POLICY AND RESOURCES COMMITTEE - 19 MARCH 2018

PART I – NOT DELEGATED

7. PROPERTY INVESTMENT STRATEGY
(DCES)

1. Summary

1.1 The Council, via the Property Investment Board (PIB), is required to set down and approve the selection parameters for the acquisition of property for investment purposes.

1.2 Following substantial experience arising from a period of active bidding for on-market investment opportunities at the end of 2017 and early 2018, the most appropriate process of identification, evaluation and approval has been established. This now requires that some of the original parameters be amended. In addition, a new opportunity, not encompassed in the original Property Investment Strategy (the Strategy) has been identified and should properly be incorporated in the approval process. The latter relates to loaning funds at a commercial rate to local Registered Social Landlords, namely Thrive Homes and Watford Community Housing, to pursue their development plans.

2. Details

2.1 *Existing Property Asset Holding*

2.1.1 The Council's existing Land and Property asset list, less the operational elements, is regarded as TRDC's existing investment portfolio. This holding is valued at about £28.6m but is currently the subject of review to, in particular, further reflect the changes arising from the South Oxhey regeneration project.

2.1.2 Analysis of this portfolio, on current values, suggests that it consists primarily of:-
28.4% Garages
25% Offices (mainly TR House, but only a proportion actually revenue generating)
21.3% Theatre (Watersmeet)
All other categories are less than 10% each

2.2 *Previous Committee Considerations*

2.2.1 The subject of future property investment has been taken to Policy and Resources Committee on multiple occasions; the first being in March 2016 when the Committee's Terms of Reference for property purchase were established. It was subsequently determined that the key financial factors would be:-
- A fund of £20m was to be made available to build up a property portfolio over a 2 to 3 year period.
- The investments acquired by this fund are to have a balanced yield of approx. 5% pa thus an implied income stream of £1m pa was established.
- The portfolio should be split approximately 50/50 across residential and commercial properties.

2.2.2 Through various and subsequent reports a strategy emerged whereby the commercial property element of the portfolio should contain approximately:-

- 30% retail
- 30% office
- 30% industrial
- 10% specialist (leisure, social, energy, environmental)

2.2.3 The strategy states the key considerations for when an opportunity is being assessed:

- Covenant Strength
- Length of tenants lease
- Rate of return and risk balance
- Growth potential
- Building age/condition and specification
- Location

2.2.4 The last relevant report was taken to Policy and Resources Committee on 20 March 2017 which clarified certain governance issues and promoted an approval flow chart. The recommendations of that report were amended in the debate and the meeting minute summarised the primary criteria at that time as follows:-

- The average financial return is to be 5% nett;
- The criteria for acquisition set out in previous reports will be followed;
- There will be a priority for development within the Three Rivers area or within 15 miles of its border;
- The preferred development will be those schemes according with the aims of the TRDC Strategic Plan, which support the community of Three Rivers;
- No single property asset should be worth at acquisition more than 25% of the total property portfolio;
- The portfolio is to comprise not less than 50% and up to 80% residential and not less than 20% and up to 50% non-residential;
- Decisions on acquisitions worth £0-5m will be in consultation with Group Leaders and the Lead Member for Resources (Shared Services);
- Decisions on acquisitions worth above £5m will be considered only by P&R Committee;
- The Scrutiny Panel (when called) will consist of 3 Members of the Administration and one Member of the Conservative Group and one Member of the Labour Group.

2.3 *Proposed Revised Approval Process*

2.3.1 Following the recent engagement with Commercial Agents there have been a substantial number of acquisition opportunities for the Council to consider. When a suitable opportunity does come forward, there are routinely only a few days to evaluate and make a bid.

2.3.2 So in order to be able to fully respond within the expected timescales and be able to make competitive bids in the marketplace, it is recommended that the Council's approval process is adjusted as follows:-

- Acquisition value up to £5m – to be approved by the PIB Chair in consultation with the Lead Member for Resources
- Acquisition value between £5m and £10m - to be approved by the PIB Chair in consultation with the Lead Member for Resources and Group Leaders
- Acquisition value over £10m – to be approved at Policy and Resources Committee.

