APPENDIX A

COMMERCIAL PROPERTY INVESTMENT STRATEGY

1.0 Introduction

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, the CIPFA Treasury Management Code of Practice (the Code) and MHCLG Investment Guidance (the Guidance) to ensure that the Council’s capital investment plans are affordable, prudent and sustainable.

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 other non-financial assets held primarily or partially to generate a profit. This wider definition includes investment property portfolios as well as loans made to wholly owned companies or associates, joint ventures or third parties. The Guidance applies for financial years commencing on or after 1 April 2018.

The Guidance requires the Strategy to be approved by Full Council on an annual basis and sets out the disclosure and reporting requirements. Any mid-year material changes to the Strategy will also be subject to Full Council approval.

The Guidance sets out the Government's position on borrowing in advance of need, which is that 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. The Council must have regard to the Guidance, but is able to depart from it where such departure can be justified.

The Council has noted and has had regard to the Guidance. It has decided to depart from the Guidance in this instance, and within the parameters set out in this Strategy, for the purposes of maintaining a robust financial position. The Council has set out within this Strategy its approach to risk and risk mitigation, including the requirement for fully tested and scrutinised business cases, due diligence indicators and regular and formal reporting and scrutiny of investment decisions and performance.

2.0 Background

Like many other local authorities the Council has accumulated significant land and property asset holdings, which are held for a number of different reasons. As at 31 March 2017 the Council owned in excess of 1,000 properties and parcels of land with a book value of £108m. 800 of these assets are let to third parties and produce an annual rent roll of circa £3m.

Current financial projections indicate that the Council will be required to make savings of at least £5.2million from its annual revenue budget over the 3 financial years to 2020/21. The Council is keen to pursue commercial opportunities to generate financial returns to support the revenue budget rather than rely purely on cuts in service.

Increasing and rationalising the Council’s existing property portfolio to generate improved yield and capital returns will form one element of the Council’s commercialisation agenda, as set out in the Council's Commercial Strategy. The returns from the Commercial Property Investment Strategy (the Strategy) will contribute positively towards the achievement of savings targets and enable the continued delivery and investment of key front line services whilst achieving a balanced budget.

The Council’s Financial Strategy factors in a net return of £600k from property investments over the period to 2021, after allowing for repayments of borrowing and financing costs.

3.0 Economic Background

Investor sentiment and property investment returns and performance are influenced by the overall political and economic background, GDP and the outlook for growth and stability trends. Economic growth, inflation, taxation, planning and land supply, the minimum wage and disruptive technologies can all influence relative sub sector performance.

The retail sub sector especially in the high street is under pressure from the growth in online and delivery which reduced investor demand and pricing but is increasing the demand for large scale distribution warehouses. After a period of rapid growth we are seeing consolidation in restaurants but the weaker pound has boosted manufacturing. Growth in the service and financial sectors has improved the outlook for offices which had a record regional take up in 2017, whilst at the same time considerable stock has been taken out of the supply chain for residential conversion.

The pricing of property and yield is related to interest rates, bonds and stock market returns. The relative illiquidity of property can be seen as a hedge against stock market falls, inflation and political instability. Overseas investors who accounted for approx. 50% of transactions in 2017, pension funds and insurance companies seek prime property investment for the same reasons that Councils have been moving into the market - for long term, well let secure property investments with a positive yield gap over bonds and the cost of money.

Current rental growth prospects are at or below inflation but capital values grew by some 5.5% in 2017 so that together with initial yields the “all property” annual total return for 2017 was some 11.2%.

The outlook for 2018 is a continuation of the sub sector trends of last year, a relative lack of supply of prime quality property investments in relation to the weight of money seeking them from UK and overseas investors but the overall property return is likely to slow after last year’s surge. However the property sector will still provide strong fundamentals for the long term.

4.0 The Strategy

The Strategy aims to provide a robust and viable framework for the acquisition of commercial property investments and pursuance of redevelopment and regeneration opportunities that can deliver positive financial returns for the Council.

Investments will be focussed within the Borough and adjoining and overlapping Humber, North Yorkshire and Leeds City LEP areas as shown in Appendix A4.

