WARRINGTON
Borough Council

Property Investment Strategy

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1. PLAIN ENGLISH SUMMARY

1.1 **What is this about?** The Council is exploring many different ways to fund the services we wish to deliver for local people. Local government expenditure is around £154 billion per year but only £20 billion of that comes from income generated by Councils. The remainder is external funding - taxation and government funding. That funding is decreasing sharply and will continue to do so.

1.2 The Government expects and is directing councils to become self-financing. In the future, councils will not be given grant and financial support from Government and will need to find other sources of income to fund services for local people.

1.3 **How does it work?** Warrington Council is investing in property that provides a positive/surplus financial return. This is done by buying property that has a tenant who pays rent to the owner of the property – the landlord. The tenant must be of good financial standing and the property and lease must meet certain standards such as being in a commercially popular location and have a number of years left on the lease providing a certain and contractually secure rental income into the future.

1.4 The Council funds the purchase of the property by borrowing money from Public Works Loans Board (funded by the Government). The rental income paid by the tenant must exceed the cost of repaying the borrowed money each year. The annual surplus supports the Council's budget position, and enables the Council to continue to provide services for local people.

1.5 Historically, property has proved to be one of, if not the best, investment in terms of capital growth over the last 50 years. If the Council owns the property for 20 years plus, and the property is managed and maintained appropriately, the Council can expect to see an increase in the value of the property as well as an annual revenue surplus.

1.6 **So what is this Property Investment Strategy for?**

- It sets out what the Council wants to achieve when acquiring property assets for investment purposes – primarily financial gain.
- It identifies the issues of the economy, the general property market and the possible risks for the Council in acquiring investment property.
- It identifies criteria for acquiring and owning property assets for investment purposes to ensure risks are minimised.
- It includes an outline of the process involved in acquiring property assets for investment purposes.
- It is part of a wider policy framework supporting what the Council does and why.

2. INTRODUCTION

2.1 It is entirely appropriate for the public sector to improve the strategic management and operation of their property assets and to take a more commercial approach to property investment decisions. This strategy outlines Warrington Borough Council's approach to the acquisition of property for investment purposes.

2.2 **The Property Investment Market**

2.3 The Chartered Institute of Public Finance and Accountancy (CIPFA) defines investment property as "…used solely to earn rentals or for capital appreciation or both…".

2.4 Investment property will usually have a commercial occupier, paying a rent to the landlord. The better the covenant of the occupier, the more secure the rental income, the better the investment value and the yield obtainable in the open market. A tenant with a strong covenant and a long lease (10 years plus) with no break clause and with responsibility for repairing and maintaining the property, is the best type of investment.

2.5 The UK commercial property investment market is very well established, attracts global investors and is defined as a 'mature asset class'. It has a wide range of new and established investors including institutions, pension funds, specialist property companies, charities, family trusts and individuals.

2.6 Returns from property ownership can be both income driven (through the receipt of rent) and by way of appreciation of the underlying asset value (capital growth). The combination of these is a consideration in assessing the attractiveness of a property for acquisition.

2.7 Property prices and returns are a function of the property type, condition, use and location, together with the lease structure and covenant strength of the tenant (in the case of a let property).

2.8 Within the property investment market there is a wide spread in financial returns (known as yields) on offer, which relate to the particular characteristics of the asset in question. Yields are used in investment markets to compare different types of investments – including those beyond the property market.

2.9 The yield represents the risk that investors associate with ensuring a long term income, including the potential for growth. In the past couple of years the wider property investment market has recovered from a somewhat fragile period following the "credit crunch" of 2008. As a result, we have seen a gradual recovery of property values and yields over the last 8 years to a position where now, most parts of the country are at least at the level of value seen 10 years ago before the economic crash. As is usual in economic cycles, London and the south east has seen the strongest growth. In the North West, Manchester's property values have grown considerably since 2011.

2.10 At the extreme ranges, property investment yields can range from 2% (low risk) for prime London property to over 20% (high risk) for dated property in secondary locations with high vacancy rates.

2.11 Section 4 (below) outlines the main factors that investors take into account when looking at property as an investment. It is a combination of these factors that determine the yield. Typically the Council is looking to invest in property with a yield in the region of 5% to 7% which represents secure, lower risk investment with potential for growth in value.

2.12 A full repair and insuring (FRI) lease is an industry standard contractual arrangement for most commercial and investment properties. The occupier or tenant has the contractual responsibility to pay all outgoings associated with the property – for example business rates, maintenance and repair, services, security, building insurance and reasonable costs of the landlord in consenting to transferring the property to another tenant and alterations. This format creates the basis of commercial property as an investment vehicle. As such, as owner (landlord) of the property with a tenant on an FRI lease, there is little or no property management responsibility and no costs. In circumstances where costs are incurred by the Landlord these may be recoverable by the Landlord through a Service Charge provision.

