DRAFT Bolsover District Council
Commercial Property Investment Strategy

1. Purpose

1.1 The objective of the Commercial Property Investment Strategy (the Strategy) is to establish a framework for the identification of commercial property investments which, if acquired, would provide the Council with an income stream and potential regeneration opportunities and additional social benefits.

2. Introduction

2.1 The Strategy aims to provide a robust and viable framework for the acquisition of commercial property investments. The key underlying objectives are:

- **Governance Arrangements** – to provide a decision making framework aligned to the requirements of **the Statutory Guidance Relating to Local Authority Investments (Appendix1);**

- **Investment Criteria** – to identify suitable property investment opportunities;

- **Risk Management** – to balance the requirement for income return with an acceptable level of managed risk;

- **Financial Viability** – each potential investment will have a full business case and be evaluated to ensure the income received is sufficient to provide an acceptable rate of return following the payment of borrowing costs, management fees and any running costs.

2.2 The management of the Council's existing property portfolio (comprising operational and commercial investment properties) is managed by the Asset Management Group. This Group will ensure that all property investments acquired under this Strategy continue to be appropriately managed.

3. Principles

3.1 Any commercial investment will follow at least one of the following principles:

- Be sustainable and provide income to the Council
- Benefit the District and provide an element of social value
- Follow the principles of an ethical investments as outlined in paragraph 5.3 of this report
- Contribute towards the economic development of the District, creating skilled jobs and housing growth
- Enhance partnership working
- Contribute towards Bolsover District Council being high performing, financially secure with good governance

- Be innovative, aspirational, creative and forward-thinking

4. Governance Arrangements

4.1 **Property Investment Panel (PIP)**

It is necessary to have a framework for determining which properties should be invested in. A dedicated Property Investment Panel (PIP) will consider property investment opportunities and where appropriate make acquisition recommendations to the Leader of the Council and the Chief Executive.

4.2 PIP membership will comprise:-

- The Cabinet
- Joint Strategic Director - Place
- Joint Head of Service – Property and Estates
- Joint Head of Service - Legal
- Joint Head of Service – Finance
- Joint Head of Service – Economic Development
- Specialist external advice to be commissioned on an 'as required' basis.

4.3 For a potential property investment to be considered by the PIP, it must:-

- achieve a minimum weighted score of 70 from the investment criteria matrix and
- be accompanied by a full and comprehensive business case.

4.4 The business case will be prepared by the a core team of Officers (Head of Property and Estates, Head of Finance and Head of Legal together with other relevant Officers for specific assets). Each potential property investment will undergo qualitative and quantitative appraisal to establish portfolio suitability and the legal and financial implications of the purchase. The core team will seek external investment and/or technical expertise where specialist property market knowledge is required.

4.5 All acquisitions, where relevant, will be subject to building survey, purchase report and valuation. Occasionally, opportunities will arise that do not score highly on the matrix criteria and in these circumstances, low scoring properties will be considered by the PIP on their own individual regeneration, economic development, employment and social value merits, in accordance with the decision making process outlined below.

4.6 The Investment Criteria Scoring Matrix is not intended to provide an assessment for regeneration opportunities. Separate elements will apply for such opportunities which are not covered by this Strategy.

4.7 Decision Making Process

4.8 It is acknowledged that commercial investment opportunities may require agile and quick decision making. However, in order to ensure appropriate governance arrangements are maintained, investment decisions will be made in accordance with the Council's existing decision making process, threshold levels and Scheme of Delegation contained within the Council's Constitution. Where it is not possible to wait until the next Executive and/or Council meeting, an extra-ordinary meeting will be arranged as soon as practicably possible.

5. Investment Criteria

5.1 All investments must reflect the requirements within the **Statutory Guidance on Local Government Investments** issued under Section 15(1) (a) of the Local Government Act 2003', which came into force April 2018. Further details of this statutory guidance are available at:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/678866/Guidance_on_local_government_investments.pdf

A copy of this guidance is also attached at **Appendix 1**

5.2 Table 1 below sets out a summary of the statutory guidance requirements:

Table 1

Requirement	**Considerations**
Clearly show how investments contribute to Council's objectives	• Need to align with Corporate Plan priorities • Clarify purpose and extent to which it supports deficit reduction and /or economic regeneration in the District
Strategy must include indicators to show how Councillors have assessed the total risk exposure on decision	• How is it funded • Rate of return expected and why (benchmarked) • Show additional debt costs • Risks over the repayment period • Extent of support for deficit gap • Mitigation if returns fail and / or borrowing increases • Assessment of capital depreciation
Clearly show how the investment is proportionate?	• Loan corresponds in size or degree (terms/rate/returns) • Risk exposure is reasonable and accepted • Within agreed and defined 'affordability ' limit

