DEVELOPMENT OF AN ACQUISITIONS AND INVESTMENT POLICY

To:	**Assets & Investment Committee**
Meeting Date:	**22nd July 2016**
From:	**Head of Strategic Assets**
Electoral division(s):	**All**
Forward Plan ref:	**N/A** *Key decision:* **No**
Purpose:	**To seek the Committee's views on the development of a Property Acquisition and Investment Policy**
Recommendation:	**That the Committee:-**

a) agrees that a Property Acquisition and Investment Policy should be adopted on the basis set out in this Report

b) a report be brought to the next meeting for a Key Decision to approve delegation arrangements for authorising individual transactions

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1. BACKGROUND

1.1 The Council is facing increasing pressure to find new revenue streams to support the delivery of frontline services, and as a result is looking at new ways to manage its property assets, including the potential acquisition of new assets for investment purposes

1.2 Members have expressed a wish to consider market opportunities to acquire property assets for investment purposes, including agricultural land to replace land being transferred to the Council's property development company.

1.3 At present, the LGSS Strategic Assets team becomes aware of opportunities for investment acquisitions through its general interaction with the market and the Council's portfolio, and by *ad hoc* mailing from property agents. Although there is no dedicated resource for investment acquisitions at present, opportunities are reviewed, and where they are considered to be of potential interest, are brought to A&I Committee through a specific Agenda Item

1.4 There is currently no set process or criteria for assessing investment opportunities, and this means that the Council is unable to react within the often short timescales required, nor to deploy appropriate skills to the assessment process

1.5 In order to create and implement an effective policy, the Council will need to agree:-

- A clear set objectives
- A clear set of investment criteria
- A clear process for approving acquisitions

2. MAIN ISSUES

2.1 Objectives

2.1.1 The Council's objectives in acquiring investment properties can be purely financial, to provide the best financial return, or there could be additional objectives, for example to support local economies, or local businesses through its ownership of properties

2.1.2 It is proposed that properties acquired under this Policy should be managed solely for financial investment returns

2.1.3 It is further proposed that investment property is acquired and managed through a Special Purpose Vehicle

2.2 Criteria

2.2.1 The Council will need to set key parameters around the criteria upon which a property will be considered for acquisition. The key criteria are set out below

2.2.2 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. It is however proposed that the Council, as a public body, will not invest in properties where the occupiers are generally seen to be undertaking business which is contrary to its corporate values

2.2.3 Lease length - 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. Commercial leases are generally let at between 5-10 years in today's market. The shorter the lease, the greater the potential for early costs of holding void property, and although a break in the lease does also provide an opportunity for positive asset management to add value, it is proposed that the Council generally does not invest properties where the remaining term is less than 5 years in length

2.2.4 Rate of return - the rate of return from the property (e.g. through annual rental incomes) will need to be equivalent or better to the returns that could be earned from alternate investments, following adjustment for risks and potential growth. Generally property yields are low at present: agricultural land is generally under 2%, prime offices and retail, from 2-4%, and good office and commercial properties 4-8%. The Council's current 'hurdle' rate for 'invest to save' on property projects is 7%, and we are aware of other Council's hurdle rates for property investment being set at 5-7% depending on their funding source. It is proposed that the Council's hurdle rate shall not be less than 2% above the appropriate Public Works Loan Board rate at which the Council borrows

2.2.5 Growth - property has the potential for both revenue and capital growth. The Council can take into account that potential when assessing the strength of the investment opportunity. Property values can fall as well as rise, and although property tends to out-perform other investments in the long run, it is susceptible to short term volatility. It is proposed that investment decisions are taken on the basis of the hurdle rate criteria, but that potential capital growth is considered as a material factor in investment decisions

2.2.6 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. A broad mix of properties would spread the risk of portfolio ownership; discussions with investment agents suggest that a minimum portfolio of £100m capital value is an optimum size for spreading risk, which is supported by the Chief Finance Officer

2.2.7 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

2.2.8 Location – whilst a location within Cambridgeshire may make management more efficient, it is possible there may not be suitable opportunities within the county, and it is proposed that acquisitions of properties outside the county will also be pursued

2.3 Process

2.3.1 All acquisition proposals could be channelled through Strategic Assets and appointed specialist agents/consultants, who would prepare an outline business case in those instances where it was felt that the investment opportunity merited further consideration.

