeneration Investments, although consideration will always need to be given to the number of smaller investments held by the Council, in pursuance of this Strategy and the burden of administering each investment before a decision is taken.

An assessment of all risks is required in each case of fresh investment in order firstly to value it and then to check its suitability for inclusion in the portfolio. Wider risks and benefits need to be considered in respect of opportunities for Regeneration Investment. It is envisaged that an outline appraisal will be prepared for consideration. Following approval of the outline appraisal, a full appraisal will be undertaken before a decision on the opportunity is made. It is however recognised that there may be some situations in which a regeneration opportunity arises at short notice, for example through auction. In these circumstances as full an appraisal as possible will need to be undertaken, and the Committee will have to consider whether it has sufficient information upon which to make a robust decision.

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

6. Oversight

Following a decision to proceed with a proposal, whether an Investment proposal or a Regeneration Investment proposal, the Investment and Regeneration Committee will maintain an oversight of their progress, in the context of:

1. the overall fund;
2. Performance of Investment and Regeneration proposals
3. Individual proposals for the Investment and Regeneration Fund; and
4. Individual proposals for Regeneration Investment opportunities, including monitoring their delivery and regeneration benefits (including existing investments that fall within the broad remit of the Investment Strategy which shall be included in this oversight, as well as other suitable assets held by the Council).

7. Due Diligence

Detailed and thorough due diligence is required to be undertaken in respect of all proposals. Appendix 1 to the strategy sets out a framework for the due diligence that will be undertaken.

Investment and Regeneration Fund

Assessment Criteria

Background

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 with an additional “multiple benefit” to the Council

- “Investments – Loans or Co Investment”. These are loans to business for capital expenditure where the objective is to increase rental income and/or interest returns to the Council. Co Investment is where Council with another investor provides finance or jointly purchases, with an additional ‘multiple benefit’ to the Council.

- “Regeneration”. These are property purchases, private sector or Council development projects within Torbay with the aim of increasing regeneration within Torbay.

This appendix sets out an outline for the management of the Investment and Regeneration Fund including purchases/investments and loans. The approach adopted should reflect a suitable balance between the risks inherent in the types of property/investments and loans 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.

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 good unexpired lease terms, and with tenants of strong financial standing, will be adopted.

All properties will be reviewed by nominated officers on a quarterly basis to review each property for potential disposal or investment depending on both current and future asset values and rental streams. Officers to include Monitoring Officer, Chief Finance Officer and lead Council officer for asset management. These officers to use external support as required.

Minimum and maximum yield

	Investment - Yield	Investment- loans	Regeneration
Yield	Rental	Loan repayments or rental	Rental
Target Yield Required	1.25% above forecast borrowing costs and forecast relevant ongoing costs Yield to be an average of an appropriate initial five year period	If capital loan 2% above forecast borrowing rates and forecast relevant ongoing costs Yield to be an average of an appropriate initial five year period	0% above forecast borrowing costs and forecast relevant ongoing costs Yield to be an average of an appropriate initial five year period Forecast to be subject to sensitivity analysis of estimates to ensure a 0% return can be realistically achieved.

Assets or loans 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 the subject of very careful analysis before a decisions are made.

Assessment of risks

	Investment - Yield	Investment- loans	Regeneration
Independent Valuation of asset	Yes	If applicable	If applicable
Condition Survey	Yes	If applicable	If applicable
Independent Assessment of Asset Life	Yes	If applicable	If applicable
Independent Assessment of Residual value	Yes	If applicable	If applicable
Independent Assessment of legal issues in relation to site	Yes	If applicable	Yes
Independent Assessment of future rental	Yes – future rent reviews and on lease break/expiry	If applicable	Yes – future rent reviews and on lease break/expiry
Security required	-	As appropriate to the identified risk	-
Financial Assessment of tenant or loanee	Yes	Yes	Yes

	Investment - Yield	Investment- loans	Regeneration
Pre commitment required	As appropriate to identified risk	As appropriate to identified risk	As appropriate to identified risk
Risk Appetite	Risk averse	Risk averse	Risk neutral
Consideration of State Aid	-	Yes	Yes
"Green Book" Financial profile over life of asset (IRR)	Yes	Yes	Yes
MRP	Yes – over asset life	No – of loan expected to be repaid – annual assessment required	Yes – over asset life
Assessment of impact on Council of any potentially abortive costs and how funded	Yes	Yes	Yes
Assessment of impact on Council of default or significant loss in value and how funded	Yes	Yes – Impairment (or contingency for) to be assessed on annual basis by CFO	Yes
Allowance for future costs, income shortfall and management of assets	An indicative amount of 0.25% - on total purchase costs per annum – but actual amount to be calculated on the specifics of the proposal.	-	An indicative amount of 0.25% - on total costs per annum – but actual amount to be calculated on the specifics of the proposal.
Lease	Tenants of good financial standing and a good remaining lease term	Loanee of strong financial standing	Tenants of good financial standing and a good remaining lease term
Loan	-	Interest rate to be linked to assessed financial risk Enforceable security required on all loans Interest required on a quarterly basis from start of loan Loan to be on a repayment basis as soon as possible	-
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.

Allowance for future costs, income shortfall and management of assets

For each purchase or development an allowance is to be made to cover the following issues:

- Future management costs of the asset – both ongoing costs such as liaison with tenants, asset inspections, insurance arrangements, service charge management, lease term enforcement and management of site but also cyclical costs such as rent reviews, marketing of vacant space, investment in assets and potential disposal.
- Future void or rent free periods on asset.
- Future landlord repair and maintenance and investment costs in asset.
- Abortive costs or set up/feasibility costs not chargeable as capital expenditure a purchase associated with the potential purchase or development of assets.

The table above gives an indicative value based on a percentage of total purchase costs to be set aside each year. The Chief Finance Officer will vary this percentage depending on an assessment of future issues and costs relevant to each asset – e.g. the expectation of an extended rent free period.

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.

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 – 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 – An assessment of any reputational risks will be undertaken in respect of all proposals, and this will be a relevant factor in decision making.

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