

Bid for Funding



Project Name:	Property Acquisition Fund		
Project Code:	2019	TBA	
Project Description:	To set up a strategy for buying new and investing in existing assets within the Guildford borough to increase income generated and stimulate and encourage business growth and sustainable development by investing in key strategic sites.		
Project / Programme Manager:	Melissa Bromham	Ward:	N/A
Senior Responsible Officer:	Marieke van der Reijden	Directorate:	Community Services
Lead Councillor:	Joss Bigmore	Service:	Corporate Property
Corporate Plan Theme:	Innovation	Confidential:	No
Expected Start Date:	01/04/2020	Exempt VAT Implications:	Yes
Target Completion Date:	31/03/2022		

Section A – Strategic Content

<p>A01. What is the project trying to achieve?</p>	<p>INTRODUCTION</p> <p>The Council's updated budget projections show that there is a budget shortfall of £10.4m over the next three years (2020-21 to 2022-23).</p> <p>The capital outturn report 2018-19 reported that for the financial year the Council's total investments of £97.32m achieved a return of 1.42%. The Council's direct property investments of £161m, however, achieved a return (net of costs) of 6.3%</p> <p>This bid proposes the creation of a property investment fund of £40million to be invested as outlined in a new property investment strategy, which will allow decisions to be delegated to officers (in consultation with the Lead Member for Finance and Asset Management) within set parameters.</p> <p>The objective of creating a new property investment strategy/fund is to help bridge the funding shortfall with the financial aim of investing in property in order to increase the rental income stream for the Council and to stimulate and encourage business growth and sustainable development by investing in key strategic sites.</p> <p>The Council's Capital and Investment Strategy 2018-19 to 2021-22 outlines the Council's strategy for overall investments and treasury management. This proposal is in line with the aspirations set out in that strategy.</p> <p>Since the conclusion of the previous Asset Investment Strategy and Business Case in 2016, with a final spend of £57 million, the Council have continued to acquire properties on an ad-hoc basis including the following:</p>
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Property	Interest	Date of completion	Price paid	Previous rent pa	Current/ projected rent pa
Midleton 9	Leasehold (to merge Freehold)	24/03/2017	£500,000	£16,920	£60,000
Slyfield, Moorfield Road, 41 (Moorfield Point)	Leasehold (to merge Freehold)	04/12/2018	£1,459,000	£221,000	£357,534
Woodbridge Meadows, 23 (Argol House)	Leasehold (to merge Freehold)	05/02/2019	£829,806	£7,225	£65,000
1 & 2 Thornberry Way (The Hub & the Rock)	Leasehold (to merge Freehold)	13/08/2019	£6,550,000	£51,570	£515,000
			£9,338,806	£296,715	£997,534

CURRENT PROPERTY FUND PERFORMANCE

The current Fund comprises 159 assets in the principal commercial property sectors: office, retail, industrial and alternatives (hotels, car showrooms, petrol stations, leisure, etc.).

The current fund size is £161 million with rental income of over £9.2 million pa. This produces a very high yield of 6.3% net of costs/voids.

The fund has performed better than the UK benchmark in every sector.

The Investment Property Fund aims to provide an above average and secure income return with the prospect of income growth and to maintain the capital value of the properties held in the Fund. This is achieved by keeping vacancy rates low (current vacancy rate of 0.78%) and associated costs to a minimum and by generating income growth through rental increases, refurbishments, active asset management and new lettings, as well as investing in a diversified commercial property portfolio.

Please see [Appendix 1 – GBC Investment Portfolio Annual Report](#)

PROPOSAL

The proposal is to set up a fund of £40 million to be invested in property as outlined in a new property investment strategy, which will allow decisions to be delegated to officers within set parameters.

Officers often become aware of key potential acquisitions but, because there is currently no budget or agreed strategy for acquisitions, cannot act quickly enough to compete with institutional investors to secure opportunities. Having a property investment strategy and budget already approved will enable the timely and decisive decision making that is essential in this type of market to respond to opportunities as they arise.

