APPENDIX C

INVESTMENT PROPERTY STRATEGY 2024/25

Introduction

1. The Investment Property Strategy forms part of the Council’s overall Capital Investment & Treasury Management Strategy and is included with the performance monitoring and reporting procedures.

2. The returns from property investment will contribute positively towards the achievement of savings targets and budgets to enable the continued delivery and investment in key frontline services and/or the bolstering of financial reserves whilst achieving a balanced budget.

3. The Investment Property Strategy aims to provide a robust and viable framework for the acquisition of property towards the pursuance of redevelopment and regeneration opportunities that can deliver positive returns and significant benefits to our residents, businesses and communities.

4. The strategy is to set out how the Investment Property Portfolio will be managed and covers the following matters:

    - Objectives and strategic priorities for Investment Property;
    - Governance and performance reporting arrangements;
    - Risks;
    - Portfolio Mix;
    - Funding, Performance monitoring and Financial Indicators for Investment; Property
    - Investment evaluation criteria;
    - Acquisition procedure; and
    - Disposal Procedure

Background

5. The Local Government Act 2003 (the Act) and supporting regulations requires the Council to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code and MHCLG Investment Guidance (the Guidance) to ensure that the Council’s capital investment plans are affordable, prudent and sustainable.

6. The Local Government Act 1972 – Section 120 of the Local Government Act 1972 empowers local authorities to acquire by agreement “any land whether situated inside or outside their area for the purpose of any of their functions under this or any other enactment, or for the benefit, improvement or development of their area”.

7. The Localism Act 2011 – Part 1, Section 1 of the Localism Act 2011. Local Authorities are allowed to confer powers for a commercial purpose or for the benefit of the Authority, its area or residents.

Government Guidance

8. In February 2018 the Secretary of State issued new guidance on Local Government Investments (the Guidance) which widened the definition of an investment to include all the financial assets of a Local Authority as well as non-financial assets held primarily or partially to generate a profit.

9. The Guidance requires the Investment Property Strategy to be approved by Full Council on an annual basis and sets out the disclosure and reporting requirements. Any mid-year material changes will also be subject to Full Council approval. Further CIPFA guidance issued in November 2019 reinforces the need for a comprehensive Investment Property Strategy.

10. In November 2020 HM Treasury published their conclusions from the consultation regarding the use of monies lent by the Public Works Loan Board (PWLB). "In recent years a minority of local authorities have borrowed substantial sums from the PWLB to buy investment property with the primary aim of generating yield".

11. New guidelines were introduced for PWLB borrowing which excludes local authorities from all future PWLB borrowing (whatever the purpose) if any projects within an Authority's three year capital programme were for the primary purpose of generating yield. Losing access to PWLB borrowing would cause significant problems and increase costs, in particular for the funding of affordable housing development and essential works through the Housing Revenue Account. Other sources of finance are unlikely to be at such competitive levels.

12. The latest edition of the Prudential Code for Capital Finance was released in December 2021. The main elements of the Code in relation to commercial property are as follows.

    The Prudential Code determines that certain acts or practices are not prudent activity for a Local Authority and incur risk to the affordability of Local Authority investment:

    - An authority must not borrow to invest primarily for financial return;

    - It is not prudent for Local Authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority and where any financial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose.

- The UK Government's rules for access to PWLB lending at the date of this publication require statutory Chief Finance Officers to certify that their Local Authority's capital spending plans do not include the acquisition of assets primarily for yield, reflecting a view that Local Authority borrowing papers are granted to finance direct investment in local service delivery (including housing, regeneration and local infrastructure) and for cash flow management, rather than to add debt leverage to return-seeking investment activity.

Since access to the PWLB is important to ensure Local Authorities' liquidity in the long term, and leveraged investment always increases downside risks, local authorities must not borrow to fund acquisitions where obtaining financial returns is the primary aim. Authorities with existing commercial investments (including property) are not required by this Code to immediately sell these investments. However, Authorities which have an expected need to borrow should review options for exiting financial investments for commercial purposes in their annual treasury management or investment strategies. The options should include using the sale proceeds to repay debt or reduce new borrowing requirements. They should not take new borrowing if financial investments for commercial purposes can reasonably be realised instead, based on a financial appraisal which takes account of financial implications and risk reduction benefits. Authorities with commercial property may also invest in the repair, renewal and update of their existing commercial properties.