Investment relating to the Strategy will be directed towards two streams of activity:

Stream 1

Prime and close to prime commercial real estate investment let on long leases to good covenants which will provide a secure long term income over and above their ability to pay back the purchase price debt.

The contributions from Stream 1 investments will include:

- Yield / profit
- Long term capital uplift

Stream 2

Investment which can 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 income or New Homes Bonus where the investment is within the Borough.

The contributions from Stream 2 investments will include positive financial returns for the Council, and may also include the following:

- Regeneration benefits for the area
- Economic benefits for the area
- A response to local market failure

The investment assessment criteria for both streams are shown in Appendices A1 and A2

5.0 Financing the Strategy

The Council will fund the 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 prudential borrowing, capital receipts, reserves and may consider other structures such as income strips. Financing decisions will link to the Council's Financial Strategy and Treasury Management Strategy.

Capital receipts may be obtained through the rationalisation of the Councils existing investment property portfolio. Performance of assets will be considered and, where appropriate, properties will be disposed of. The disposal proceeds can then be utilised to invest in other income generating properties that deliver higher financial returns.

The use of capital receipts will result in the Council being able to generate a greater net return from investments as there would not be a need to provide for interest and minimum revenue provision within the General Fund.

6.0 Governance Arrangements

It is necessary to have a framework for determining which properties and development opportunities should be invested in.

A dedicated Officer level Property Selection Team (PST) will be formed and structured as outlined in Appendix A3. This team will advise a Property Investment Governance Board (PIGB) on potential purchases and development opportunities that meet the pre-determined selection criteria contained within the Strategy. The PST will identify investment opportunities based on the selection criteria set out in this Strategy, will carry out all necessary due diligence and will present a full business case to the PIGB for challenge.

The structure of the PIGB is also outlined in Appendix A3. The purpose of the PIGB is to challenge and scrutinise investment opportunities identified by the PST, ensuring that only credible options are progressed, and providing the forum for the strategic management of the overall portfolio of investments, consistent with the aims of the Strategy.

The PIGB will be advisory in nature and will assist the Commercial Director in his decision making by reviewing, challenging and recommending to him the progression or rejection of property investments.

In order to enable the timely and decisive decision making at Director level which is essential in this type of industry, to respond to opportunities as they arise, all executive decisions on investments associated with this Strategy shall be delegated to the Commercial Director.

Decisions of the Commercial Director will be subject to fulfilment of the minimum criteria set out within the Strategy, satisfaction with the business case and risk assessment, and will have regard to the recommendation of the PIGB.

Acquisitions and development opportunities that do not meet the minimum criteria set out within the Strategy may still be considered where they would bring other compelling benefits to the Borough, but would require approval of the Leader.

Further oversight and scrutiny will be provided by Audit Committee.

7.0 Capacity, Skills and Use of External Advisors

The Guidance requires that elected members and 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. 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.

The Council will appoint specialist advisors to provide training to ensure that relevant officers and members have the required skills to make informed decisions and assess the associated risks. This training will take place before any investment decisions associated with the Strategy are considered. The Property Selection Team includes representatives from Legal Services and Corporate Finance, who will ensure that advisors and officers negotiating deals are aware of the Council’s financial and regulatory frameworks.

The Council recognises that investing in land and properties to generate yield and capital returns is a specialist and potentially complex area. The Council will engage the services of professional property, legal and financial advisors, where appropriate, in order to access specialist skills and resources to inform the decision making process associated with this Strategy.

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.

8.0 Prudential Indicators

The Guidance requires local authorities to develop quantitative indicators that allow Councillors and the public to assess a local authority's total risk exposure as a result of commercial property investment decisions.

The indicators associated with the Council's proposed Commercial Property Investment Strategy are detailed below.

8.1 Debt to Net Service Expenditure (NSE) Ratio

This indicator measures the gross debt associated with Commercial Property Investments as a percentage of the Council's net service expenditure, where net service expenditure is a proxy for the size and financial strength of a local authority.