2.13 What should be sought by the Council are property investments which produce the best returns possible, whilst carrying an acceptable level of risk. The main mitigation measure in managing risk is to target investments which are let to 'blue chip' tenants, on relatively long leases with little or no landlord management involvement – typically the tenant is responsible for all property costs such as repair, maintenance and outgoings. In this way, the Council will be primarily buying a secure income stream and the buildings themselves become almost secondary considerations.

2.14 Any property asset coming onto the market could be for a number of reasons. Investors seek to buy and sell in many different circumstances - rebalancing their portfolio, seeking cash to influence balance sheet or share price, requirement for a more "liquid" asset, short term investment taking advantage of small capital growth, moving into different property classes, etc.

3. WHY SHOULD WE BUY AND HOLD PROPERTY INVESTMENTS?

3.1 The reasons for buying and owning property investments are primarily in this order:

- Financial gain to fund our services to local people
- Market and economic opportunity – the time is right
- Economic development and regeneration activity in Warrington

3.2 **Financial Gain** – The Council has a Medium Term Financial Plan target to raise property income by £200,000 per year for each year 2016 to 2019. The Council also has a clear policy framework to maximise financial return through documents such as the Enterprising Warrington Commercial Strategy 2017-2020. This sets out a strategy to improve the financial envelope of the Council to help support and sustain the delivery of priority outcomes as outlined in the Council strategy, Growing a Strong Warrington, as well as those identified in our new Outcome Based Budgeting process and the Medium Term Financial Strategy.

3.3 Property is usually described as a low to medium risk asset. Its returns invariably lie between those produced by equities and those produced by bonds. Properties leased long term to tenants of good covenant strength have a lower risk of default and will produce secure income streams. Consequently their risk profile is much nearer to that of bonds than of equities. If income streams from property rent exceed the cost of borrowing required to initially acquire the property, surpluses will be generated. Such surpluses can be used to assist in funding frontline services, or to pay off the capital borrowed, or a combination of the two.

3.4 The Council has access to capital resources at advantageous borrowing rates through the Public Works Loan Board, which increases the prospects of such surpluses being achieved.

3.5 The purpose of acquiring and holding property for investment purposes is primarily to generate income – treasury management.

3.6 Budget cuts and austerity measures have seen significant funding gaps in local authorities' finances. Income generation is now at the forefront of many local authority financial strategies. Local authorities can take a longer term view of income and capital growth than most of the current investment market as their approach is long term ownership and benefit. Many current investors are looking to improve returns in the short term to maximise short term benefits to drive asset value and sale value. As a Council, we also have access to cheap debt finance, cheaper than most of the current investment market.

3.7 Acquisition for investment and treasury management purposes, to generate an income stream is a natural progression from acquisition for regeneration purposes. The two can also be combined – Warrington is a good example of this with the Council acquisition of DW Sport on Academy Way in September 2016, which offers a secure income stream and the option for future regeneration of a site adjacent to the Time Square development.

3.8 Most property investments that the Council will consider will therefore relate to property that is already occupied by a tenant of strong covenant, by way of a lease and therefore generates reasonably secure income for a number of years.

3.9 **Market and economic opportunity** – In certain aspects of the financial markets and the investment world, we are living in unprecedented times. Interest rates have held at a 300 year low for the last six years. In the medium to long term, investment analysts are forecasting interest rate rises.

3.10 The Public Works Loan Board (PWLB) provides the Council with access to cheap debt finance – and cheaper than the majority of investors in the market place – at fixed rates of interest. That makes us competitive in investment markets, as shown by London based international investment agencies recently contacting the Council over availability of investment property.

3.11 The property market economic cycle tends to mirror wider economic trends. At the moment, the property market in the UK offers value, certainty and elements of potential rental and capital value growth. This does depend on the individual property and location. The London market, while offering more certainty in terms of long term risk, is generally considered "overheated" with little short term prospect of rental or capital growth – again depending on the individual property. The north of England property market is seeing increasing investment from within and outside the UK. In Warrington, two property assets, Golden Square and Birchwood Park have both sold for in excess of £100 million in the last couple of years to American investors.

3.12 Warrington has a strong local economy and property market compared to much of the rest of the north west. Although central Manchester and prime Liverpool city centre have greater attraction for investors, our town is competitive with strong prospects for growth. Although the Council's approach to buying property investments may not be limited to Warrington (we have the powers to buy outside of the borough), the approach to date has been focused on the town centre.