2.3.3 Accordingly the new working arrangements would adopt a revised three stage selection and approval process for a prospective acquisition below £10m as follows:-

- Stage 1. Having established from the sales information that the opportunity has a broad fit with TRDC criteria the details are measured in the appraisal matrix at appendix A. Provided the property meets the selection threshold scoring, and is below £5m, the known facts are shared with PIB Members and the Lead Member for Resources. If the opportunity is likely to be between £5m and £10m in value, Group Leaders will also be included in that circulation. That report will seek preliminary support to bid for the opportunity.

- Stage 2. Assuming support, officers then instruct high level due diligence (DD) to include at least:-
- Legal review of title and tenant lease terms,
- Assessment of tenant covenant strength (utilising a D&B credit rating),
- Local market research to establish trading levels and comparable values
- A viewing of the property and immediate area by Council property officers.
- At this point enough will be known about the opportunity to assess a value range, any potential legal issues and any other conditionality that should be included in a bid. On the basis that bids are being sought on an informal basis, a report on the above, and a suggested offer range with any recommended conditionality will be made. Circulation will be as at Stage one. Responses from Members are directed to the Chair of PIB.
- During this time, the Agent will have made soundings as to interest in the market place for the opportunity and possibly determined the vendor's expectations. With continued support, and taking any response from the consultees into account, a bid will be instructed to be made at the consensus level.

- Stage 3. On the basis that the Council's bid is indicated as being the preferred offer, a period of time (normally short) will be given to conduct definitive investigations, satisfy any conditionality and formalise matters to exchange of contracts. Specifically that due diligence will cover:-
- Detailed description of the property, a market commentary and analysis of comparable evidence
- Full review of title, tenant lease terms and any restrictive covenants
- Description of the tenants and their business, D&B report on the company and intelligence on the business activity
- Business plan to include income projections, risk analysis, asset management possibilities and potential capital expenditure
- Specialist advice on the building as may be required, including condition, dilapidation issues, environmental, planning and energy performance reports
- Proposed Heads of Terms
- VAT and SDLT treatment to maximise tax-efficiency.
- Formal Valuation where required.

2.3.4 In the event that the Council's bid is apparently only shortlisted, and full and final bids are called for, stage 2 will be repeated, taking into account any new information and market intelligence.

2.3.5 As noted above, in addition to the approach of buying property to secure a financial return, the opportunity has arisen of loaning funds to Thrive Homes and Watford Community Housing at a commercial rate (not less than 5%) to enable them to pursue their development plans. This would be separate to any involvement in Joint Ventures where TRDC would be putting funds or an asset into such a vehicle. It is recommended that the approval process be similar to that for purchasing property and the recommendation below has been set out accordingly.

2.4 Revised Selection Criteria

2.4.1 From our experience and related advice of those Agents working in our interest, it is recommended that the previously stated purchasing criteria are reviewed. In particular consideration is given to:-

- Lowering of the priority of the location "distance from TRDC" criterion
- Removing the portfolio 50/50 split between residential and commercial
- Removing the 'no single property asset should be worth at acquisition more than 25% of the total property portfolio' criterion

2.4.2 As to the location of any investment being within 15 miles of TRDC's boundary, it is recommended that such priority be reduced. In the last three months of active search only one opportunity (representing less than 5% of the total) worthy of consideration, and fitting this criterion, came forward. The only tangible reason for having elements of the Council's investment portfolio being geographically so proximate is travel time for Officers to and from the location. On the basis that primary among the Council's selection criteria are that the investment opportunity has good tenant covenant, a reasonably long lease term and a minimal capital expenditure requirement, the distance away from TRDC is largely irrelevant. Clearly if a suitable opportunity arises it will be given due attention.