	2018/19 Estimate £'000	**2019/20 Estimate £'000**	**2020/21 Estimate £'000**	**Limit**
Gross Debt	30,000	30,000	30,000	
NSE	14,397	14,373	13,763	
Debt to NSE Ratio	**208%**	**209%**	**218%**	**300%**

The indicator shows that the debt level proposed by the Strategy will be approximately 2 times the level of the Council's net revenue budget if the proposed £30m investment in the Strategy is funded solely from borrowing.

Given that the Strategy will take the risk profile of investments into account in the decision making process and the Council sees property investments as a long term investment this ratio is considered to be reasonable.

A maximum limit of 300% has been set for this indicator.

8.2 Commercial Income to NSE Ratio

This indicator measures the Council's dependence on the income from commercial property investments to deliver core services.

	2018/19 Estimate £'000	**2019/20 Estimate £'000**	**2020/21 Estimate £'000**	**Limit**
Commercial Income	1,845	1,845	1,845	
NSE	14,397	14,373	13,763	
Commercial Income to				

NSE Ratio	**13%**	**13%**	**13%**	**20%**

The income generated from the investments set out within this Strategy will fund 13% of the Council's Net Service Expenditure in 2018/19. This ratio is considered reasonable.

A maximum limit of 20% has been set for this indicator.

8.3 Investment Cover Ratio

This indicator measures the total net income from property investments compared to interest expense.

	2018/19 Estimate	**2019/20 Estimate**	**2020/21 Estimate**
Investment Cover Ratio	2.3	2.3	2.3

The indicator shows that the net income from property investments is expected to be 2.3 times higher than the anticipated interest expense.

8.4 Loan to Value Ratio

This indicator measures the amount of debt compared to the total asset value. In the period immediately after purchase it is normal for the directly attributable costs of purchasing commercial property investments to be greater than the realisable value of the asset (e.g. because of non-value adding costs such as stamp duty). The gradual decrease in the loan to value ratio reflects that property values are expected to remain constant, however borrowings will be repaid.

	2018/19 Estimate	**2019/20 Estimate**	**2020/21 Estimate**
Loan to Value Ratio	1.06	1.04	1.03

Each year the Council will assess whether assets purchased via the Strategy retain sufficient value to provide security of investment using the fair value model in International Accounting Standard 40: Investment Property. If the fair value of assets is not sufficient to provide security for the capital investment the Strategy will provide detail of the mitigating actions that are being taken, or are proposed to be taken, to protect capital investment.

8.5 Target Income Returns

This indicator shows net revenue income compared to equity and is a measure of achievement of the property portfolio. The net return is shown after making allowance for financing and borrowing repayment costs.

	2018/19 Estimate	**2019/20 Estimate**	**2020/21 Estimate**
Target income returns	2%	2%	2%

8.6 Gross and Net Income

	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
Gross Income	£1,845	£1,845	£1,845
Net Income	£600	£600	£600

The net income target of £600k from Commercial Property Investments is incorporated into the Council's financial projections for the period up to 2021. This saving will need to be delivered if current service delivery is to be maintained by the Council.

The non-achievement of this saving will require the identification of alternative savings proposals, which may result in cuts in service.

The achievement of the target savings required from the Strategy will be closely monitored as part of the Council's standard budget monitoring process.

8.7 Operating Costs

	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
Operating Costs	£200	£200	£200

The above operating costs relate to the cost of the Council's internal Estates and Strategic Land team. The costs shown reflect the cost of managing the Council's entire property portfolio, not just the assets acquired under this Commercial property Investment Strategy.

Additional operating costs may be incurred as a result of the purchase of Commercial Investment Properties. Any such costs will be factored into the financial appraisals as part of the purchase assessment to ensure that target net rates of return are achieved. This indicator may therefore be revised once investments are made.

8.8 Vacancy Levels and Tenant Exposures

This indicator measures and sets targets for the void periods within the property portfolio.

	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Void periods	0%	0%	0%

The target of 0% reflects the strong tenant covenant strengths that will be required under the Stream 1 investment criteria. Void periods will be factored into the financial appraisals as part of the assessment criteria where relevant, therefore this indicator may be revised once investments are made.