3.13 **Economic development and regeneration activity in Warrington** – In the case of Warrington, a third reason for the Council buying and owning property investments is to have and maintain an influence in place-shaping of the town. Although traditional property investors are considered to be entirely financially motivated and influenced, the local authority has a wider, moral and principled role.

3.14 The Council is already making an investment of over £100 million in the town centre Time Square development. As funder and owner of the scheme, the Council will benefit financially from the income from commercial tenants such as the cinema and restaurants. However, the Council will also be in total control of the development and regeneration of this critical site in 25 to 30 years time. This long term, regeneration and place-shaping role is a key aspiration of the Council, to retain control of the key parts of the town for the benefit of local people and the community.

3.15 In summary, acquiring property investments in Warrington is recommended for the following reasons:

- To enable the Council to practice strategic regeneration for the benefit of the town rather than be restricted to policy and theory
- To enhance the Council's position as a major land owner with the ability to influence the growth of the future development of the town
- To take advantage of current property values and seek long term (20 years) capital growth
- To enable the Council to be seen to be acting proactively and taking leadership, investing in the town to promote economic development

3.16 The Council has the powers to follow this strategy (see section 4 below) and the Government is directing Councils towards income generation so this is an opportunity to take advantage of market conditions. If interest rates rise, the Government may cap local authority borrowing or market conditions may change, so this opportunity to generate significant income may no longer be available to us.

4 KEY CONSIDERATIONS WHEN ACQUIRING PROPERTY AS AN INVESTMENT

LEGAL POWERS

4.1 **The Council has various powers to purchase property and to acquire property as an investment**. These powers are summarised below:

4.2 **Land Acquisition Powers**

4.2.1 Pursuant to the Local Government Act 1972 ("LGA 1972"), Section 120 provides the power for local authorities to acquire property by agreement (whether inside or outside their area) for the purpose of:

- The purposes of their functions under this or any other enactment, this covers all the Council's duties and powers, or
- The benefit, improvement or development of their area – this is broadly construed and can take into account the wider questions of public benefit.

4.2.2 Furthermore the Council may also rely on the powers contained under the Town and County Planning Act 1990 of which s.227 contains a further, although more limited power to acquire land in circumstances where:-

- The acquisition will facilitate the carrying out of development, re-development or improvement on or in relation to the land; or
- The land is required for a purpose necessary to achieve the interests of proper planning of the area in which the land is situated.

4.3 **Investment Powers**

4.3.1 An acquisition may be classed as an investment if the Council is purchasing the corporate entity which owns the property itself, as opposed to an outright purchase of the land.

4.3.2 Where the Council is treating any property acquisition as an "investment", as opposed to a straight forward land transaction, the Council must look to the investment powers contained in the Local Government Act 2003 ("LGA 2003"), the acquisition of the site must be treated as an investment and recorded as such on the Council's balance sheet.

4.3.3 Section 12 provides that the Council has the power to invest for:

- any purpose relevant to its functions under any enactment; and
- the process of the prudent management of its financial affairs.

4.3.4 The key question for consideration is what constitutes the "prudent management of its financial affairs". The Council must be able to demonstrate prudence, and when doing so the Council should have regard to:-

- Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 ("Capital Finance Regs");

- "Treasury Management in the Public Service: Code of Practice and Cross –Sectoral Guidance Notes" which in turn have been issued by CIPFA in amended form as the Treasury Management Guidance ("CIPFA Guidance");
- Department for Communities and Local Government guidance ("DCLG Guidance");
- The Council's own Investment Strategy.
- The risk, security and liquidity of the proposed investment.

4.4 **Borrowing Powers**

4.4.1 Where the Council needs to borrow to fund any property investment, the Council needs to be sure that it has the powers to do so.

4.4.2 Similar to s.12 LGA 2003, pursuant to s.1 LGA 2003, the Council has the power to borrow for:-

- any purpose relevant to its functions under any enactment; or
- purposes of the prudent management of its financial affairs.

4.4.3 Again, the Council must demonstrate that the borrowing is within the "prudent management" of the Council's financial affairs. Counsel does however point out that there are a number of controls and restriction on the borrowing power. The Council must have regard (amongst other things) to:-

- "Affordability" as interpreted by the CIPFA code;
- The limits imposed by s.2 LGA 2003 – this states that we can't borrow where it would result in breaches of affordable borrowing limits;
- The degree of flexibility which capital expenditure plans lease for future or capital spending priorities.
- The development of 3 year revenue forecasts as well as 3 year capital expenditure plans and the need to estimate the impact of capital investment decision on Council Tax.

