Appendix 2

PROPERTY INVESTMENT STRATEGY 2020-2022

1. PLAIN ENGLISH SUMMARY

1.1 **What is this about?** Since 2010 the Council has seen a real terms cut in its government funding of 23.3% - National Audit Office figures. At the same time we have experienced an unprecedented increase in demand for our services, particularly in the area of children's and adult social care. Like many authorities the Council has invested in commercial property to generate surplus funds which can be re-invested in our services. Although generating a commercial return is a key objective of the Property Investment Strategy there are many more objectives and benefits to the Council from doing so.

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

- Wellbeing of the residents of Warrington
- Increase Gross Value Added (GVA) of Warrington
- Financial gain to fund our services to local people
- Market and economic opportunity – the time is right
- Economic development and regeneration activity in Warrington

1.3 The Government expects and is directing councils to become self-financing. Increasingly councils are not given grant and financial support from Government and need to find other sources of income to fund services for local people.

1.4 **How does it work?** Following the 2017 Property Investment Strategy, 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. External consultants and specialist property, legal and finance investment advisors support the Council in this strategy.

1.5 The Council funds the purchase of the property by borrowing money. 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.

1.6 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 may see an increase in the value of the property as well as an annual revenue surplus.

1.7 **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 wellbeing of the residents of Warrington.
- It aligns with Government guidance and ensures appropriate compliance
- It identifies the issues of the economy, the general property market and the range of 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 The statutory guidance on local government investments states:

"The definition of an investment covers all of the financial assets of a local authority as well as other non-financial assets that the organisation holds primarily or partially to generate a profit; for example, investment property portfolios. This may therefore include investments that are not managed as part of normal treasury management processes or under treasury management delegations."

2.5 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 value of the asset. 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.

2.6 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.

2.7 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.

2.8 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).

2.9 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.

2.10 The yield represents the risk that investors associate with ensuring a long term income, including the potential for growth. The current property investment marketplace has seen uncertainty in recent years around both the UK political and Brexit related climate. However, the fundamentals of investing in UK real estate remain sound. Demand for secure income product remains unwavering, while tight supply in the business space markets offers potential for growth.

2.11 At the extreme ranges, property investment yields can range from 3% (low risk) for prime London property to over 20% (high risk) for dated property in secondary locations with high vacancy rates.

2.12 This strategy 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 4% to 6.5% which represents secure, lower risk investment with potential for growth in value.

2.13 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.

2.14 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.

2.15 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 and moving into different property classes.

3. WHY SHOULD WE BUY AND HOLD PROPERTY INVESTMENTS?

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

- Wellbeing of the residents of Warrington
- Increase Gross Value Added (GVA) of Warrington
- 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 **Funding our services for local people** – The Council has been successfully investing in property for the past few years and our property portfolio currently generates a surplus of around £13 million each year. The Council plans to purchase additional properties in 2020/21 and beyond to generate further surpluses in the region of £7 million. Full details of these can be found in the Council's Capital Strategy and Medium Term Financial Plan reports. Prudence guides the Council's Property Investment Programme and the Council makes an annual allocation in the region of 15% from any surpluses into a reserve on an annual basis. This reserve acts as a sinking fund for performance monitoring costs, management, future repairs and maintenance, void periods and impairments.

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.

3.4 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.

3.5 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.

3.6 **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.

3.7 The Public Works Loan Board (PWLB) provides the Council with access to competitive debt finance at fixed rates of interest. That makes us competitive in investment markets, as shown by London based international investment agencies continuing to contact the Council over availability of investment property.

3.8 The property market economic cycle tends to mirror wider economic trends. At the moment, the property market in the UK now 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.

3.9 **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.

3.10 The Council is already making an investment of over £140 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 town centre 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.

3.11 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 and growth

4 DOES THE COUNCIL HAVE THE POWERS AND AUTHORITY TO ACQUIRE PROPERTY INVESTMENTS?

4.1 The Council has completed the purchase of a number of properties with a view to generating an income for various purposes. This has been conducted with careful and prudent reference to the powers available to the Council. To that end the Council has sought advice on the matter from leading Queens Counsel ("Counsel").

4.2 The Council has a number of powers available to it in respect of acquiring properties, the key distinctions are whether the land is within or outside of the Council's area, and what the purpose of the acquisition is. Broadly those powers are:

4.3 Land Acquisition powers pursuant to s.120 Local Government Act 1972 ("LGA 1972"), the Council has specific land acquisition powers. When the property is within the borough and is for the purpose of the Council's functions or the benefit, improvement or development of our area, this is the most appropriate power.