Risk assessment should be robust	• Market assessment (competition, demand, trends) • Proper quality external advice and expertise • Credit ratings
Contingency	• Loss of investment return / Increase in loan repayments • Capital depreciation • Extra costs and budget impact • Loss of revenue stream - service delivery impact

5.3 Consideration must also be given to a number of essential elements which will inform acceptable investment choices, specifically:

- Ethical investment (for instance, prohibiting investment in alcohol and tobacco production or sale, animal exploitation, gambling, sex establishments, arms trade or environmentally damaging practices)
- Geographic spread of investments
- Limits of individual and cumulative risk
- Timescales for the achievement of objectives
- The level of losses that can be tolerated
- The degree to which the Council can realistically become reliant on the income stream to provide services

5.4 As with other forms of investment at their most basic level, property investment is a trade-off between risk and return. A traditional well diversified property portfolio (spread across different property sectors and geographical regions) will deliver a balanced long term return with minimal risk.

5.5 This strategy adopts the same underlying principles of diversification in acquiring property investments. Four main property sectors will be included (industrial, office, leisure and retail) and in turn, these will be diversified on criteria including location, the tenant's financial (covenant) strength, lease term (income duration) and investment lot size. This will assist in protecting the Council portfolio's return should a property investment cease to be income producing (for example, it is undergoing refurbishment or awaiting a new tenant).

5.6 An Investment Criteria Scoring Matrix (Matrix) allows the relative merits of an investment opportunity to be measured and assessed against a target threshold.

The Matrix is attached at **Appendix 2** and includes the following criteria:

- **Location** - the location of the property is critical to ensure it is an attractive position, so that in the long term it optimises its ability to re-let/re-sell if capital is required, or is strategically located for re-development. The location of the property will affect the ability of the Council to undertake inspections and to deal with management issues without the need to employ specialist agents. It will also affect income to the Council from Business rates, Council Tax and New Homes Bonus, depending on the type of investment.

- **Tenant Covenant** – the quality of the tenant and, more importantly, their ability to pay the rent on time and in full is essential. This is particularly important where the Council has borrowed against the investment, and minimum acceptable financial strength for any given tenant will be determined through a financial appraisal of company accounts and the use of appropriate methods of risk assessment and credit scoring. 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 business which is contrary to its corporate values.

- **Lease Terms** - the unexpired length of the term of the lease is of key importance in ensuring that the revenue stream is secure and 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.

- **Occupational Lease Length –** the lease term will determine the duration of the tenant's contractual obligation to pay rent. The most attractive investments offer a long lease with a strong tenant covenant. The lease term will reflect any tenant break clauses.

- **Building Quality –** a brand new or recently refurbished building will not usually require capital expenditure for at least 15 years. This is attractive for income investors requiring long term rental income with the minimum of ongoing capital expenditure.

- **Tenure –** anything less than a freehold acquisition will need to be appropriately reflected in the price.

- **Tenant Repair obligations –** under a Full Repairing & Insuring Lease (FRI), the tenant is responsible for the building's interior and exterior maintenance / repair. The obligation is limited to the building's interior under an Internal Repairing & Insuring Lease (IRI). The preference will be to favour FRI terms (or FRI by way of service charge i.e. all costs relating to occupation and repairs are borne by the tenants and administered through a service charge).

6. Risk Management

6.1 Market forces

6.2 As with all investments, there are risks that capital values and rental values can fall as well as rise. To mitigate against future unfavourable market forces, acquisitions will be made on the basis that the Council is willing and capable of:-

- Holding property investments for the long term i.e. 25 years +. This will ensure income and capital returns are considered over the long term thereby smoothing out any cyclical economic/property downturns.

- Fixing borrowing liabilities. The Council can borrow from the Public Works Loan Board at historically low levels thus protecting the Council from future Increases in financing rates.

- Effective partnership working to share risk where appropriate, for example, joint venture arrangements.

6.3 Portfolio Management

6.4 To mitigate the risk of void periods where the property is either partially or fully vacant, or a tenant has defaulted on its rental obligations, the investment portfolio will be actively managed.

6.5 In addition, the investment criteria specified in the scoring matrix will favour secure property investments i.e. high quality buildings in prime locations, thus mitigating the risk of void periods on re-letting.

6.6 Resources

6.7 Property investment markets are, in general, controlled by national and regional commercial property agencies and establishing links and relationships with a number of such property agents is the best method of sourcing suitable properties for acquisition.