Appendix A1

PROPERTY INVESTMENT STREAM 1

1.0 Objective

The objective of the Stream 1 investment criteria is to establish a framework for the identification of commercial property investments which, if acquired, would provide the Council with a positive rental return and capital growth.

The investment criteria are designed to ensure that funds are invested in properties that deliver yield and security commensurate with the Council's risk appetite.

Each potential investment will be evaluated to ensure the income received is sufficient to provide an acceptable rate of return following the payment of borrowing costs, acquisition costs, management fees and any running costs.

Purchases will take regard of the need to diversify the Council's property portfolio to manage risks across the entire portfolio.

2.0 Market Analysis and Background

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 long term rental and capital growth with relatively low risk. Prime property in the target regions 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.

The Strategy will adopt the same underlying principle of diversification in acquiring property investments offering a similar return profile. The three main property sectors will be included (industrial, office and retail) and in turn, these will be additionally diversified on criteria including location, the lease term and lot size. When added to the existing portfolio this will assist in protecting the Councils overall risk and return profile should an individual property investment cease to be income producing (for example, it is undergoing refurbishment or awaiting a new tenant).

3.0 Property Acquisition Methodology

Identification, consideration and recommendation of assets suitable for acquisition will be undertaken by a suitably qualified member of Estates and Strategic Land in conjunction with outside specialist guidance and support, procured in accordance with the Council's Contract Procedure Rules

Estates and Strategic Land and appointed agents will undertake a search of the market which will include approaches and introductions of opportunities direct from the sellers, their agents and third parties.

Introductions from third party agents will be accepted on a first come first serve basis by verbal or written communication to Estates. If after the introduction the Council wishes to pursue the purchase further written agreement on the "basis of engagement" and fees will be required.

The use of independent consultants will be required to assess properties prior to bidding and any purchase will be subject to due diligence on all physical, financial and legal aspects of the property to address its suitability as an asset for long term security and growth.

All investments considered for purchase will undergo qualitative and quantitative appraisal to establish portfolio suitability which will consider rental levels, location, property type, rent review and lease expiry pattern, tenant(s), industry sector, tenure, lease covenants, market exit constraints and physical and environmental factors. In addition 3rd party advice will be called upon where specialist market knowledge is required.

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. Staffing resources will need to be made available in order to source suitable property assets for acquisition that match the criteria set under the Strategy. This can be done by both recruitment into the existing Estates team and by employing additional external expertise as required.

4.0 Minimum Investment Criteria

For a Stream 1 property investment to be considered by the PIGB for recommendation to the Commercial Director it must:-

1. Achieve a minimum weighted score of 100 from the investment criteria matrix shown in Appendix A1.1;
2. Have an initial net yield of 2% after making allowance for financing costs, borrowing repayments and other associated costs;
3. Be accompanied by a full business case prepared by the Property Selection Team.

Each potential property investment will undergo a qualitative and quantitative appraisal and risk assessment to establish portfolio suitability and the legal and financial implications of the purchase. The findings of these appraisals will be reported to the PIGB as part of the business case. Appendix A1.2 details the specific areas that will be included in the business case as a minimum.

All acquisitions, where relevant, will be subject to building and plant survey, independent advice and valuation.

An investment opportunity that does not meet the minimum criteria under investment stream 1 may have separate investment or regeneration benefits and therefore may be considered separately under Stream 2 of the strategy.

5.0 Risk Management

5.1 Financing Risk

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 Stream 1 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.

Where the purchase of a property is reliant on increases in borrowing the business case will factor in fixed rate borrowing costs. By utilising fixed rate borrowing options the Council will be protected from future increases in financing costs.

5.2 **Portfolio Risk – void periods**

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 in accordance with the Council's adopted PAMS. The investment criteria specified in the scoring matrix will tend to favour secure property investments i.e. high quality buildings in prime locations, thus mitigating the risk of void periods on re-letting.

Void periods for commercial investment properties acquired under this Strategy will be monitored and vacancy levels will be reported to the PIGB and Audit Committee throughout the year so that they can be actively managed.

