APPENDIX B

Commercial Property Investment Acquisition Strategy

<u>Introduction and Objectives</u>

1. The Asset Management Plan which is updated biennially includes a Property Strategy, Disposal Strategy and a Repairs and Maintenance Strategy. In order to maximise the returns on resources which the Council has available for investment, the Council is considering how commercial property can play a role. The approach to acquiring commercial property for investment is set out in this “Commercial Property Investment Acquisition Strategy” (CPIAS).

2. The CPIAS aims to be a viable and sustainable strategy for the acquisition of commercial property investments. It seeks to:

   (a) Optimise the returns on all property investment, while offering a reasonable level of protection to the Councils initial investment;

   (b) Exploit new opportunities for income generation from the Council's assets and investments;

   (c) Promote key strategic Council policies;

   (d) Provide value for money and facilitate assets that represent a sound financial investment for the Council;

   (e) Property investment decisions made within the scope of the CPIAS will need to satisfy one of two objectives;

      i. Investments to promote the key strategic policies of the Council

         This relates to buildings that fall within certain development areas or that are likely to enhance the standards within the borough for council tax payers, such as properties in and around Fareham Shopping Centre or others where an interest in held. These investments would be location specific, i.e., within the Borough.

      ii. Investment to maximise 'value for money'

         This relates to investments to be purchased on a purely commercial basis because they provide a good income stream and maximise the return on investment. These investments would not be location specific and therefore could be outside of the Fareham Borough.

   <u>Commercial Property as an Investment</u>

   (f) All investment sectors, including commercial property, have seen revenue streams depleted during the economic downturn. However, current market conditions have led to opportunities that may previously not have existed leading to a re-balancing of pricing favouring the investor.

(g) Property as an asset can provide a reliable and long term source of revenue income, but which is sufficiently liquid such that it can be traded or disposed of if required. Growth in the capital value of the investment is also possible, although in current markets, the focus should be principally on securing a reliable source of revenue income.

<u>Managing the risks of investing in commercial property</u>

(h) Investing in property is not risk-free, so it is important that any acquisitions reflect the Council's risk appetite in terms of maintaining the capital value of the asset and extent to which rental income is guaranteed.

(i) The main risk is vacancy and the resultant loss of income. The added costs of holding a vacant property include non-domestic rates, insurance, utilities, security, inspections and management. In addition, there would be the cost of marketing the property, the agent's disposal fees and legal fees for completing the lease documentation for re-letting the premises.

(j) Other risks include tenant's defaulting on rental payments, repairs not being undertaken or unauthorised works or sub-lettings being undertaken.

(k) Risks will need to be minimised through a series of measures:

a. Funds available for the purchase of commercial investments will be disaggregated to limit the overall impact that any single investment would have on the Council's finances;

b. Assets with existing tenants of a "high quality" only will be considered, as measured by undertaking appropriate financial checks;

c. Assets with a sufficiently long tenancy term will only be considered;

d. Appropriate checks will be carried out to ascertain the tenant's reliability including provision of satisfactory trade, landlord and bank references for tenants;

e. Other "due diligence" must be undertaken to protect the Councils investment as far as possible. These would include checks such as planning conditions, land contamination issues, planning policy issues, quality and strength of tenant lease agreements, etc.

(l) The steps that must be taken before any decision to purchase a property will be clearly documented, and this will be tested via a challenge process involving the Head of Estates, Director of Finance and Resources and the Executive portfolio holder for Policy Strategy and Finance.

<u>Managing the costs related to investing in commercial property</u>

(m) The process of identifying, acquiring, managing and maintaining, then ultimately disposing of commercial property can be substantial. It is therefore important that these costs are recognised when contemplating an investment decision.

(n) The overriding principle of the strategy is that any investment in commercial property will generate a higher net financial “return” than would otherwise be expected through an investment in the financial markets.

(o) Any increase in costs must therefore be kept to a minimum so they do not undermine the rental income stream achieved from the investment. To do this, preference will be given to properties with a full repairing liability upon the tenant, and where the management overhead is minimal.

<u>Identification of potential investments</u>

(p) Potential investments will need to be considered against certain criteria as follows.

a. Covenant strength

Covenant strength will affect the yield profile of an investment as a strong covenant will generally offer more security and therefore less risk. A tenants covenant can be measured against a series of “due diligence” checks, including a measurement of a tenant’s financial standing and long term strength.

b. Location

Assets purchased to improve the wellbeing of the borough are likely to be within Fareham. These could be funded from cash resources or via prudential borrowing.