6.8 Staffing resources will be made available in order to source suitable property assets for acquisition that match the criteria set under the Strategy. If additional resources are required for specific projects, this can be done either by recruitment into the existing Property and Estates Team or by employing suitable and appropriate external expertise as required. It is recognised that expertise is essential to enable informed decision making.

7. Financial Viability

7.1 The financial viability of each individual potential investment opportunity will be fully assessed within a comprehensive business case. In order to reflect the potential risk that may arise as a consequence of undertaking commercial property investment and provide a sufficient financial contribution to the Council’s General Fund, a positive Internal Rate of Return (IRR) is required. However, the Council may still consider pursuing a property acquisition if the IRR is positive but low if a social and/or regeneration opportunity is identified.

7.2 The level of return will be heavily influenced by two factors: (a) the cost of capital and (b) the regulatory requirements of the minimum revenue provision (MRP).

Appendix 1

STATUTORY GUIDANCE ON LOCAL GOVERNMENT INVESTMENTS

(3rd Edition)

Issued under section 15(1)(a) of the Local Government Act 2003 and effective for financial years commencing on or after 1 April 2018

POWER UNDER WHICH THE GUIDANCE IS ISSUED

1. The following Guidance is issued by the Secretary of State under section 15(1)(a) of the Local Government Act 2003. Under that section local authorities are required to “have regard” to “such guidance as the Secretary of State may issue”.

DEFINITION OF TERMS

2. In this guidance the 2003 Act means the Local Government Act 2003.

3. Local authority has the meaning given in section 23 of the 2003 Act. To the extent that this guidance applies to parish councils and charter trustees (see paragraph 11) a reference to a local authority includes those councils and trustees.

4. 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.

5. For the avoidance of doubt, the definition of an investment also covers loans made by a local authority to one of its wholly-owned companies or associates, to a joint venture, or to a third party. The term does not include pension funds or trust fund investments, which are subject to separate regulatory regimes and therefore are not covered by this guidance.

6. A credit rating agency is one of the following three companies:

• Standard and Poor’s;

• Moody’s Investors Service Ltd; and

• Fitch Ratings Ltd.

7. For the purposes of this guidance a loan is a written or oral agreement where a local authority temporarily transfers cash to a third party, joint venture, subsidiary or associate who promises to return it according to the terms of the agreement, normally with interest. This definition does not include a loan to another local authority, which is classified as a specified investment.

8. The **Treasury Management Code** means the statutory code of practice issued by CIPFA: “Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes, 2017 Edition”.

9. The **Prudential Code** means the statutory code of practice, issued by CIPFA: “The Prudential Code for Capital Finance in Local Authorities, 2017 Edition”.

10. The **Capital Strategy** is the strategy required by the updates to the Prudential Code and Treasury Management Code.

APPLICATION

Effective date

11. This guidance applies for financial years commencing on or after 1 April 2018. It supersedes all previous editions of the Statutory Guidance on Local Authority Investments.

12. Strategies presented to Council or equivalent before 1 April 2018 but relating to 2018-19 and future financial years do not need to include all of the additional disclosures required by this edition of the guidance should it not prove practical or cost effective to do so. If a local authority chooses not to include the new disclosures in its 2018-19 Strategy, it must include the disclosures in full in the first Strategy presented to full Council or equivalent after 1 April 2018.

Local authorities

13. This guidance applies to all local authorities in England.

14. This guidance applies to parish councils and charter trustees, providing their total investments exceed or are expected to exceed £100,000 at any time during the financial year. Where a parish council or charter trustee expects its total investments to be between £10,000 and £100,000, it is encouraged to adopt the principles in this guidance.

KEY PRINCIPLES

Transparency and democratic accountability

15. For each financial year, a local authority should prepare at least one Investment Strategy (“the Strategy”). The Strategy should contain the disclosures and reporting requirements specified in this guidance.

16. The Strategy should be approved by the full council. For authorities without a full Council, the Strategy should be approved at the closest equivalent level. The

Secretary of State recommends that the Strategy should be presented for approval prior to the start of the financial year.

17. Where a local authority proposes to make a material change to its Strategy during the year a revised Strategy should be presented to full council or equivalent for approval before the change is implemented.

18. The Strategy should be publicly available on a local authority's website. Where a parish council or charter trustee does not maintain its own website, they should post a public notice detailing how local residents can obtain a copy of the Strategy, free of charge.

19. Where a local authority prepares a Capital Strategy in line with the requirements of the Prudential Code, a Treasury Management Strategy in line with the requirements of the Treasury Management Code, or any other publicly available document, the disclosures required to be included in the Strategy can be published in those documents instead of in the Strategy.