The proposed 2020 property investment strategy will provide a robust and viable framework for the acquisition of commercial properties located within the borough. This will direct investment in assets that local businesses occupy as well as those nationally or internationally that contribute to growth in the local economy.

The property investment strategy will provide continual evaluation of the property investment portfolio to meet the Council's priorities and ensure it is fit for purpose. A larger and more balanced portfolio will help achieve the Council's aim of increasing income to support the delivery of services throughout the borough.

The investment strategy will have a framework for determining which properties should be invested in and over the following main areas (in more extensive detail):

1. Methods of acquisition

The Council can increase its exposure to property investments in a variety of ways.

The Council may hold property assets directly or indirectly. Direct property investment gives the Council full control over the property and responsibility for its management. Indirect property investment would take the form of either setting up a wholly owned local authority trading company or forming a joint venture with another property investment company.

The holding of property assets in a wholly owned property company would enable greater freedom and flexibility of the decision making process and the ability to trade assets. This could potentially deliver higher levels of net returns. However, there are significant risks and set up costs involved, the company would be subject to corporation tax and incur higher financing costs than if the asset investment programme is undertaken directly. The Council would also need to be aware of state aid issues in relation to the funding of the company. Although there is potential for higher returns, there is also the potential for significant losses.

Officers recommend that direct property acquisition gives the Council the optimum balance of return, risk and control, subject to available funding and will contribute the strategic properties set out in our corporate plan for Economy.

2. Criteria for Selection

Investment property acquisitions need to be subject to the agreed parameters of the property investment strategy. This will be set by the Council's 'Investment Property Fund Management Group' (IPFMG) which includes the Director of Finance, Financial Services Manager, Corporate Property Manager, Investment Property Manager and Property Surveyors. There will be pass and fail criteria as below:

- A minimum net Initial yield (NIY) (return less purchase costs including SDLT);
- A minimum internal rate of return (IRR), which will allow for rental growth, void periods, refurbishment costs, financing costs, etc.
- The lease should also be classified, for accounting purposes, as an operating lease rather than a finance lease to ensure that all rental income can be treated as revenue income.

Other criteria will be in the form of a matrix and be similar to those agreed by the Executive in July 2014 (below), although Building Condition/required capital expenditure may become an additional criteria.

SCORING CRITERIA	Score	4	3	2	1	0
	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

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

In addition to the above criteria, the IPFMG will also have consideration to the Council's policies in terms of climate change and ethical investments.

3. Conditions to purchase

All investments will be approved on the basis of a robust business case which will give due consideration to the balance between risk and reward, an assessment of the underlying security of the investment, and potential exit strategies. As a minimum this will include:

- a purchase report (including details of the opportunity, location, age, tenure, lettings, etc.);
- an investment matrix (a score matrix based on the chosen criteria); and
- a financial analysis (a cashflow analysis demonstration the long term income and costs based on a number of scenarios).

Acquisitions will also be conditional on full due diligence, including:

- full title report;
- an independent surveyor's valuation of the property and detailed purchase report to support the purchase price; and
- satisfactory surveys.

4. Knowledge and skills

The Council recognises that investing in properties to generate yield and capital returns is a specialist and potentially complex area. However, the Council is satisfied that we currently have internal staff with the requisite skills and experience to undertake these investments. The Council will also engage the services of professional property, legal and financial advisors, where appropriate, to access specialist skills and resources to inform the decision-making process associated with this Strategy.

The Council recognises that is responsible for property investment decisions at all times and will ensure that undue reliance is not placed upon external service providers and will maintain sufficient in-house expertise to manage the procurement of investments through the Corporate Property team.

5. Risk Management

The Council considers security, liquidity and yield when making treasury investment decisions, across the portfolio as a whole.