6.0 Portfolio Management

Newly purchased property acquired under this Strategy would be added to the existing portfolio and Asset Management and Estates and Strategic Land would undertake asset and property management to maintain and improve the performance of an investment property; or additional specialist resources may need to be bought in as necessary. This would include ensuring statutory and regulatory compliance, tenant compliance, landlord responsibilities, securing receipt of rents, dealing with voids and insurance matters. The costs associated with these areas would be considered in the financial appraisal for the property acquisition.

The property asset management will be subject to an annual review and incorporated within the Property Asset Management Plan (PAM) which is presented to Full Council annually.

APPENDIX A 1.1

Stream 1 Investment Criteria Matrix

The PST will score the property against the scoring criteria shown below in order of priority. The minimum score for Stream 1 should be at least 100 out of a maximum score of 184; this is equivalent to at least the 54th percentile of the maximum. There will however always be a trade-off between the level of return and the score. For example, a high return would reflect higher risk and consequently a lower score; conversely, a lower level of return would reflect a lower level of risk and a higher score.

The table below shows the suggested scoring criteria to be applied when considering an investment property under stream 1.

Score		**4**	**3**	**2**	**1**	**0**
SCORING CRITERIA	**Weighting Factor**	**Excellent / very good**	**Good**	**Acceptable**	**Marginal**	**Unacceptable**
Location	**12**	Major prime	Micro prime	Major secondary	Micro secondary	Tertiary
Tenancy strength	**10**	Single tenant with strong financial covenant	Single tenant with good financial covenant	Multiple tenants with strong financial covenant	Multiple tenants with good financial covenant	Tenants with poor financial covenant strength
Tenure	**9**	Freehold	Lease 125 years plus	Lease between 50 & 125 years	Lease between 20 & 50 years	Lease less than 20 years
Occupiers lease length	**5**	Greater than 10 years	Between 7 and 10 years	Between 4 & 7 years	Between 2 & 4 years	Less than 2 years; vacant
Building Quality/ Obsolescence	**4**	Newly Built	Recently Refurbished	Average condition and likely to continue to be fit for current use for 25+ years	Aged property with redevelopment potential	Nearing end of useful life/use unlikely to continue when lease expires
Repairing terms	**4**	Full repairing & insuring	Internal repairing - 100% recoverable	Internal repairing - partially recoverable	Internal repairing - non recoverable	Landlord
Lot size	**2**	Between £6m and £12m	Between £4m & £6m or £12m & £18m	Between £2m & £4m or £18m & £20m	Between £1m & £2m or £20m & £25m	Less than £1m or more than £25m

- **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 a town would be prime, whereas a unit on a peripheral neighbourhood shopping parade would be considered tertiary.
- **Tenant Covenant –** the financial strength of a tenant determines the security of the property's 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.
- **Lease Terms –** Is the lease free from unencumbered/onerous terms? Is the rent periodically reviewed to take into account inflation and upward market movement?
- **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).
- **Lot Size –** to maintain portfolio balance the preference will be for no single property investment to exceed £10m for a single let property.

In addition to the above criteria the PIGB and the Commercial Director should, when assessing the merits of an investment, specifically consider compatibility with all SBC policies on matters relating to use such as:-:

- Alcohol or tobacco production or sale;
- Animal exploitation;
- Environmentally damaging practices;
- Gambling;
- Pornography.

APPENDIX A1.2

Stream 1 Business Case

The PST will prepare a business case for Stream 1 investments where the minimum weighted score target has been met. The business case will include the following as a minimum:

Financial Appraisal

A detailed financial appraisal setting out the projected income and costs associated with a potential acquisition along with an assessment of the proposed financing options and associated risks and considerations.

Lease Classification

A lease should be classified, for accounting purposes, as an operating lease rather than finance lease, to ensure that all rental income can be treated as revenue income (rather than a mix of capital receipt and revenue income). Operating leases are those where the risks and rewards of ownership are retained by the lessor (the Council) and must meet certain criteria. The main criteria being that the lease term should not be for the major part of the property's economic life and at the start of the lease, the total value of minimum lease payments (rents) should not amount to a significant proportion of the value of the property.