Objectives and Strategic priorities for the Property Investment Portfolio

13. The objective of the Investment Property Strategy is to establish a framework for the identification of property investments which, if acquired, would either provide economic, social and environmental benefits to residents and businesses and/or development opportunities for the District.

14. The Council has moved away from acquisitions of commercial property for yield. Nevertheless, the Investment Evaluation Criteria (Annexe A) and the Acquisition and Disposal Procedure (Annexe B) remain applicable as they cover good practice of all property purchase circumstances.

15. In delivering the strategy over the next year the following main priorities are to be used to guide the growth of the investment property portfolio:

    a) A major driver for acquisition of new investment property will be economic benefit for the residents of the Council either through protection of commercial space or employment generation/protection.
    b) Properties that have a development potential will also be considered for their long-term benefits.

    Investments will be mainly focused within the District boundary. It is not considered that there will be many opportunities for properties outside the District over the next three years of the Strategy which will align with the Council's priorities

16. Investment relating to the Strategy will be directed towards:-

Regeneration and Development Opportunities

Investment which can facilitate/generate regeneration or economic development benefits as well as positive financial returns for the Council. Financial returns for the Council may come in the form of increased business rates or New Homes Bonus where the investment is within the District.

The Contributions from Regeneration and Development Investments will include positive financial returns for the Council and may also include the following:

- Regeneration benefits for the area including employment opportunities;
- Economic benefits for the area;
- Social value improvements e.g. place-making, public realm space, pride in one's local area and surroundings; and
- Environmental improvements e.g. demolition or refurbishment of old, inefficient and/or vacant/unsightly properties.

Economic, social and environmental benefits collectively make up the strategic value of an asset, and collectively, they can drive inward private investment and prosperity for an area.

Governance and Performance

17. The Strategy and Resources Committee will be responsible for approving the strategic priorities and the arrangements set out in this policy. There will be an annual report to the Committee that will set out performance over the previous year and plans for the next.

18. Operational management, including acquisitions is to be delegated to officers acting within Financial Regulation 17 of the Council Constitution.

19. The Council recognises that investing in land and properties is a specialist and potentially complex area. The Council will require the services of professional property, legal and financial advisers, where appropriate, in order to access specialist skills and resources to inform the decision-making process associated with the strategy.

20. The lead officer for Asset Management shall lead on potential purchases and development opportunities that meet the pre-determined selection criteria contained within the strategy. The criteria to evaluate potential acquisitions is attached as **Annexe A**. The Asset Management team will identify opportunities based on the selection criteria, will co-ordinate all necessary due diligence in accordance with the Acquisition Procedure (**Annexe B**), and will present a business case for challenge and scrutiny to the relevant Committee or Chief Executive as required under Financial Regulation 17.

21. CIPFA Guidance requires that elected members and officers involved in the investment 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. In addition, it places a duty on the council to ensure that advisors negotiating deals on behalf of the Council are aware of the core principles of the prudential framework and the regulatory regime in which the Council operates.

22. The Council recognises that it is responsible for property investment decisions at all times and will ensure that undue reliance is not placed upon our external service providers.

23. The lead officer for Asset Management is to be accountable for the performance of the Investment Property Portfolio and will be charged with making recommendations to the Chief Executive for acquisitions.

24. Disposal of Investment Property assets are to be undertaken in accordance with the Council's Financial Regulations and delegated Authorities. The lead officer for Asset Management will make recommendations to the Strategy & Resources Committee and in accordance with officer delegated powers.