There are some key identifiable risks of investing in property which were highlighted in the Council's Capital and Investment Strategy 2018-19 to 2021-22. A downturn in the property market could lead to falling rents or higher vacancies meaning that rental income may not cover the borrowing costs. In addition, a downturn could lead to a fall in property values which could impact capital receipts if the Council wanted to sell property to use the receipt for other purposes.

Officers will seek to mitigate the risk by:

- preparing detailed cash flow models for each prospective investment in order to appraise the cash flow risk and the internal rate of return of the investment;
- keeping abreast of the latest property market information and using it to inform decisions;
- having a diverse investment property portfolio;
- reviewing tenant covenant strength prior to contract (including a review of the company finances and credit checks);
- requesting rent deposits where appropriate.

CURRENT PROPERTY MARKET

There is uncertainty in the current property market due to the current political environment and changing consumer spending patterns.

Cluttons IM 'Commercial Property Examiner' published in Q2 2019, explores the latest underlying economic and financial market drivers that help shape our real estate portfolio strategies.

In the medium to long-term, they continue to expect the UK's exit from the EU to reinforce the current slowdown in economic growth that will restrain rental growth and cause yields to soften. As a result, they are anticipating a gradual weakening in property values over the next three years with an average annualised total return of 4%. However, these returns should still compare favourably to both UK equities and gilts on a relative basis.

The report states that:

"the current pricing in UK real estate remains attractive relative to other asset classes.

The forward looking public real estate markets indicate that private direct property investors should be looking to sell down their exposure to retail and buy student accommodation, healthcare and logistics assets.

MSCI data indicates that All Property values contracted in Q2 for the third consecutive quarter. The capital values of all retail segments are falling. Only Industrials are benefitting from an uplift in capital values.

Rental value growth for South East Industrials is weakening but it is still strong by historical standards. However, rental values for Shopping Centres, Retail Warehouses and Shops have decreased sharply.

May's IPF Consensus forecast round continues to indicate that 2019 is expected to represent a cyclical trough.

All property performance expectations for 2019 weakened from 2.4% to 1.8% and expectations for were reduced to 3.1% from 3.5% in February. Capital values are now expected to shrink by 2% or more in both 2019 and 2020.

In the medium to long-term we continue to expect the UK's exit from the EU to entrench the current slow-down in economic growth that will restrain rental growth and cause yields to soften. Consequently, we expect a gradual weakening in property values over the next three years."

Please see the attached GBC Investment Property Fund Portfolio Annual Report for further analysis on the local property market sectors.

A02. Which strategic priorities in the Council's Corporate Plan is the project trying to achieve?

- Delivering the Guildford Borough Local Plan and providing the range of housing that people need, particularly affordable homes.
- Making travel in Guildford and across the borough easier.
- Regenerating and improving Guildford town centre and other urban areas.
- Supporting older, more vulnerable and less advantaged people in our community.
- Protecting our environment.
- Enhancing sporting, cultural, community and recreational facilities.
- Encouraging sustainable and proportionate economic growth to help provide the prosperity and employment that people need.