4.4 Where the Land Acquisition Power is not available the Council has powers under the Local Government Act 2003 ("LGA 2003"), particularly section 1 ("the Borrowing Power") and section 12 ("the Investment Power").

4.5 When relying on LGA 2003, the Council has regard of:-

- Local Authorities (Capital Finance and Accounting) (England) Regulations 2003;
- "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");
- Secretary of State and other relevant guidance;
- The Council's own strategies, such as the Corporate Strategy, the Treasury Management Strategy and the Property Investment Strategy.

As well as the below in respect of the borrowing:-

- "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 in respect of future capital expenditure plans

4.6 Furthermore, if the investment is to be properly treated as an "investment", the acquisition must be treated as such and recorded on the Council's balance sheet accordingly.

4.7 When relying on the Borrowing and Investment Powers, the Council will fully consider the available powers and set the grounds for compliance on a case by case basis.

4.8 As the Council continues to make significant increases in its commercial investments, funded in most part by borrowing, as well as a risk analysis of each specific investment on an case by case basis, it will also require examination of the overall risks of the property investment strategy and take into account the proportionality of the overall strategy.

4.9 To date the Council has acquired a number of properties most of which are within the Council's boundaries or the North West Region.The properties are set out below:-

Tenant/Property	Location	Sector
Tesco	Bolton	Food store
Tesco	Widnes	Distribution
Asda	Manchester	Food store and mixed retail
Movianto	Haydock	Distribution
Apollo Park	Warrington	Mixed food and leisure
Stobart HQ	Warrington	Distribution
Birchwood Park	Warrington	Mixed
Pure Gym	Warrington	Gym
Matalan	Warrington	Retail
DW Sports	Warrington	Gym
New Balance	Warrington	Office
Highways England	Warrington	Office
Stanford House	Warrington	Office

4.10 Whilst the Council aims to hold a diverse portfolio of property investments to mitigate certain risks, this may be tempered by increases in investments in particular sectors. This means that when looking at further commercial investments the Council should also consider questions such as:-

- Are the Council's individual investments disproportionally weighted to a particular sector;
- Is a particular investment disproportionally large when taken in the context of the wider portfolio;
- Are the Council's individual investments disproportionally weighted to a particular geographical area;
- Instead of considering the failure of one investment on its own, what are the consequences of the failure of a particular sector and what how would that impact the overall portfolio;
- What would the consequences of any specific changes in law (e.g. MRP or legislation in respect of legal powers) be on the each investment and the overall portfolio.

4.11 When considering the individual acquisitions, the Council needs to be satisfied that the individual risks, as well those in the context of the wider portfolio, are fully considered. When considering the risks, the consequences such as proportionate loss of income from the individual property or sector, as well the Council's ability to meet its ongoing liabilities (e.g. servicing the debt) and the impact that this may have upon the Council's finances as a whole must be considered.

4.12 A final point to note regarding the use of the Investment and Borrowing Powers is that there is no requirement for the acquisition and ongoing ownership of the property to be conducted through a company. The reason being that the acquisition and ongoing operation of the property is as an investment and not for the purposes of trading i.e. a commercial purpose.

5 PRUDENTIAL PROPERTY INVESTMENT

5.1 The Council in making any property investment has regard to the Prudential Code, Ministry of Housing Communities and Local Government Guidance and CIPFA Property Investment Guidance. Any departure from Guidance is reported in the Council's Capital Strategy and Treasury Management Strategy. The Council's Chief Finance officer (Section 151 Officer) must be alert to these risks and advise accordingly before, during and after investment decision making. The Council's existing practice and governance approach ensure this and the recommendation of this policy is that this continues.

5.2 The Prudential Framework (including statutory guidance and the Prudential Code itself) allows local authorities the flexibility to take their own decisions; provided that the decisions taken are prudent, affordable and sustainable and that they have regard to the statutory guidance.

5.3 The Council will include a business case for any property investment acquisition proposal. The business case will reflect these two points at 5.1 and 5.2 above and also make the following specific decisions regarding any proposed acquisition of investment property:

Can we acquire commercial property?

- Are there legal powers to support the acquisition and, crucially, are they powers specifically to acquire property or to make investments?
- Where borrowing is required, are powers available to support the taking out of loans?

Should we acquire commercial/investment property?