2.4.3 As to the proportionate split between residential and commercial, it is recommended that particular guideline is set aside. This Council is already investing in residential development through its participation in Three Rivers Homes developments and its potential on-lending of funds to local Housing Associations as set out above. Further the Council are actively pursuing development opportunities, which are longer term and almost entirely residential by nature. The Council will maintain a watching brief on local residential development by others, and if suitable opportunities present themselves, they will of course be investigated.

2.4.4 Thus, and in the medium term of say 3 to 5 years, assuming the Council's plans come to fruition, there will be a good balance between acquired commercial investments and direct residential involvement.

2.4.5 With regard to the single asset value limitation, two of the more interesting opportunities investigated to date would have been precluded by this criterion, as would one of the loan to housing Association proposals which is currently being developed. It is argued that the Property Investment Board arrangements provide sufficient scrutiny to delete this criterion.

2.4.6 The property investment strategy will be reviewed during the year to ensure compliance with the revised CIPFA Prudential Code for Capital Finance in Local Authorities. There is at present no conflict as the Strategy does not involve borrowing money at this time.

3. Reasons for Recommendation

3.1 It is necessary that Policy and Resources Committee agrees to the recommendations in order that property investment activity can proceed with some prospect of success.

4. Policy/Budget Reference and Implications

5. Financial Implications

5.1 A business case for property investment has already been presented and approved.

4.1 The principle of property investment has been approved at Full Council and the 2018/19 budgets onwards require a revenue source coming from this activity.

6. Legal Implications

6.1 Nothing further than is referred to in this report.

7. Risk Management Implications

7.1 The Council has agreed its risk management strategy which can be found on the website at http://www.threerivers.gov.uk. The risk management implications of this report are detailed below.

7.2 The subject of this report is covered by the Property and Major Projects service plan. Any risks resulting from this report will be included in the risk register and, if necessary, managed within this plan.

7.3 The following table gives the risks if the recommendations are agreed, together with a scored assessment of their impact and likelihood:

	Description of Risk	Impact	Likelihood
1	A Housing Association defaults on a loan made by the Council.	II	F

7.4 The following table gives the risks if the recommendations are rejected, together with a scored assessment of their impact and likelihood:

The above risks are plotted on the matrix below depending on the scored assessments

Description of Risk	Impact	Likelihood
2. The property investment target for the year may not be achieved.	III	D

7.5 The above risks are plotted on the matrix below depending on the scored assessments of impact and likelihood, detailed definitions of which are included in the risk management strategy. The Council has determined its aversion to risk and is prepared to tolerate risks where the combination of impact and likelihood are plotted in the shaded area of the matrix. The remaining risks require a treatment plan.

Likelihood					
A					
B					
C					
D			2		
E					
F		1			
	I	II	III	IV	V
	Impact				

Impact	Likelihood
V = Catastrophic	A = >98%
IV = Critical	B = 75% - 97%
III = Significant	C = 50% - 74%
II = Marginal	D = 25% - 49%
I = Negligible	E = 3% - 24%
	F = <2%

7.6 In the officers' opinion, the risk(s) above were they to come about would seriously prejudice the achievement of the Strategic Plan and are therefore operational risks. The effectiveness of treatment plans are reviewed by the Audit Committee annually.

8. Recommendations

1. That the Committee approves the recommendation to revise the approval process to be as follows:-
   Acquisition/loan value up to £5m – to be approved by the PIB Chair in consultation with the Lead Member for Resources
   Acquisition/loan value between £5m and £10m - to be approved by the PIB Chair in consultation with the Lead Member for Resources and Group Leaders
   Acquisition/loan value over £10m – to be approved at Policy and Resources Committee.

2. That the Committee approves the recommendation to revise the selection criteria as follows:-
   Lowering of the priority of the location "distance from TRDC" criterion
   Remove the portfolio 50/50 split between residential and commercial
   Remove the 'no single property asset should be worth at acquisition more than 25% of the total property portfolio' criterion

Appendix

A – Investment Appraisal Matrix

Report prepared by Alan Head, Head of Property & Major Projects and Geof Muggeridge, Director of Community & Environmental Services