25. The Council's Constitution sets out delegations to Officers in respect of the acquisition and disposal of assets.

Risk Assessment

26. Property investment has its own specific risks, set out below:

    a) **Property Risks** – the property market is cyclical and is affected by the wider economic environment. There are also property risks that are specific to a building due to its location, condition and quality of the tenants. Mitigation proposed in this policy for these risks include diversifying the portfolio (portfolio mix) to include investments that perform during different cycles of the economic cycle. The evaluation criteria, diversity of location, due diligence tests, approval processes and accountability for implementation are also proposed to address property specific risks;

    b) **Financial Risks** – the primary financial risks are borrowing levels, interest rate movement, ongoing ability to service debts, the general investment market conditions and its effect on rental income. Proposals have included the creation of a fully owned subsidiary property investment company, Gryllus Property Ltd and a funding strategy that allocates debt and all associated costs to the investment property portfolio so that the net revenue benefits to the Council is transparent and can be benchmarked; and

c) **Corporate Risks** – effective delivery of the Strategy requires staff with the requisite expertise, effective arrangements for asset management and the recognition of the reputational risks that can come from inappropriate tenants and from legal and environmental breaches. In accordance with the Statement of Investment beliefs as we are investing public money we will be sensitive to the ethical considerations of local residents.

27. The Council assesses the risk of loss before entering into and whilst holding property. The approach is laid out in **Annexe A** – Investment Evaluation Criteria.

Liquidity

28. Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. The funding of long-term investments is financed by fixed long term borrowing, so that there is no short or medium-term risk to the liquidity of the Council, which would require the Council to be forced to liquidate its asset and suffer a loss nor impact upon the Council's provision of services. As these long-term investments are matched by long term borrowing, it will not be necessary to access the invested funds in an emergency. Investments in property are not undertaken unless they are secure over the medium term, have additional socio- economic benefits and the target rate of return significantly exceeds the annual cost of borrowing.

Portfolio Mix

29. The medium and long term aims of the Strategy have been adjusted following the publication of the HM Treasury consultation to:

a) Acquire properties within the District in areas with strong sustainable economic activity i.e. areas with the environmental and business activities capable of providing an economy whereby capital and rental growth over the mid to long term was possible;
b) When making investments the Strategy and Resources Committee will have regard to other economic and social benefits for the residents of Tandridge; and
c) Achieve a balanced portfolio where after 6 (was 4) years[1] no single class of property, ie retail, industrial, office and leisure is larger than 60% and none smaller than 10%, other than retail or leisure.

Contribution

30. The Council has previously invested in commercial property with the intention of making a surplus that will be spent on local services and for socio- economic benefits. The portfolio is at an early stage of development.

[1] Change made in 2020/21 Investment Property Strategy

31. Table 1 shows the properties currently held by Tandridge District Council for Investment Purposes, by type:

Property by Type	Value in Draft Accounts 31st March 2022	Value in Draft Accounts 31st March 2023
Offices & Mixed/other	£18,090,200	£16,236,300
Leisure	£978,300	£972,800
Total	**£19,068,500**	**£17,209,100**

Values taken from external annual valuations by Wilkes, Head & Eve

32. Investments held under Gryllus Holdings are reported separately.

33. Gross & Net Income from Investment Property

	2022/23 Actual	2023/24 Forecast
Gross Income	£832,215	£925,074
Net Income	£689,859	£630,976

Funding and Financial Performance of the portfolio

34. The Council will fund investment property acquisitions by utilising the most appropriate and efficient funding strategy available at the time of purchase. The Council has the option of utilising long term prudential borrowing, capital receipts or reserves. Financing decisions will link to the Council's Capital & Investment Strategy and Treasury Management Strategy.

35. All new acquisitions are to achieve an appropriate positive return net of borrowing and other costs associated with the acquisition. Properties purchased for redevelopment, refurbishment or regeneration may not provide an immediate positive return. These will be assessed through a business case and considered by Strategy & Resources Committee

36. Separate accounts are to be kept for income and expenditure in connection with investment property and are to be included in the annual report to the Strategy & Resources Committee.

37. Key Indicators have been adopted to monitor performance of the portfolio. Performance will be reported against the following indicators along with a property market narrative:

    - **Total Return** – the annual increase in capital value plus income expressed as a percentage of the previous year's capital value (adjusted to include purchases);
    - **Effective Return** – total return receivable less costs expressed as a percentage of the previous year's capital value;
    - **Growth in Asset Value** – Percentage increase per year;
    - **Income Growth** – Percentage increase in gross income per year; and

- **Vacancy Rate** – Expressed as a percentage and number of vacant units compared with total number of units. This will also be expressed in terms of lost rental. Void periods are factored into financial appraisals as part of the assessment criteria.