- Is it reasonable to exercise the authority's legal powers in the way proposed?
- Do the authority's decisions have proper regard for the statutory guidance?
- Do the authority's decisions have proper regard for the Prudential Code in terms of affordability, prudence and proportionality?
- Is the acquisition defensible under the best value duty?

Will we acquire commercial property?

- Is the proposal consistent with the authority's corporate and financial strategies?

- Can the proposal be accommodated within the authority's investment strategy and property strategy?
- Does the authority have the necessary competence to take the proposed decision?
- Does the authority have appropriate skills to manage the asset?

5.4 The Council will satisfy itself in the business case that acquiring a property investment will be **reasonable**. This will involve:

- Consideration of the Wednesbury principles of reasonableness – these can be summarised as a reasoning or decision is Wednesbury unreasonable (or irrational) if it is so unreasonable that no reasonable person acting reasonably could have made it. This principle comes from the legal case Associated Provincial Picture Houses Ltd v Wednesbury Corporation in 1948.
- Regard in making an acquisition and managing the investment to the MHCLG's Statutory Guidance on Local Government Investments, including:
  - Its support for the CIPFA view on not borrowing more than or in advance of need
  - The requirements for transparent reporting about the implications of an acquisition for the security, liquidity and proportionality of the investment and the authority's risk exposure
  - The need for appropriate capacity, skills and culture
- Regard to the CIPFA Prudential Code, which requires any acquisition to be:
  - Affordable – taking into account the extent to which expenses will be covered by income, including any need to make provision for capital expenditure consistently with the MHCLG's Statutory Guidance on Minimum Revenue Provision
  - Prudent – maximising the reliability of the elements of the affordability analysis and ensuring risk is controllable within acceptable limits
  - Proportional – ensuring that the authority's revenue budget is not over-reliant on income from commercial property and that property does not constitute an inappropriate proportion of the overall investment portfolio.

5.5 The Council will assess the key issues relevant to decision making informed by the principles in the Investments Guidance. These are:

- Transparency and democratic accountability – proposals will be compliant with this investment strategy approved in advance by members and made publicly available.
- Contribution – we will disclose the contribution that investments make towards service delivery objectives and the authority's placemaking role.
- Use of indicators – quantitative indicators will be provided to allow members and the public to assess the authority's risk exposure
- Security – we will have a strategy for assessing risk of loss before entering

into a transaction and disclose the extent to which the fair value of investment property provides security against loss and the mitigating actions proposed if there is insufficiency.

- Liquidity – each acquisition will set out procedures for ensuring that funds invested in property can be accessed when needed – it is appropriate to make this individual to each asset as all property investments by their nature are unique and different exit strategies will be applicable to different properties.
- Proportionality – we will reference the plans to achieve a balanced budget where there is any dependence on profit-generating investment activity
- Borrowing in advance of need – Each property acquisition decision will include a clear reference to compliance or otherwise with guidance and where guidance has not been wholly complied with, an explanation for any variance.
- Capacity, skills and culture – The Council has commenced an officer skills audit and a process to ensure that members and officers have appropriate capacity, skills and information to be involved in decision making.

5.6 Each investment property acquisition business case will reference:

- Understanding of local and wider property markets
- How the investment opportunity is identified
- Assessment and confirmation of the reasonableness of the acquisition price
- Option appraisal
- Due diligence
- The involvement of external advisers and agents in due diligence and decision making evidence and data
- Implications for the Council's VAT partial exemption position.
- Risk register
- Arrangements to be in place to manage the property following acquisition
- Any new frameworks required for assessing the performance of property as an investment including:
    - What the valuation arrangements will be
    - If any other key performance indicators are required
    - How often they will be measured and who by
    - Appropriate performance benchmarking
    - Frequency of future property yields review and risk assessments
- Any appropriate contingency plans will also be highlighted to deal with potential under-performance:
    - dealing with vacancies and defaults on rental payments
    - strategies for falls in market value
    - exit strategy

6. OTHER CONSIDERATIONS

6.1 **The Priorities** for the Council when acquiring property interests for investment purposes are (generally 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 continuing to fund services for local people. 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 5 to 10 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 borrowing and management.

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. 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. A wider geographical diversification and spread of property investment assets also mitigates risk in the portfolio.

7. 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. However, value is very much related to the tenant occupier, their covenant and length of lease remaining.

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.

6.2 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. This ensures a prudent investment to be show positive characteristics of **security** and **liquidity**. In effect, a property investment asset that has a secure rental income and can be realised relatively quickly in disposal.
- 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.
- Pursue opportunities to increase returns and improve the investment value of commercial assets.