2.3.2 To ensure that good investments are not lost through delays in the process, it is recommended that an Investment Appraisal Group which will comprise both Members and officers is established to consider recommendations in a timely manner

2.3.3 The Group could comprise the Chair of Assets and Investment Committee, the Chief Finance Officer, and the Head of Strategic Assets, (or nominated deputies), and would need to have delegated authority to act on investment opportunities to provide the necessary speed of response

2.3.4 Once an acquisition is approved by the Group, it is likely 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

2.3.5 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

2.3.6 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).

3. ALIGNMENT WITH CORPORATE PRIORITIES

3.1 Developing the local economy for the benefit of all

The following bullet points set out details of implications identified by officers:

- It is proposed that a Property Investment portfolio should be managed purely for financial returns outside any economic policy for the county

3.2 Helping people live healthy and independent lives

There are no significant implications for this priority.

3.3 Supporting and protecting vulnerable people

There are no significant implications for this priority.

4. SIGNIFICANT IMPLICATIONS

4.1 Resource Implications

The following bullet points set out details of significant implications identified by officers:

- A Property Acquisition and Investment policy would be 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.

- The Council will fund acquisitions by borrowing funds from the Public Works Loan Board (PWLB), and potentially from recycling capital receipts from investment properties or other parts of its property portfolio

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

- Other costs would include legal fees, at approximately 1.5% of the purchase price, Stamp Duty Land Tax, at 4% and 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.

- An acquisition may give rise to VAT implications. The Council will need to consider strategies to protect its Partial Exemption limit

- All of the costs described will be accounted for within a business case for an acquisition

- The Council's present approach involves the assessment of acquisition opportunities most often presented by selling agents, who bring potentially suitable properties to our attention on an ad hoc basis

- Given the specialist nature of the investment properties market, it would be difficult for the current resources in the Strategic Assets team to actively identify and evaluate suitable opportunities. There is a competitive market for good investment property, and knowledge of the market availability, and particularly pre- or off-market opportunities can be key. The Council should consider building formal or informal relationships with property agents active in the field 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

4.2 Statutory, Risk and Legal Implications

The following bullet points set out details of significant implications identified by officers:

- The property market is volatile and may experience periods of recession. As has been evidenced by the economic downturn, Property investment clearly carries inherent risks due to wider economic conditions beyond the immediate control of the Council

- 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

- 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

- 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

- Investment properties may become vacant and carry risks of void rent periods, during which the Council may have to carry holding costs (such as business rates

- If Investment property is held within the electoral boundaries of Cambridgeshire, the Council may come under pressure to compromise investment decisions (such as rent reviews, lease renewals or disposals) for local economic or other reasons

- Property assets require active management, and this will need to be resourced and will carry a cost. If acquisitions are made outside Cambridgeshire, there is an additional risk of disproportionate management costs unless local agents are employed to provide this service

- The Performance of any acquired investments will need to be viewed as a portfolio, to properly account for abortive costs, acquisition and disposal costs, and management and void costs

- Risks can be managed through:-

    - the adoption of a clear set of Investment Objectives and Criteria

    - a robust due diligence process being undertaken prior to completion

    - Ongoing management of properties to maximise investment returns

4.3 Equality and Diversity Implications

There are no significant implications under this heading

4.4 Engagement and Consultation Implications

The following bullet points set out details of significant implications identified by officers:

- A Property Acquisition and Investment Policy should operate within criteria and process prescribed by this Committee

4.5 Localism and Local Member Involvement

The following bullet points set out details of significant implications identified by officers:

- A Property Investment and Acquisition Policy should operate outside the normal requirements for local member and community consultation

4.6 Public Health Implications

There are no significant implications under this heading

Source Documents	Location
None	N/A