Risk Management Assessment

A detailed risk assessment of the potential purchase, including but not limited to:

Specific risks associated with individual assets:

- Tenant default on rental payment (covenant risk)
- Risk of failure to re-let (void risks)
- Costs of ownership and management
- Differing lease structures (e.g. rent review structure, lease breaks).
- Sector risk (portfolio spread)

Market Risks, including risks of structural change or market failure, which may affect the market as a whole or particular subsectors or groups of property:

- Illiquidity upon sale (e.g. lot size, transaction times, availability of finance)
- Failure to meet market rental expectations (forecast rental growth)
- Failure to meet market yield expectations (forecast yield shift)
- Risk of locational, economic, physical and functional depreciation through structural change
- Risks associated with legislative change (e.g. planning or changes in fiscal policy)

Portfolio Assessment

An assessment to establish suitability against the Council's existing property portfolio which will consider rental levels, location, property type, rent review and lease expiry patterns, industry sector, tenure, lease covenants, market exit constraints and physical and environmental factors.

Report on Title

APPENDIX A2

PROPERTY INVESTMENT STREAM 2

1.0 Objective

The objective of the Stream 2 investment criteria is to establish a framework for the identification of properties or land for redevelopment. These opportunities may deliver regeneration or economic development benefits **as well as** positive financial returns for the Council in the form of future revenue income streams or capital uplifts. Future revenue income streams could include increases in retained business rates income and New Homes Bonus.

Developed properties may be retained for the benefit of their long-term rental income and will become an investment asset after completion.

The Stream 2 investment criteria will be designed to ensure that the financial returns delivered from investments are commensurate with the deemed levels of associated risk. A higher risk investment will therefore require the delivery of greater financial returns.

2.0 Market Analysis and Background

Stream 2 investment opportunities could come in a diverse range of forms. Examples include, but are not limited to:

- Redeveloping Council owned assets;
- Building homes and commercial premises;
- Using public land and buildings to achieve long term socio economic sustainability for the Borough and wider LEP areas;

As with other forms of investment there is a trade-off between risk and return. Given the more speculative nature of this type of investment activity the risks associated with this type of investment may, in some cases, be higher than those associated with Stream 1 activity. It may be possible to share risks and rewards of stream 2 activities with adjoining councils and other public sector and private sector partners.

The assessment criteria for Stream 2 activities needs to be agile enough to allow significantly different schemes to be assessed using the same overarching principles.

3.0 Minimum Investment Criteria

For a Stream 2 property investment to be considered by the PIGB and the Commercial Director it must:-

1. Deliver a rate of return commensurate with the deemed level of risk associated with the investment;
2. Be accompanied by a full business case prepared by the Property Selection Team, and other officers where relevant.

The investment opportunities considered under Stream 2 could vary significantly and, due to the speculative nature of some schemes, there will be higher risks attached to some investment opportunities.

A scoring matrix will be developed for Stream 2 activities to set target rates of return for investments dependent on the levels of deemed risks involved with the activity. Schemes with higher risks will be expected to deliver higher levels of return to cover the risk considerations, and only schemes that deliver the assessed rate of return will pass the minimum assessment criteria.

The minimum net rate of return for a low risk Stream 2 investment would be the 2% required to deliver the savings attached to the Investment Strategy, after making allowance for financing costs and borrowing repayment costs. A high risk scheme, for example, may be required to achieve a return of up to 20%.

It is proposed that the scoring matrix for Stream 2 schemes be approved by the Audit Committee prior to any Stream 2 schemes being approved or considered by the PIGB. Once approved the scoring and risk matrix will be attached to this Strategy at Appendix A2.1.

Each potential Stream 2 investment will undergo a qualitative and quantitative appraisal and risk assessment to establish the financial returns, financial and legal implications and risks associated with the purchase. The findings of these appraisals will be reported to the PIGB as part of the business case.

An investment opportunity that does not meet the minimum criteria under investment stream 2 may have separate investment or regeneration benefits and therefore may still be considered for progression however decision making in this case is to be reserved to the Leader of the Council rather than the Commercial Director.

4.0 Acquisition / Development Methodology

Identification, consideration and recommendation of assets suitable for acquisition and / or development will be undertaken by a suitably qualified member of Estates and Strategic Land in conjunction with internal and external specialist guidance and support.