	2020/21	2021/22	2022/23
A) Total Return	-0.017%	-2.20%	0.2%
B) Effective Return	-0.02%	-5.93%	-3.6%
C) Growth in Asset Value	-0.05%	-6.3%	-3.4%
D) Income Growth*	n/a	n/a	-21.8%
E) Vacancy Rate	Redstone House is vacant pending sale. Quadrant House remains 33% vacant by floor area	Redstone House was sold. Quadrant House is 31% by floor area	Quadrant House vacancy was 31%

*Gross income was not reported in 2020/21 so there is not a comparator to use for 2021/22. Net income reduced by 36.3% from 2020/21 (£746,000) to 2021/22 (£475,429).

Due to a lease renewal and associated incentive in 2022/23, rental income against the portfolio dropped by c.£232k. This is expected to be recovered in 2023/24.

38. In addition to property specific performance indicators are quantitative indicators that will be reported within the Council's Capital & Investment Strategy and Treasury Management Strategy to allow Councillors and the Public to assess a local authority's total risk exposure as a result of property investment decisions.

39. The operating cost of the Council's internal Strategic Asset Management Team excluding the Housing Development Specialists is projected to be £152k (£138k in 2022/23). The costs reflect the cost of managing the Council's entire property portfolio and *functions*, not just the assets acquired under this Property Investment Strategy. Additional costs may be incurred if new commercial activity takes place. Any such costs will be factored into the financial appraisals as part of the assessment to ensure that anticipated net rates of return are achieved.

Investment Property Strategy – Annexe A

Investment Evaluation Criteria

1. As with other forms of investment at the 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 areas) will deliver long-term rental and capital growth with relatively low risk.

2. Prime property in the target region covered by this strategy will typically provide an initial yield of between 5 –7% with the additional prospect of capital growth leading to a higher total return to the Council. Equivalent /Income yields over longer periods will also be reported.

3. The four main commercial property sectors will be included (industrial, office, retail and leisure) and in turn, these will be additionally diversified on criteria including location, the lease term and lot size. This will assist in protecting the Council's overall risk return profile should an individual property investment cease to be income producing (for example, it is undergoing refurbishment or awaiting a new tenant). Residential and mixed used sites will be considered using similar criteria albeit for residential investments lease terms and repairing obligations are likely to be very different. Regeneration opportunities and potential development sites will be considered using additional criteria, including if a development appraisal shows strong potential or if there is strong asset management potential.

4. The following Criteria are to be used to make decisions on acquiring new property investment properties:

    a. **Location** – Property is categorised as prime, secondary or tertiary in terms of its location desirability. For example, a shop located in the best trading position in the town would be prime, where as a unit on a peripheral neighbourhood shopping parade would be considered tertiary;
    b. **Tenant covenant** – the financial strength of a tenant determines the security of the property is rental income. A financially weak tenant increases the likelihood that the property will fall vacant. The minimum acceptable financial strength for any given tenant will be determined through financial appraisal of company accounts and the use of appropriate methods of risk assessment and credit scoring. To minimise management and risk, the preference will be for single occupancy investments wherever possible;
    c. **Lease terms** – the lease is to be free from unencumbered/onerous terms. The lease must have mechanisms for the rent to be periodically reviewed to take into account inflation and upward market movement;
    d. **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 clause;
    e. **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 a minimum of ongoing capital expenditure;

f. **Tenure and Title** anything less than a freehold acquisition will need to be appropriately reflected in the price. The legal title is required to be clean and free from any onerous conditions;
g. **Tenant repairing obligations**. – Under a full repairing and 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 and 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 repairs are born by the tenants administered through a service charge; and
h. **Lot size** – to maintain portfolio balance the preference will be for no single property to exceed £25 million for a single let property.

5. In addition, it must -

    a. Have passed a **building and plant survey;**
    b. Show a **positive return** after making allowance for financing costs, borrowing repayments and other associated costs;
    c. Be supported by an Independent **RICS Red Book Valuation;** and
    d. Be accompanied by a **full business case report** prepared by the Executive Head of Communities and other officers where relevant.

6. Each potential property investment will undergo a quantitative and qualitative appraisal and risk assessment to establish portfolio suitability and the legal and financial implications of the purchase.