4.4.4 As stated at paragraph 4.5, the Council can also rely on the GPOC where borrowing.

4.5 **Localism Powers**

4.5.1 As well as the powers to invest and borrow under LGA 2003, the Council has powers under the Localism Act 2011 ("LA 2011") to both borrow and invest.

4.5.2 S.1 LA 2011 confers upon the Council a "general power of competence" ("GPOC"), which enables the Council to "do anything which individuals may do".

4.5.3 Broadly speaking the GPOC is subject to five conditions being satisfied, and where the Council wishes to rely on the GPOC we must look at:-

Is the proposal within the broad language of s.1?

- The GPOC gives the power to do something:-
  - In whatever way;
  - Anywhere in UK or elsewhere;
  - For a commercial purpose of otherwise, with or without charge;
  - For or otherwise than for the benefit of the authority, its area or persons resident in the area.

Is there limitation or restriction to the GPOC?

- There are boundaries set under s.2 of 2011 Act which refers to any pre or post limitations on the powers.

Are there any statutory duties that must be fulfilled?

- Such duties could relate to procurement rules or other duties set out in legislation.

Is the exercise of the power in accordance with the administrative law principles?

- Generally, the Council's powers are exceeded if they are exercised for an improper purpose, such as circumventing statutory controls.

Are there any limits in respect of "charging" or doing this for the "commercial purpose" in the exercise of the general power?

- If what we were doing was for a "commercial purpose" then we must do so through a company and he goes into further detail on this point. Generally speaking, if acting on the basis of an investment, is not considered for a "commercial purpose".

4.6 Out of area investments

4.6.1 When proposing any property investment within the Council's area, the above powers can be applied fairly easily, however, where the Council wishes to purchase or invest in property out of the Council's area, the legal powers to do so are more limited.

4.6.2 Previous advice from a leading barrister suggests that we are not able to rely on GPOC for out of area loans, as the investment is purely for a financial return, with no economic regeneration or other benefit to the Council's. It would difficult to argue against that view for property investments which are out of the Council's area.

4.6.3 In the absence of the GPOC, we must therefore turn to the other powers that are available to the Council, and whether they can be applied to any out of area investments. The available powers come under LGA 1972 and LGA 2003.

4.6.4 The powers under the LGA 1972 are stated above and confirm that the Council can invest in property for:-

- The purposes of their functions under this or any other enactment, this covers all the Council's duties and powers, or
- The benefit, improvement or development of their area – this is broadly construed and can take into account the wider questions of public benefit.

If an outright property purchase was being made (as opposed to an investment), the Council needs to demonstrate one of the above points.

4.6.5 If the acquisition is by way of and investment i.e. purchase of the corporate entity that owns the land, then the relevant powers are contained in s.12 LGA 2003. Previous barrister's advice in relation to investments has stated that the location of the investment is a material factor. If a property is out of the Council's area then this can affect the Council's purpose and propriety.

4.6.6 Furthermore, if the Council were to borrow to make any such out of area investment, then the investment is likely to be more controversial as the connection may be insufficiently direct. Additionally, the Guidance on Local Government Investments published by the Department for Communities and Local Government ("DCLG guidance"), which we must have regard to, specifically states that the "speculative procedure of borrowing purely to invest at a profit is unlawful".

4.6.7 Distance will also be relevant to due diligence and reasonableness.

4.7 OTHER CONSIDERATIONS

4.7.1 In December 2012 the Executive Board approved a capital funded strategic property acquisition fund. The main purpose of this fund and aims and objectives are:

- To seek revenue income to cover the costs of capital funding borrowing and support the wider financial position of the Council
- To bring key town centre assets into Council ownership
- To enable the Council to practice strategic regeneration for the benefit of the town rather than be restricted to policy and theory
- To enhance the Council's position as a major land owner with the ability to influence the growth of the future development of the town

- To take advantage of current property values and seek long term (20 years) capital growth
- The Council is seen to be acting proactively and taking leadership, investing in the town to promote economic development

4.7.2 The principles of this fund include individual business cases for each acquisition, appropriate due diligence and a clear purpose for acting.

4.7.3 **Are other councils doing this?** Yes and for the same reasons. In September 2016, Spelthorne Borough Council purchased the BP International Centre for Business and Technology in Sunbury-on-Thames. The purchase price paid by the Council was £340 million, funded from the Public Works Loans Board (PWLB). The site and lease provide a rental income to the Council.