Contribution

20. Investments made by local authorities can be classified into one of two main categories:

• Investments held for treasury management purposes; and

• Other investments.

21. Where local authorities hold treasury management investments, they should apply the principles set out in the Treasury Management Code. They should disclose that the contribution that these investments make to the objectives of the local authority is to support effective treasury management activities. The only other element of this Guidance that applies to treasury management investments is the requirement to prioritise Security, Liquidity and Yield in that order of importance.

22. Local authorities should disclose the contribution that all other investments make towards the service delivery objectives and/or place making role of that local authority. It is for each local authority to define the types of contribution that investments can make and a single investment can make more than one type of contribution.

Use of indicators

23. The Strategy should include quantitative indicators that allow Councillors and the public to assess a local authority's total risk exposure as a result of its investment decisions. This should include how investments are funded and the rate of return

received. Where investment decisions are funded by borrowing the indicators used should reflect the additional debt servicing costs taken on.

24. Local authorities should consider the most appropriate indicators to use, given their risk appetite and capital and investment strategies. Whilst this guidance does not prescribe specific indicators or thresholds, the indicators used should be consistent from year to year and should be presented in a way that allows elected members and the general public to understand a local authorities' total risk exposure from treasury management and other types of investment.

25. Where a local authority has entered into a long term investment or has taken out long term debt to finance an investment the indicators used should allow Councillors and the general public to assess the risks and opportunities of the investment over both its payback period and over the repayment period of any debt taken out.

Security, Liquidity and Yield

26. A prudent investment policy will have two underlying objectives:

• Security – protecting the capital sum invested from loss; and

• Liquidity – ensuring the funds invested are available for expenditure when needed.

27. The generation of yield is distinct from these prudential objectives. However, this does not mean that local authorities are recommended to ignore potential revenues. Once proper levels of security and liquidity are determined, it will then be reasonable to consider what yield can be obtained consistent with these priorities.

28. When entering into treasury management investments, local authorities should consider security, liquidity and yield in that order of importance.

29. When entering into other types of investments local authorities should consider the balance between security, liquidity and yield based on their risk appetite and the contribution(s) of that investment activity.

Security

Financial Investments

30. Financial investments can fall into one of three categories:

• Specified investments;

• Loans; and

• Other Non-specified investments.

Specified Investments

31. An investment is a specified investment if all of the following apply:

• The investment is denominated in sterling and any payments or repayments in the respect of the investment are payable only in sterling.

• The investment is not a long term investment. This means that the local authority has contractual right to repayment within 12 months, either because that is the expiry term of the investment or through a non-conditional option.

• The making of the investment is not defined as capital expenditure by virtue of Regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [as amended].

• The investment is made with a body or in an investment scheme described as high quality (see paragraph 33 or with one of the following bodies:

i. The United Kingdom Government;

ii. A local authority in England or Wales (as defined in section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland; or

iii. A parish council or community council.

32. For the purposes of paragraph 32 the Strategy should define high credit quality. Where this definition incorporates ratings provided by credit rating agencies paragraph 42 is relevant.

<u>Loans</u>

33. A local authority may choose to make loans to local enterprises, local charities, wholly owned companies and joint ventures as part of a wider strategy for local economic growth even though those loans may not all be seen as prudent if adopting a narrow definition of prioritising security and liquidity.

34. Local authorities can make such loans whilst continuing to have regard to this guidance if they can demonstrate in their Strategy that:

• Total financial exposure to these type of loans is proportionate;

• They have used an allowed "expected credit loss" model for loans and receivables as set out in International Financial Reporting Standard (IFRS) 9 Financial Instruments as adopted by proper practices to measure the credit risk of their loan portfolio;

• They have appropriate credit control arrangements to recover overdue repayments in place; and

• The local authority has formally agreed the total level of loans by type that it is willing to make and their total loan book is within their self-assessed limit.

<u>Non-specified investments</u>

35. A non-specified investment is any financial investment that is not a loan and does not meet the criteria to be treated as a specified investment.

36. For non-specified investments (i.e. those not meeting the criteria in paragraph 31), the Strategy should:

• Set out procedures for determining which categories of investments may be prudently used (and where these procedures involve the use of credit ratings, paragraph 32 is relevant).

• Identify which categories of investments have been defined as suitable for use.

• State the upper limits for the maximum amounts both individually and cumulatively that may be held in each identified category and for the overall amount held in non-specified investments and confirm that investments made have remained within those limits.