Assets purchased purely for investment purposes would not be location specific and therefore could be outside of the borough. The strength of the investment opportunity will dictate the wider locations which may be considered, as opposed to the location being the driving force.

(q) <u>Investments to promote the key strategic policies of the Council:</u> For asset purchases falling into this category, covenant strength will remain important, but by other strategic factors are likely to supersede this. For example, the asset may be in a key location which will offer long term development opportunities for the Council, or it may be in an area of high vacancy rates where start up or small businesses may be encouraged in order to improve the overall success of the area. It could also be that the Council is looking to promote a certain service or facility which may not be achieved by a tenant with a strong covenant.

(r) <u>Investment to maximise 'value for money':</u> The aim of purchasing assets falling into this category is to maximise income, provide a secure investment with a strong covenanted tenant in place and to minimise outgoings.

(s) Return on Investment / Yield: The aim of the majority of investments is to provide a secure return on income. The Council will manage its commercial property as a single portfolio, ensuring that the collective returns achieved on the investments meet the overall financial target that is set. It is therefore also important that any purchasing decisions also contribute positively to the performance of the portfolio, both financially and in minimising the overall risks.

(t) Sector Types: The main property sectors are retail, office, industrial and leisure/healthcare. The portfolio will aim to spread its investment across the sectors to limit exposure to any volatility in a particular area.

(u) Management of Property: Properties with fully repairing and insuring leases shall be sought as a preference for investment, in order to minimise the cost of management and maintenance. Exceptions could be made for properties that are purchased for specific development or planning reasons. In order to minimise management overheads, use of an external property management firm would be considered to handle the day to day operational issues with the portfolio, particularly for properties which are outside the Borough.

(v) Tenure: Assets acquired with tenants in place may be subject to sub leases granted within the security of tenure provisions of the Landlord and Tenant Act 1954. This may be less attractive if assets are purchased for future development possibilities as ending the tenancies will require the Council to satisfy one of the grounds under the Act to take back possession. Conditions of tenure will therefore be a further important consideration in any investment decision.

(w) "Exit Strategy": There will be a need in the future to dispose of property investments. This may happen because of the need to return the investment to cash for other purposes, or it could be due to poor financial performance of a particular property, etc. So, while it is likely that the majority of investments will be held for a medium to long term in order to achieve the required return and to justify the cost of the acquisition, it is important to understand the opportunities to dispose of any investment at the outset. Therefore, as part of the investment decision, consideration must be given to the potential ways in which the Council could "exit" from the investment, such as sale to another investor, sale for redevelopment, etc. An investment would only proceed where there is a clear exit strategy, should it be required.

Monitoring and Review

(x) The risks associated with property investment are arguably greater than those associated with cash investments. Equally, the returns achieved from investment can be very positive to assist in funding day to day services in the borough. For this reason, a robust and on-going method of monitoring portfolio performance will be necessary.

(y) A portfolio performance framework will, on an on-going basis, consider the following aspects:

i. How an asset is performing against an individual financial target
ii. Whether the risk profile of the asset has changed since the point of investment
iii. Whether the portfolio remains sufficiently well balanced and diverse to limit the risk to the Council
iv. Whether the portfolio is performing satisfactorily against its financial target

(z) The responsibility for managing the performance of the portfolio will reside with the Council's Head of Estates. This will reviewed by the Director of Finance and Resources, and will periodically be scrutinised by the Council's Corporate Asset Management Group.

(aa) A Portfolio performance report will also be published at least annually for Member scrutiny.

Way Ahead

(bb) The CPIAS document shall be kept under review, to ensure that it remains relevant to the changing economic outlook, and also to the Council's own financial circumstances. In the meantime, the following actions will be undertaken to deliver the objectives of the strategy.

		Target date
1	Develop a property risk assessment template, identifying the measures for considering new property acquisition opportunities.	31st January 2013
2	Develop a "Portfolio Performance Management Framework" to monitor the performance of properties against agreed targets and to consider retention, disposal or management of each asset.	28th February 2013
3	Engage the Council's retained property agent to identify opportunities which are consistent with CPIAS.	31st January 2013
4	Establish a challenge process for assessing property opportunities, prior to acquisition.	28th February 2013
5	Establish a member scrutiny process, to ensure there are transparent arrangements for reporting the performance and activity of the portfolio on a periodic basis.	30th June 2013