4.7.4 Other Council significant property acquisitions for investment purposes include:

- Canterbury City Council's acquisition of a 50% stake in Whitefriars from the Canada Pension Plan Investment Board in July 2016 for £79 million.
- Merseyway shopping centre, which was bought by Stockport Council in April 2016 for £80 million.
- Northumberland County Council acquired Manor Walks shopping centre in Cramlington in July 2016 from Hammerson for £78 million.

4.7.5 During 2016, local authorities across the UK spent in excess of £1 billion purchasing property investment opportunities on the principle of securing an income stream.

4.7.6 **The Priorities** for the Council when acquiring property interests for investment purposes are (in order of importance):

1. Covenant Strength - in the case of a let property, the quality of the tenant and, more importantly, their ability to pay the rent on time and in full. The Council's primary reason and objective for this strategy is financial gain. The underlying principles of a Property Investment Strategy imply, assume and default to nothing taking higher priority than financial gain. It is however worth noting that the Council, as a public body, may not wish to invest in properties where the occupiers are generally seen to be undertaking a business which is contrary to its corporate values.

2. Lease length - in the case of a let property, the unexpired length of the term of the lease or a tenant's break clause is of key importance in ensuring that the landlord's revenue stream is uninterrupted. The Council will take into

consideration the risks associated with a tenant vacating and the potential to attract good quality replacements tenants at acceptable rental levels. Generally occupiers are moving away from 25 year leases which were more common back in the late twentieth century with 10 to 15 years now becoming more acceptable unless some form of lease break provisions are included in favour of the tenant.

3. Rate of return - the rate of return from the property (for example through annual rental incomes) will need to be equivalent or better to the returns that could be earned from alternate investments, such as placing monies on deposit, following adjustment for risks and potential growth. The property will also need to produce an annual return in excess of the cost of PWLB borrowing (interest only).

4. Risk – rate of return is one side of the coin; risk is the other. In general, the higher the sought level of return from an investment, the higher level of risk that it carries. For example, if a property is let at an attractive rent which would create a good return, it could still be risky if the tenant does not possess good covenant strength and could default at any time.

5. Lease Terms – The terms of leases vary and even those held on an "Institutionally acceptable basis" can be very different in nature particularly as such leases have developed over time. The Council is seeking to invest in modern leases with full repairing and insuring obligations on the Tenant and a full Service Charge recovery to include any management fees where applicable. This will ensure a certain income/return to the Council.

6. Growth - property has the potential for both revenue and capital growth. The Council will take into account that potential when assessing the strength of the investment opportunity. Property values can fall as well as rise and mechanisms to minimise revenue reductions should be identified. Generally the nature of standard, institutional leases is that rent review clauses are upward only which protects landlords from any downward pressure on rental income giving some security as to the level of income.

7. Location - should a tenant default or vacate, the location of the property is the key factor in influencing the ability to re-let and find another tenant. Location is also important when considering future redevelopment or regeneration opportunities. Ideally the Council will be able to undertake inspections and to deal with any management issues without the need to employ specialists or agents. Preference should be given to properties located within Warrington or in

the wider north west of England. This does not prevent investment outside of Warrington, subject to the appropriate justification and business case and correct governance procedure.

8. Sector - information as to the sector of use of the property (e.g. office, retail, industrial, leisure) will assist in deciding on the risks associated with specific properties and the mix of sectors within the portfolio.

9. Building Age and Specification - in the case of a let property, whilst the Council, as an investor, may be principally concerned with the characteristics of the tenant and lease, the age and specification of the property will also affect the ability of the Council to let or sell the property in the future. It must also be taken into consideration in respect of the cost of protecting the investment. An example of this would be the undertaking of repairs and refurbishment if the cost cannot be fully recovered from the tenant.

4.7.8 In summary, the strategy for acquiring investment property assets is therefore to:

- Seek property let to tenants who are of strong covenant strength and sound financial standing with at least more than five years remaining on an FRI lease.
- Minimise risk.
- Maximise rental income and minimise management costs to ensure the best return is generated.
- Identify opportunities for future growth, redevelopment or regeneration via property in commercially popular or development areas.
- Prioritise Warrington and the north west.
- Pursue opportunities to increase returns and improve the investment value of commercial assets.

5 FUNDING AND FINANCING PROPERTY INVESTMENT

5.1 The Council has access to a number of funding sources for property investment acquisition. Depending on the particular circumstances, the Council will fund acquisitions utilising prudential borrowing, or by releasing cash investments, or by a combination of both.

5.2 The Council has the ability to borrow funds via the Public Works Loan Board (PWLB) both quickly and at competitive fixed rates. This potentially places the Council ahead of many other potential bidders for investment property and this advantage should be exploited where appropriate.