	<input type="checkbox"/> Creating smart places infrastructure in Guildford. <input checked="" type="checkbox"/> Using innovation, technology and new ways of working to improve value for money and efficiency in Council Services.
A03. How does it meet the strategic priorities outlined?	<p>Developing a property investment fund and strategy will contribute to the capital and investment strategy and as such, help the Council achieve financial excellence and value for money. It will enable the Council to make the best use of its resources and it therefore underpins the Council's strategic framework and the delivery of the corporate plan. It was also identified as part of the future Guildford service challenge.</p> <p>The proposed 2020 property investment strategy will focus on buying new assets located within the borough. This will direct investment in assets that local businesses occupy as well as those nationally or internationally that contribute to growth in the local economy.</p> <p>The property investment strategy will provide continual evaluation of the investment portfolio to meet the Council's priority to ensure that our property asset portfolio is fit for purpose. A larger and more balanced portfolio will help achieve the Council's aim of increasing income to support the delivery of services throughout the borough.</p> <p>The Council's strategic priorities include aspirations to regenerate and improve Guildford town centre and other urban areas, and encourage sustainable and proportionate economic growth to help provide the prosperity and employment that people need. Therefore, another major objective of the property investment strategy is to invest in assets that support the strategic priorities set out in the Corporate Plan. The strategy will recommend that officers concentrate our investment search within the borough of Guildford, particularly on assets that would provide a longer-term strategic benefit as well as financial return.</p> <p>The types of assets that are likely to meet the Council's criteria include leased properties let to local businesses, whilst being mindful of the need to retain a wide exposure to property types. The acquisition of property interest in order to consolidate leasehold and freehold ownerships (i.e. buy back in long leaseholds) will also qualify as part of the property investment strategy. In such cases, the Council will buy the asset, refurbish and upgrade them where appropriate and lease them to good quality tenants.</p>
A04. Explain the problem that is being addressed and why the project is necessary.	<p>The Council's updated budget projections show that there is a budget shortfall of £10.4m over the next three years (2020-21 to 2022-23).</p> <p>The objective of creating a new property investment strategy/fund is to help bridge the funding shortfall with the financial aim of investing in order to increase the rental income stream for the Council.</p>
A05. What are the critical success factors or KPI's of the project? ie which measures will you use to determine success?	<p>Investment property acquisitions will need to be subject to the agreed parameters of our property investment strategy. As detailed in section A01.</p>
A06. What are the expected benefits or outcomes for local	<p>The objective of creating a new property investment strategy/fund is to help bridge the funding shortfall with the financial aim of investing in order to increase the rental income stream for the Council which will enable services to continue.</p>

residents and businesses?	
A07. Outline options considered or that will be considered for delivery of the project.	See A01. In addition, officers did consider procuring an investment consultant to act on the Council's behalf. However, it was decided that this would prevent the Council from hearing about deals early or off-market through introductions unless we were to pay a double fee.
A08. Outline project dependencies eg with other projects or partner organisations.	Increasing the Council's investment portfolio will have an impact on workloads within the Corporate Property team. All assets need to be managed and maintained correctly in order to protect the Council's investment this will have a resource impact that will need to be addressed.
A09. Legal / statutory requirement ?	No
A10. Legislative / statutory implications ?	No
A11. Planning permission required?	No
A12. Building regulation required?	No
A13. Land acquisition required?	Yes
A14. Environmental consents?	No
A15. Highways / traffic consents?	No
A16. Details of other required consents.	

Section B – The Financial Case

B01. Costs

Year	Description	Capital Value (£)	Revenue Cost Centre Code	Revenue Cost Centre Name	Revenue Account Code	Revenue Account Name	Revenue Value (£)
2020/21 – 2022/23	Acquisitions and associated costs	40,000,000	N/A	N/A	N/A	N/A	N/A
Choose an item.							
Choose an item.							
Choose an item.							
Choose an item.							
Choose an item.							
Choose an item.							

B02. Costs Totals

Year	Capital Total (£)	Revenue Total (£)
2020-2023	40,000,000	/
Choose an item.		
Choose an item.		
Choose an item.		
Choose an item.		

B03. Outline the assumptions used to cost the project.

Acquisitions + standard costs of 6% (including stamp duty, legal fees, surveys SDLT, etc.)

