Appendix 2

December | 17

Peterborough City Council

Investment Acquisition Strategy

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PETERBOROUGH CITY COUNCIL

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1.0 SUMMARY TABLE

This table should be read in conjunction with the full text below.

Element	**Description**
Investible Funding	£70 million
Investment Period	To 31 April 2021
Investment Geography	Assets located in areas capable of being effectively managed by Peterborough City Council.
Objectives	To acquire and manage a portfolio of investments capable of providing income returns to support the Council's strategic objectives
Investment approach	Assets acquired and directly held by the Council. Investment through third parties only by exception.
Investment Selection	Acquisitions selected on the basis of: location, tenant covenant, occupier lease length, rental growth potential, building condition.
Investment diversification	Single investments capped at a maximum of 25% of the overall investment committed to the programme. By exception, cap increased to 30% for high scoring acquisitions.
Expected Portfolio Return	5% p.a. net income return on cost (before borrowing costs).
Risk Profile	When fully invested, the risk profile of the portfolio is intended to be **MODERATE.**
Frequency of Investment Strategy Review	Within the annual Growth and Regeneration Property update.

2.0 CONTEXT FOR THIS INVESTMENT STRATEGY[1]

The context for this Investment Strategy is set out in the Peterborough City Council: Asset Investment Strategy, Acquisition Strategy, Capital Programme and Disposals 2017/18-2026/27

The documents refers to the requirement for councils to move to a 'self-funding model' reflecting Government changes around reduction in grant funding and future retention of business rates.

The principle of using of property returns to fund front line services is not new with many local authorities actively involved to a greater or lesser degree for many years. However, historically acquisition of investment property by councils has not necessarily been on a structured basis. With the changing operating climate and an imperative to improve income generation there is increasingly a need to adopt more formal approaches to ensure compliance with financial statutes and a focus on the performance of the investment portfolio.

This Investment Acquisition Strategy relates specifically to the Investment Portfolio and sets out the defined strategy and acquisition framework to be adopted in order to allow the Council

[1] Extracted from Peterborough City Council: Asset Investment Strategy, Acquisition Strategy, Capital Programme and Disposals 2017/18-2026/27

to bid competitively, particularly on a timescale basis, in the open market referred to in the Asset Investment Strategy.

The Strategy sets parameters for investment allocation, geography and type of acquisition target.

3.0 INVESTMENT STRATEGY OBJECTIVES

This strategy is an integral part of the Peterborough City Council Medium Term Financial Strategy (MTFS). Over the period of the MTFS, the Council needs Asset Investment to help deliver its priorities.

This strategy is underpinned by Core Principle 1 of the Council's Asset Investment Strategy[2]:

Principle 1 – Managing the impact of investment decisions on revenue budgets

- *Ensuring Asset Investment decisions do not place any unnecessary pressure on the MTFS or Council Tax, and they are also within the Council's Prudential Indicators (see the Prudential Code and Treasury Management Strategy and Minimum Revenue Provision Policy).*
- *Promoting Asset Investment which enables invest to save outcomes.*
- *Making sure assets yield maximum return, through effective ongoing asset management, consistent with levels of investment.*

This strategy also aligns with specific aims of the Council Asset Investment Strategy, in that:

- Stakeholders can understand the Council's Asset Investment decisions and the management of its Asset Investment projects;
- Invest to save projects are encouraged;
- The Council works within the Prudential Code framework and demonstrates robust and linked Asset Investment and treasury management;
- Asset Investment spending plans are affordable, financially prudent, sustainable and integrated with the Medium Term Financial Strategy (MTFS)

In order to support the above Strategy and specific aims, the Council intends to:

- Acquire properties that provide long term investment in accordance with corporate objectives
- Maximise return whilst minimising risk through prudential management processes
- Prioritise properties that yield optimal rental growth and stable income at 5% yield net of costs
- Protect capital invested in acquired properties

This Investment Strategy shall be reviewed and revised annually to take into account advice on changing market conditions. In the review, the acquisition and scoring criteria may be amended as required.

4.0 DELEGATION OF AUTHORITY

The arrangements for delegation of authority below are consistent with the Council's Asset Investment Strategy[3].

[2] Peterborough City Council: Asset Investment Strategy, Acquisition Strategy, Capital Programme and Disposals 2017/18-2026/27

[3] Peterborough City Council: Asset Investment Strategy, Acquisition Strategy, Capital Programme and Disposals 2017/18-2026/27

All acquisitions will be undertaken using the Council's existing protocols; but there may also be specific instances where the Council has to act in a speedy and confidential manner because of market circumstances and the need for commercial confidence. Current governance arrangements provide for special urgency provisions, for example to ensure that they allow the Council to participate in the market to acquire assets in a timely, competitive and confidential way.

The Council will acquire assets where it can demonstrate that the agreed criteria are met.

The process for acquisitions will cover the stages outlined below:

1. All acquisitions will be assessed through a robust business case and with particular reference to the investment, returns, portfolio impacts and risks of the transaction and how it relates to the Council's corporate objectives.
2. In all cases, Investment advice and an independent valuation will be obtained from a properly qualified member of The Royal Institution of Chartered Surveyors to ensure that the transaction represents good value. The Council will consider whether to rely on the acquiring agent's advice or procure a third party opinion.
3. Valuation advice will be accompanied by completion of the necessary due diligence including building condition survey and reports on title. The Council will determine whether to procure a panel of surveyors and lawyers to provide this advice.
4. Acquisitions (and disposals) will, under the Council's Rules of Financial Governance require consultation with and agreement of the Section 151 Officer. In all cases, be supported by a financial appraisal providing the financial / budgetary implications. Under the Council's scheme of delegations nominated senior officers along with Corporate Management Team and/or Cabinet can approve acquisitions or disposals subject to a maximum value. These nominated officers shall comprise the "Investment Committee". That Committee shall seek external advice as required.