5.3 The difference between the rate of borrowing and the rate of return generated by the investment is effectively a revenue surplus which may be used to fund front line services or pay off the capital borrowed, or a combination of both.

5.4 The Council will have full regard to the CIPFA Prudential Code and DCLG Investment Guidance in making any investment.

6 FINANCIAL IMPLICATIONS

6.1 This Property Investment Strategy is a framework designed to secure long term and sustainable income streams for the Council and to increase its financial resilience over time, so that it is less reliant on declining funding from Central Government.

6.2 The Council will fund acquisitions by borrowing funds from the Public Works Loan Board (PWLB), money markets, and/or by running down cash investments.

6.3 The financing costs, which will include interest and possibly principal repayments, will need to be met from the income stream generated by each investment.

6.4 Given the specialist nature of investment acquisitions, the Council will obtain advice from appointed agents with a proven track record in this field.

6.5 When considering a property acquisition, it is important to recognise that there are significant other costs beyond purchase price. These may include:

- External valuation report and property investment analysis
- Building surveys
- Legal due diligence on property title
- Legal conveyancing fees
- Investment advice
- Agency fees at approximately 1% of purchase price
- Stamp Duty Land Tax (variable depending on price)
- Land Registry fees
- Certain vendors may also request payment of the seller's advisers' costs by the buyer, although that should be resisted wherever possible.

6.6 Advice will be taken on a case by case basis, but the Council should be VAT neutral, especially when acquiring a going concern. In addition, each acquisition will be assessed separately and advice taken as to the most financially (and as appropriate) tax efficient method of holding the ownership of the property.

6.7 All of the costs described will be accounted for within each business case for an acquisition.

7. RISK ANALYSIS

7.1 **Key Risk** - The key risk of property investment for the Council is based on the quality of the tenant and the ability to pay the rent and property outgoings.

7.2 If a tenant vacates a property and or fails to pay the rent, the liabilities of occupation costs (utility services, vacant property business rates, insurance, security, repair and maintenance) may fall on to the Council as owner. In addition, if there is no rental income, the Council will not have a direct income source to repay the borrowing of any initial acquisition cost or replace the opportunity cost of invested cash.

7.3 The mitigation factors in this risk are that financial, business and credit checks on the tenant(s) and the business viability are completed ahead of a decision on acquisition.

7.4 **Acquisition Risk** - The Council will be targeting low risk, low management investments and those which have continued to remain occupied and attractive to tenants, landlords and investors.

7.5 Interest in this type of property investment has remained strong and the Council will often find itself as one of several potential bidders. This means that there will be instances when the Council will be unsuccessful in its bids. All concerned should be aware of this possible outcome and the potential for abortive costs. This may be for example on internal and external advice around valuation reports, legal due diligence, credit and finance checks and tax advice.

7.6 Mitigation here will be around maintaining positive relationships in the property investment market with agents, seeking early advice on property availability and securing either exclusivity or lock-out agreements with the vendor if possible.

7.7 Due to the nature of the property market, decisions may need to be taken quickly in order to put offers forward. However, offers can be made on a conditional basis and contracts for sale would not be exchanged until the usual due diligence process has been satisfactorily undertaken. However, a private purchaser will usually be able to move quicker than the Council in acquiring property in terms of decision making and approach to risk. It is **not** suggested that the Council compromise either democratic decision making or principles of risk in competing in the property market.

7.8 **Cost Risk -** Abortive costs may be incurred in forming unsuccessful bids, or failing to reach exchange of contract as a result of due diligence undertaken. These may include feasibility studies, ground investigations, advisers' costs, legal costs, survey fees and officer time.

7.9 This is a risk which is inherent to the property market and should be managed at the earliest stage of each potential acquisition and as set out above through seeking exclusivity or lock out agreements if possible.

7.10 **Property Market Risk** - As has been evidenced by the economic downturn (credit crunch) of 2008, property investment clearly carries inherent risks due to wider economic conditions beyond the immediate control of the Council. This is not a risk free strategy. There are no guarantees. The Council has to be prudent in managing risk and reward.

7.11 The mitigation here is around investment and economic advice, being aware of trends and the external factors over which we have no control. In addition, the Council will undertake annual property valuations of each investment property owned alongside investment portfolio review.

7.12 It is also important to consider the Council's longer term strategy and the reasons for acquisition in the first place. For example, in a worst case scenario, a catastrophic economic collapse, where the majority of property investments may be affected by tenant business failure, which may result in vacancies in the portfolio with holding costs and no income to cover cost of borrowing. We may seek to dispose (potentially at a loss) of a number of assets while consolidating into a smaller number of more successful investments, resilient to the economic conditions. However, the Council may also wish to take a longer term view. Property has consistently demonstrated over the last 50 years that capital and rental growth exists over a 15 to 20 year economic cycle.