Non-financial investments

37. As defined in paragraph 4 of this guidance non-financial investments are non-financial assets that the organisation holds primarily or partially to generate a profit. Where a local authority holds a non-financial investment, it will normally have a physical asset that can be realised to recoup the capital invested. Local authorities should consider whether the asset retains sufficient value to provide security of investment using the fair value model in International Accounting Standard 40: Investment Property as adapted by proper practices.

38. Where the fair value of non-financial investments is sufficient to provide security against loss, the Strategy should include a statement that a fair value assessment has been made within the past twelve months, and that the underlying assets provide security for capital investment.

39. Where the fair value of non-financial investments is no longer sufficient to provide security against loss, the Strategy should provide detail of the mitigating actions that the local authority is taking or proposes to take to protect the capital invested.

40. Where a local authority recognises a loss in the fair value of a non-financial investment as part of the year end accounts preparation and audit process, an updated Strategy should be presented to full council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

Risk Assessment

41. The Strategy should state the local authority's approach to assessing risk of loss before entering into and whilst holding an investment, making clear in particular:

• How it has assessed the market that it is/will be competing in, the nature and level of competition, how it thinks that the market/customer needs will evolve over time, barriers to entry and exit and any ongoing investment requirements.

• Whether and, if so how, a local authority uses external advisors be they treasury management advisors, property investment advisors or any other relevant persons.

• How the local authority monitors and maintains the quality of advice provided by external advisors.

• To what extent, if at all, any risk assessment is based on credit ratings issued by credit ratings agencies.

• Where credit ratings are used, how frequently they are monitored and the procedures for taking action if credit ratings change.

• What other sources of information are used to assess and monitor risk.

Liquidity

42. For financial investments that are not treasury management investments or loans the Strategy should set out the procedures for determining the maximum periods for which funds may prudently be committed and state what those maximum periods are and how the local authority will stay within its stated investment limits.

43. For non-financial investments the Strategy should set out the procedures for ensuring that the funds can be accessed when they are needed, for example to repay capital borrowed. It should also state the local authority's view of the liquidity of the investments that it holds, recognising that assets can take a considerable period to sell in certain market conditions. Where local authorities hold non-financial investment portfolios they can choose to assess liquidity by class of asset or at a portfolio level if appropriate.

Proportionality

44. Where a local authority is or plans to become dependent on profit generating investment activity to achieve a balanced revenue budget, the Strategy should detail the extent to which funding expenditure to meet the service delivery objectives and/or place making role of that local authority is dependent on achieving the expected net profit. In addition, the Strategy should detail the local authority's contingency plans should it fail to achieve the expected net profit.

45. The assessment of dependence on profit generating investments and borrowing capacity allocated to funding these should be disclosed as a minimum over the life-cycle of the Medium Term Financial Plan. However, an assessment of longer term risks and opportunities is recommended.

Borrowing in advance of need

46. Authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed.

47. Where a local authority chooses to disregard the Prudential Code and this Guidance and borrows or has borrowed purely to profit from the investment of the extra sums borrowed the Strategy should explain:

• Why the local authority has decided not to have regard to this Guidance or to the Prudential Code in this instance; and

• The local authority's policies in investing the money borrowed, including management of the risks, for example, of not achieving the desired profit or borrowing costs increasing.

Capacity, skills and culture

48. The Strategy should disclose the steps taken to ensure that those elected members and statutory officers involved in the investments decision making

process have appropriate capacity, skills and information to enable them to take informed decisions as to whether to enter into a specific investment, to assess individual assessments in the context of the strategic objectives and risk profile of the local authority and to enable them to understand how the quantum of these decisions have changed the overall risk exposure of the local authority.

49. The Strategy should disclose the steps taken to ensure that those negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate.

50. Where appropriate the Strategy should comment on the corporate governance arrangements that have been put in place to ensure accountability, responsibility and authority for decision making on investment activities within the context of the local authority's corporate values.

Appendix 2 Property Investment Matrix

Criteria	Maximum score
Location	15
Tenant covenant	20
Lease terms	15
Lease length	15
Building quality	15
Tenure	10
Tenant repair obligations	10

As previously highlighted, the score for each of the criteria could be weighted at application, in order to reflect how the opportunity ranks. Table 4 below sets out details of how the weighted process could work

Excellent	5	100%
Good	4	80%
Acceptable	3	60%
Marginal	2	40%
Poor	1	20%

Based on the proposed criteria and the weighting an example of its application is set out below.

- If 'opportunity' scores 5 on a criteria it achieves 100% of the weighting – so 5 for location achieves 15 points
- If 'opportunity' scores 4 on a criteria it achieves 80% of the weighting – so 4 for location achieves 12 points
- If 'opportunity' scores 3 on a criteria it achieves 60% of the weighting – so 3 for location achieves 9 points