B04. Financial Benefits eg savings or additional income

Year	Description	Capital Value (£)	Revenue Value (£)
2021/22	If the criteria allows for acquisitions at an NIY of above 4.5% there will be additional rental income in excess of £1.8. If we achieve an average NIY of 4.75% this will increase to £1.9m.		2,700,000

B05. Funding

Year	GBC Funding Request (£)	Third Party Contributions (£)	Sources of Third Party Contributions
2020/21	40,000,000	N/A	N/A

B06. Non Financial Benefits

Title	Category	Measure	Expected Delivery Date
Increased rental income	Improved Income Generation	Based on NIY	By 2023
Investing in good quality property - Less expenditure on R&M	Reduced Asset Costs	Surveys	By 2023

Section C – The Economic Case

C01. Expected number of homes brought forward.	0
C02. Expected number of jobs created.	Not quantifiable
C03. Expected amount of employment floor space delivered.	Not quantifiable

C04. Outline your assumptions in determining the economic benefits.	The Council will be directly investing in property held for employment use. This will be in assets that local businesses occupy as well as those held nationally or internationally that contribute to growth in the local economy and employment.
C05. Describe any other economic benefits.	N/A

Section D – The Commercial Case

D01. Outline any procurement requirements.	The strategy will allow for the Council to use introductory agents and pay them the normal fee (1%) or less.
D02. Outline preferred procurement route / strategy.	Exemption to procurement rules to enable the Council to take advantage of off-market deals and introductions.
D03. Outline key procurement risks.	If the Council cannot instruct an agent quickly it may lose the opportunity.

Section E – The Management Case

E01. High Level Project Timetable

Item	Stage of Project	Start Date	Finish Date
To obtain full Council approval of capital bid	Approval	25/02/2020	
To obtain sign-off of the for the Council's new property investment strategy from the Investment Property Fund Management Board	Approval	Sept 2020	Jan/Feb 2020
To obtain Executive Liaison Approval for the Council's new property investment strategy	Approval	04/03/2020	
To obtain Executive approval for the Council's new property investment strategy	Approval	24/03/2020	
To start pursuing available investments	Main project	01/04/2020	31/03/2023

E02. High Level Project Milestones

Milestone	Description	Indicative Date
N/A		

E03. Project Risks

Title	Description
Lack of properties available	Officers will try to overcome this by ensuring they maintain relationships with external agents and pay introductory fees on successful acquisitions. It has considered the use of an investment consultant but this would prevent the Council from hearing about deals from introductory agents unless it s willing to pay a double fee.
Lack of resource to asset manage portfolio	There is a concern that there may be a lack of resource in the existing team to manage the portfolio and take advantage of opportunities. Increasing the Council's investment portfolio will have an impact on workloads within the Corporate Property team. All assets need to be managed and maintained correctly in order to protect the Council's investment this will have a resource impact that will need to be addressed.
Inability to act quickly enough	Many acquisitions are completed on very tight timescales. It is hoped by having approvals already in place that the Council will be able to compete with institutional investors to take advantage of opportunities. The Council will also need to address the resource impact as above.

E04. Provide high level details of proposed project management arrangements & project team (please use post names / titles rather than	All matters are to be approved by the Lead Member for Finance and Asset Management and the IPFMG which includes the Director of Finance, Financial Services Manager, Corporate Property Manager, Investment Property Manager and Property Surveyors. If the group cannot meet in time then the matter will be signed off by the Lead Member for Finance and Asset Management, the Director of
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naming individuals).	Finance, Financial Services Manager and Corporate Property Manager. The Council will also consult with the Director of Community Services and the Council's Solicitor and Monitoring Officer
E05. Provide a brief outline of key stakeholders eg who they are and how they will be engaged.	As above
E06. Will any public consultations be required? If so, provide a brief outline.	N/A
E07. How will the project be evaluated post implementation?	By successfully investing the capital in to strong investment properties that will obtain a net return above a certain percentage (to be set by the new property investment strategy).

E08. Outline any expected formal Council / Committee / Board decisions or consultations and expected timescales.

Committee / Board	Type of Decision	Expected Date
Council	To approve bid	25/02/2020
Executive	To approve the Council's new property investment strategy	Early 2020-21
Community Executive Advisory Board	N/A	
Place making and Innovation Executive Advisory Board	N/A	
Overview and Scrutiny	N/A	
Planning	N/A	
Licensing	N/A	
Corporate Governance and Standards	N/A	