All investments considered for purchase will undergo qualitative and quantitative appraisals to establish financial suitability and risks. In addition 3rd party advice will be called upon where specialist market knowledge is required.

5.0 Risk Management

5.1 Financing Risk

As with all investments, there are risks that capital values, rental values and development values can fall as well as rise. Where the acquisition or development is reliant on increases in borrowing the business case will factor in fixed rate borrowing costs commensurate with the anticipated holding period of the asset. By utilising fixed rate borrowing options the Council will be protected from future increases in financing costs.

Financial returns from Stream 2 activities may come in the form of capital receipts rather than revenue returns. This would need to be considered carefully as part of the overall Strategy given the requirement to achieve net revenue returns of 2% from the investment. The returns linked with this Strategy will be carefully managed and monitored as part of the Council’s budget monitoring framework and there will be clear links between this Strategy and the Financial Strategy.

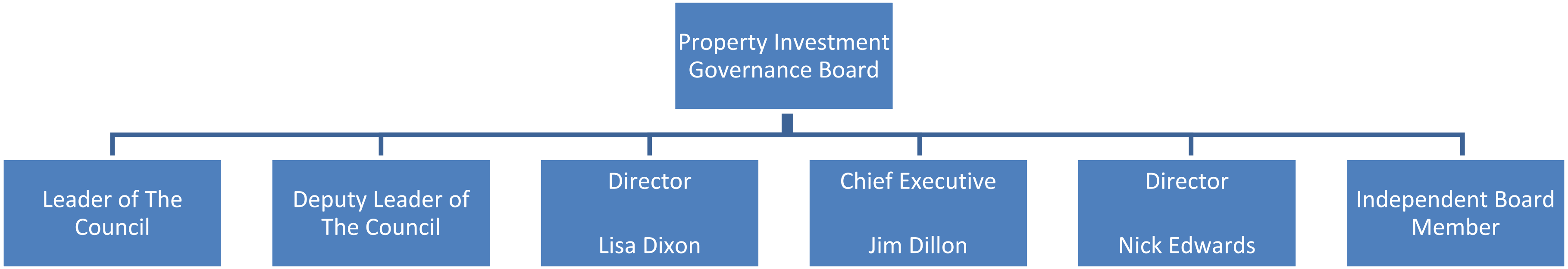
APPENDIX A2.1

Stream 2 – Risk / Rate of Return Matrix

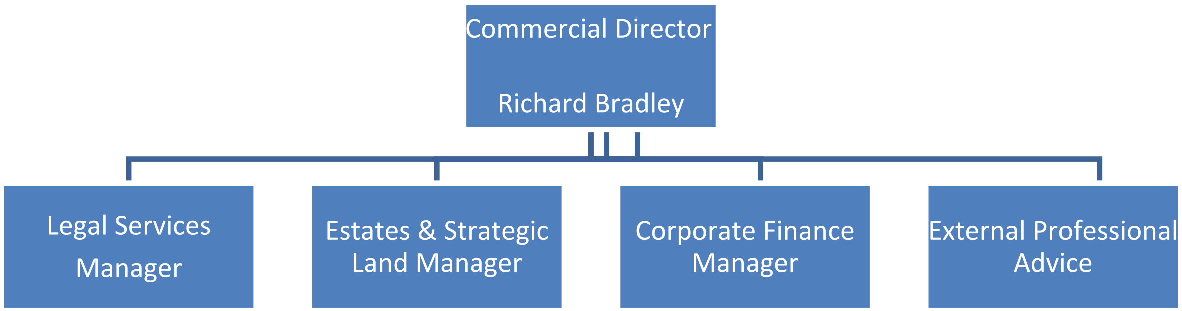
[To be inserted once approved by Audit Committee]

APPENDIX A3

PROPERTY INVESTMENT GOVERNANCE BOARD STRUCTURE



PROPERTY SELECTION TEAM STRUCTURE



APPENDIX A4

Commercial Property Investment Target Area

Adjoining and Overlapping LEP areas

North Yorkshire, Yorks & East Yorkshire LEP – 38

Humber LEP – 18

Leeds City Region LEP - 20