7 FUNDING AND FINANCING PROPERTY INVESTMENT

7.1 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.

7.2 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.

7.3 The Council will have regard to the CIPFA Prudential Code and MHCLG Investment Guidance and CIPFA Property investment Guidance in making any investment.

8 FINANCIAL IMPLICATIONS

8.1 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. All investments are fully secured on the land and properties being purchased. With regards to liquidity if the properties were to be sold it is estimated it would generally take between 3 to 12 months to do so. Yield of the investment is benchmarked to the market when carrying out the pre-acquisition due diligence.

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

8.3 The financing costs, will need to be met from the income stream generated by each investment.

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

8.5 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.

8.6 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.

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

9. RISK ANALYSIS

9.1 The Property Investment Officer Group assesses the risks associated with this strategy. A report is produced each year on Implementation Risks and Issues. The following are all considered and recommendations made on how to proceed.

- General property investment related risks & issues for the Council
  - How to avoid "Chasing the money"
  - Valuation and overpaying to secure assets
  - Buying outside Warrington and beyond the North West
  - Buying outside the UK
  - Buying on market and or off market
  - Scale – lots of small ones or a few big deals?
  - The zeitgeist of new municipalism – this opportunity on borrowing and investing may not last for ever

- Finance risks & issues
  - Full year effect of income target
  - Sinking fund (links to MRP policy and value) and a project reserve
  - Overhead costs, SDLT, agent fees, external consultants
  - Revenue implications of abortive costs up front at risk costs
  - Professional Indemnity insurance cover for legal and property advisors
  - Property agent fees

- Governance issues
  - Property Investment Strategy – ability over time to sell and buy
  - MRP policy – risks – basis of calculation
  - Decision and governance process
  - External and internal audit advice
  - Project Risk Register
  - Governance and minutes to CIPG and Treasury Management Board updates

- Resources
  - Property database
  - Property, Finance & Legal teams
  - External specialists/consultants
  - Annual asset valuations

9.2 **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.

9.3 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.

9.4 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.

9.5 **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.

9.6 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.

9.7 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.

9.8 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.

9.9 **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. Before resources are committed on an investment proposal, approval to offer and bid will be granted by the Chief Executive, Sect 151 officer and Director of Growth – see section 10.16 below.

9.10 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.

9.11 **Property Market Risk** - Property investment 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.

9.12 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.

9.13 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.

9.14 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.

9.15 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.

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

9.17 **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.

10. PROPERTY INVESTMENT ACQUISITION PROTOCOL

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

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

10.3 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.

10.4 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. 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.

10.5 A decision to acquire property intended to make an investment return will have three parts:

- the identification of the legal powers that support the proposed transactions
- demonstration that the exercise of these powers would be reasonable
- confirmation that the authority wishes to take the proposed course of action.

10.6 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.

10.7 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.

10.8 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.

10.9 **Acquisition Criteria**

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

10.10 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:

10.11 Investment Acquisitions

- The key financial benefits with a projected target return of at least 1.5% 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 6.1 above

10.12 Strategic Acquisitions

- How the acquisition fits with the Council's place making role and assists in strengthening the local economy?
- The key consideration Priorities set out at section 6.1 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?

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

The Process of Acquiring Property Assets

10.14 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.

10.15 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.

10.16 All acquisition proposals will be channelled through the Property & Estate Management Team, Property Investment Officer Group and the Director of Growth. They will then draft an outline business case in those instances where it was felt that the investment opportunity merited further consideration. The outline 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 6.1 above. Authority to proceed to commit expenditure on due diligence will be approved following formal consultation with the Chief Executive, Sect 151 Officer and Director of Growth.

10.17 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 Cabinet for acquisitions for more than £250,000, or in urgent and appropriate cases – use of Special Procedures and subsequent reporting to Cabinet in compliance with Financial Regulations and the Constitution.

10.18 Any report to Cabinet or use of Special Procedures will include a Business Case document setting out benefits, risks, a clear and transparent decision making process, analysis of exposure to potential revenue loss risk and clarifying compliance with guidance and statute. All acquisitions will also be reported to Treasury Management Board and Capital Investment Programme Group.

10.19 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.

10.20 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.

10.21 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).

10.22 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 Cabinet Member for Finance and Corporate 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.

11. ENVIRONMENTAL AND SUSTAINABILITY

11.1 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.