7.12 Other property related risks, such as those relating to physical defects and characteristics, can be assessed by appropriate surveys and due diligence ahead of acquisition. The Council will focus on properties with FRI lease and minimal or no management holding cost, liability or responsibility. Mitigation is through proactive portfolio management with resource and capacity available to the Property & Estate Management team to carry out or oversee annual market valuations, inspections, maintain positive tenant relationships, legal support on lease management and enforcement of tenant covenants. Resources to fund these mitigations will be deducted from the rental income as is standard in the property investment industry.

7.13 It is not uncommon for potential investment opportunities to be offered directly or via limited / targeted marketing to specific clients and those opportunities may never be advertised to the wider market. In those circumstances, the ability of the Council to act quickly is key. Increased knowledge of investment opportunities can also be achieved through adopting a proactive approach with property owners and specialist property investment agencies.

7.14 The process of due diligence being undertaken prior to completion is key to the mitigation of most property risks.

7.15 **Brexit** - Following the result of the EU referendum in June 2016, the Bank of England made the unprecedented step of reducing the base rate to 0.25%, a new historic low. The Bank has stated they will not hesitate to take additional measures as required as the markets adjust and the UK economy moves forward. This includes supporting the functioning of markets by being ready to provide more than £250 billion of additional funds.

7.16 In the immediate period following the vote to leave the European Union, the value of the pound fell to a 31 year low. The combination of attractive yield levels, lower prices, plus exchange rate effects should draw in overseas investors looking to acquire assets in the UK, attracted by a G7 country with a track record of achieving strong economic growth.

7.17 The uncertainty within the UK market no longer surrounds the vote to leave the EU, but more what will happen now that Article 50 and the process of leaving the EU has been activated.

7.18 The Royal Institution of Chartered Surveyors UK Property Market Chart Book reports that consumer spending remains the principal driver of UK growth. With business investment likely to weaken in the coming quarters, consumer spending will remain the overarching determinant of growth. The sentiment behind consumer spending remains and there is no defined reason why long-term success should be impacted by the EU referendum outcome.

7.19 **Property Investment market risks** – The Council has two key advantages over many competing investors in the market place:

- The Council is able to take a longer term view on holding property assets as investment, rather than prioritising shorter term objectives around share price for example.

- The main disadvantage of property compared to other investments is its liquidity. Again, the Council is not in the same position as many investors and can take a longer, more mature view on liquidity risk.

7.20 **Positive Risk** – English local authorities are facing at best, a further 20% reduction in funding by 2020. As a percentage of Gross Domestic Product, local authority funding has fallen from 9% in 2009 to 7% in 2016. Local government revenue and capital spending is now at the same level as 1948.

7.21 APSE (the Association for Public Service Excellence) and CIPFA are advising on a proactive approach for councils commercialisation – income generation is absolutely critical. However, there are only four sources for income generation – council tax growth, business rates growth, trading services / fee charging and asset investment. Asset investment offers the potential for the greatest return with possibly the lowest political risk.

7.22 The opportunities through combined property market conditions, economic conditions, legal powers and a “laissez-faire” Government approach may not remain. The circumstances exist at the moment to maximise financial income generation at a time it is critically needed. The risk of not investing in property at the moment may be greater than the risk of doing so.

8. PROPERTY INVESTMENT ACQUISITION PROTOCOL

8.1 Purpose - To ensure that there is a consistency of approach involving appropriately qualified officers, the Council should adhere to a formal Acquisition Protocol.

8.2 This protocol will apply to all non-operational acquisitions of land and property for the purpose of inclusion within the investment portfolio.

8.3 Definition of an Acquisition - An acquisition is defined as the purchase of a legal interest in land and property, (by way of freehold, leasehold or license) for strategic or investment purposes.

8.4 The Local Government Act 1972 gives the Council powers to acquire any property or rights which facilitate, or are conducive or incidental to, the discharge of any of its functions or for the benefit, improvement or development of the local area. Although not yet fully tested, the Localism Act 2011 may also provide extended powers to local authorities. Local authorities do, however, have wider fiduciary roles and can face criticism or challenge if they do not have robust business cases for all purchases.

8.5 Property Acquisition by the Council - The Council's Treasury Management team and Property & Estate Management team will continually assess the mix of properties it holds and will look at its overall exposure to risk, including any over-reliance on specific property sectors. It will consider options to increase or decrease that exposure and to minimise the management time and costs of its portfolio.