7. All due diligence findings will be included in the reporting procedure. The business case is to include reference to all areas above, the financial modelling, a risk assessment matrix and Strengths, Weaknesses, Opportunities and Threats (SWOT) analysis.

8. An investment opportunity that does not meet the minimum criteria and investment criteria may have separate investment or regeneration benefits and therefore may be considered separately under the regeneration and development stream of the strategy.

9. For a regeneration or development opportunity to be considered by the Council it must:

    a. Deliver a rate of return commensurate with the deemed level of risk associated with the investment. The financial returns from regeneration activities may be capital rather than revenue. If the returns are capital all the full costs will be capitalised; and
    b. Be accompanied by a full business case prepared by officers.

10. Some of the above criteria may be reconsidered if the property is of strategic value to the Council and has gained Strategy & Resources Committee Approval. Strategic Value may be seen where a property is close to significant Council land ownership, a property gives economic benefits through Council ownership and or there are opportunities to change the use in accordance with Council priorities.

Investment Property Strategy - Annexe B

Acquisition Procedure

1. Acquisition of new investment properties is to follow the following process:

Activity	**Acquisition Stage and Timeline Guide**
a) Property identified as a potential investment by Asset Management or by Agents b) Property to be discussed with in house Legal team for initial review c) Lead officer for Asset Management to notify Chief Executive and the Statutory Officers (includes Head of Legal & Chief Finance Officer) of potentially suitable property and summarise to seek views d) If possible, obtain desktop valuation from suitably qualified and experienced Valuer e) Review the valuation against the cost of Borrowing with Finance f) Finance to undertake search of tenant to ascertain the tenant's current financial status g) Finance to produce initial financial appraisal	Initial Review 2 to 3 weeks
h) Make offer for property, subject where appropriate to any of the following: • Contract • Approval by Chief Executive, or relevant Committee • RICS Red Book valuation carried out by external Registered Valuer (independent of introducing Agent) • Searches • Legal due diligence to include receipt and analysis of all leases to determine landlord's financial obligations • Disclosure of freehold title and review to ensure clear of any onerous restrictions. • Pre-acquisition survey by chartered building surveyor to include, if appropriate, structural, mechanical and electrical survey • Internal inspection • Valid Energy Performance Certificate • Disability Discrimination Assessment if appropriate • Environmental desktop study if search suggests one is appropriate	Under Offer 3 to 4 weeks

Activity	Acquisition Stage and Timeline Guide
• Asbestos or other contamination survey if appropriate • Resolution of any TUPE transfer implications • VAT • Insurance requirements • Tax implications If offer accepted: i) Instruct legal services to deal with contract documentation, searches and legal due diligence j) Instruct valuation k) Instruct surveys l) If appropriate based on any of the above, propose adjustment to purchase price to reflect the monetary value of any issues discovered.	
m) Complete any outstanding surveys/ M&E reports and resolve all contractual matters before exchange n) Complete TDC Strategic Asset Management Acquisition Checklist o) Complete full Business Case for approval in accordance with Financial Regulation 17. p) Following agreement of terms and before instructing exchange of contract prepare Record of Officer Delegated Decision Notice and advise Leader of the Opposition and Ward Councillors if located in the District prior to publication date q) Arrange for transfer of funds r) Arrange Insurance Cover s) Exchange Contracts, if not simultaneous with Completion	Exchange 1-2 weeks
t) Complete purchase. All Documents and Management handed over to Asset Management to take forward as appropriate.	Completion 1 day

2. Newly purchased property acquired under this strategy would be added to the existing portfolio. The Asset Management Team would undertake management to maintain and improve the performance of an investment property; or additional specialist resources may need to be brought in as required.

Disposal Procedure

3. Properties will be considered for sale based on their performance and fit for the portfolio.

4. Any property considered for sale should be appropriately marketed. If an off-market approach is made and considered the property would not be sold unless the price offered is in excess of an independent Red Book Valuation to support such a decision

5. A property will be disposed of in accordance with the Financial Regulations of the Council's Constitution and in line with the Delegated Authority provisions in place. The lead officer for Asset Management will make recommendations to the Strategy & Resources Committee and in accordance with officer delegated powers.