8.6 It is likely that synergies will arise from acquiring new assets which have physical proximity to existing assets (including the marriage value of merging adjoining legal interests – for example the acquisition on DW Sport on Academy Way in 2016). They may also be derived from achieving a more commercially focussed approach to the management of the entire portfolio.

8.7 Acquiring property can also have a regeneration investment effect and support areas of decline. However, the must be a clear and objective focus on the reasons for acquiring any property.

8.8 **Acquisition Criteria**

The following criteria will be used when considering acquiring property investments:

8.9 Each acquisition will be looked at on its own merit and all recommendations for funding will require a supporting Business Case. Key elements of each business case shall include:

8.10 Investment Acquisitions

- The key financial benefits with a projected return of at least 2% above borrowing/investment rates. Note that initial returns may not immediately provide this level dependant on where the property is within the rent review cycle.
- Level of financial security. Acquisitions should normally be pre-let to tenants of good covenant ideally on fully repairing and insuring terms (or inclusion of full cost recovery mechanisms) with an unexpired term of at least five years.
- The key consideration Priorities set out at section 4.11 above

8.11 Strategic Acquisitions

- How the acquisition fits with Warrington Means Business and assists in strengthening the local economy?
- The key consideration Priorities set out at section 4.11 above
- Measurable benefits attained through ownership. (This may also include consolidation of existing ownerships to enable future sales, modernisation of the Borough's business infrastructure encouraging inward investment,

benefits associated with relocation and business start-up within the Borough)
- How direct intervention will expedite agreed key strategies.
- Any potential conflicts with strategic planning policies?

8.12 Where a proposed property acquisition demonstrates both investment and strategic value to the Council, some of the above criteria may be relaxed.

8.13 **The Process of Acquiring Property Assets**

8.14 Given the specialist nature of the investment properties market, it would be difficult for the Property & Estate Management team to actively identify and evaluate suitable opportunities. Consequently the Council will look to use and where appropriate appoint external consultants to provide the specialist advice needed in each business case. The primary role of the investment advisers will be to identify the most suitable investment opportunities and present them to the Council for consideration.

8.15 In addition to the Council's own Property & Estate Management team of Chartered Surveyors, external advice will be procured from Chartered Surveyors to review and advise on:

- The range of appropriate values for the investment.
- Prospects for rental growth.
- Sector specific advice in particular risks associated with specific occupiers, sectors and locations.
- Capital growth prospects and liquidity (the last two factors are particularly important, as consideration also needs to be given to what happens to assets in the future).
- The approach to forming offers, bidding and achieving best value.

8.16 All acquisition proposals will be channelled through the Property & Estate Management Team and the Managing Director Warrington & Co. They will then draft an outline business case in those instances where it was felt that the investment opportunity merited further consideration. The business case for the acquisition will include an indexation score for the property in accordance with the assessment criteria and key consideration priorities set out at section 4.11 above.

8.17 All acquisitions will also be reported to Treasury Management Board and Capital Investment Programme Group.

8.18 To ensure that transparency and appropriate governance is applied at all times, and an appropriate audit trail exists on decision making, all decisions will follow Financial

Regulations and comply with the Council's Constitution requirements. This will involve reports to Executive Board for acquisitions for more than £250,000, or in urgent and appropriate cases – use of Special Procedures and subsequent reporting to Executive Board in compliance with Financial Regulations and the Constitution.

8.19 Once an acquisition is approved in the appropriate way, it is possible that the appointed advisers will also act as the Council's agents in respect to the bidding process, deal negotiation and final purchase. The agents will be given specific parameters for the terms of each purchase.

8.20 All valuations must be carried out, or verified, by a fully qualified member of the Royal Institution of Chartered Surveyors with sufficient current local knowledge of the particular market, and the skills and understanding necessary to undertake/verify the valuation competently.

8.21 All acquisitions will be carried out in accordance with rules laid down by any relevant professional bodies and laws (in particular, in compliance with all relevant Public Sector and Local Government Legislation, Statutory Instruments, Government Circulars, and existing Council procedures, policies and the Constitution).

8.22 It should be recognised that, in some instances it will be necessary for the Council to make a conditional offer on acquisitions where time is limited. This will be after consultation with the Leader of the Council, the Executive Member for Finance and Property and in line with the agreed principles and priorities above. Any final offers will be subject to approval in accordance with Financial Regulations of the Council and the Constitution.

9. ENVIRONMENTAL AND SUSTAINABILITY

9.1 Whilst the main criteria in assessing the attractiveness of the investment will be in respect to financial return and risk, the Council should give due consideration to those property investments which display higher levels of environmental sustainability.