5.0 INVESTMENT PARAMETERS

The Investment Strategy applies to funds committed by Peterborough City Council to acquire Investment Assets as agreed by Cabinet. Specific parameters to operate within are:

5.1 Investment Allocation and Period

The initial sum allocated to the Investment Strategy is £70m and the Investment Strategy covers the commitment period to 31st April 2021.

5.2 Geographical Coverage

Assets will be located within a geographic area where:

- They are in markets that the Council has knowledge
- Are capable of being effectively managed by the Council on a day to day basis
- The economic benefit of those assets will contribute to the economic growth of Peterborough through provision of workspace, retail, leisure and homes whilst providing ongoing income to support core council services.

5.3 Project selection

Investments will be selected by reference to the framework below taking into account a range of attributes of potential acquisition targets.

These attributes fall into three categories:

1. Value for money
2. Inclusion or exclusion criteria
3. Those capable of scoring.

A. Value for Money

Attribute	Investment Impact
Price / Yield	Level of income in relation to the cost of the investment and subsequent valuations. As a guide (depending on prevailing market conditions): • Prime retail: **2-4%** • Retail / office let to strong covenant tenants with > 10 years lease remaining: **4-6%** • Prime offices or retail within established town centres: **6-8%** • Prime industrial and offices in established locations: **6-10%** • Secondary/tertiary assets – all sectors: **10-18%**

B. Inclusion or Exclusion Criteria

Attribute	Investment Impact
Tenure - must be freehold or virtual freehold (125 year lease)	The basis upon which the Council acquires the asset – freehold (ownership of the land itself and the building) gives the highest level of control to the Council.
Repairing terms – must be full repairing and insuring lease (FRI).	The Council has limited funds to invest in repairs so an obligation on the tenant to maintain the property in good order is required.
Investment size – no less than 5% and no greater than 25% of the investment allocation and by exception up to 30%	Larger investments are more efficient to assemble into a portfolio and total transaction costs are lower. The Council should consider assets up to 30% of investment allocation where those assets are deemed by the Investment Committee to represent good quality assets with low risk.
Sector – certain sectors are unsuitable for public sector investment.	There will be certain sectors that the Council may decide not to invest in. These may include: • Gaming • Tobacco • Adult entertainment • Nuclear industries • Defence • Animal testing

C. Investment Selection

Attribute	Investment Impact
1. Location	Prime locations are more likely to be resilient in terms of ability to secure stronger tenants and re-let space on good commercial terms if they become let. Prime locations in larger conurbations are most preferable given the depth of market in those areas.
2. Tenant covenant	The ability of the tenant to meet commitments under the lease and the stronger potential for renewal of the lease is something to give a high weighting to. Strongest preference is for properties let to single tenants with a strong financial covenant with multi let properties acceptable if the tenants are of strong covenant.
3. Occupiers lease length remaining	Longer leases are preferred if the tenant has a strong covenant. However, multi let buildings with shorter leases in vibrant markets can generate higher returns. Leases less than four years are likely to be unacceptable.
4. Scope for rental growth	Leases with scope for fixed or inflation-based indexation will maintain real income.
5. Building quality	New or excellent condition property is preferred as this is more likely to attract and retain tenants.

5.4 Financial assessment

Individual properties will be fully financially and physically appraised using industry standard techniques and current market benchmarks to ensure the return is acceptable for the level of overall risk. This will be specific to each and every property proposed for purchase.

Each property will also be assessed by reference to the overall portfolio balance of risk and return (income and capital). Sensitivity analysis will be undertaken to understand how different scenarios impact on the asset and the portfolio.

Further performance measurement, portfolio analysis and valuation will be undertaken during the holding period to allow for buy/sell/hold decision making.

5.5 Strategy to identify and acquire Investments

The Council's Head of Property will act as the "Investment Acquisition Surveyor" to undertake the analysis, presentation and transactional management role.

The Investment Acquisition Surveyor will source suitable opportunities externally from predominantly the investment agency community.

6.0 STRUCTURES

6.1 Direct versus Indirect Investment

The Strategy proposes a preference for assets to be acquired and directly held by the Council as opposed to acquired and held through a subsidiary or joint venture arrangement with another party or parties.

Indirect arrangements can provide a division of risk and access to scale greater than what is possible with the Council investing alone but also carry additional cost and risk relating to separation from decision making and agreement between the parties.

On balance, the Strategy proposes that other by excepetion only direct investments are pursued.

6.2 Exit Provisions

The Strategy is to assemble and hold a portfolio of assets over the medium term subject to the Investment Strategy terms as reviewed annually. The intention is that assets may be sold and replaced to maintain a balanced portfolio and to optimise returns and balance risk.

At a point in time, the portfolio may be liquidated through sale.

7.0 RISKS

The acquisition and management of an Investment Portfolio is subject to a range of risks that are reflected in the returns possible from the portfolio. These are:

7.1 Market forces

To limit risk the criteria for purchase and due diligence will be followed for all transactions; however fluctuations in demand and supply of the individual market and the wider economy will see the value of the investment and the income rise and fall, the Council may not recoup the original amount invested in full.

7.2 Liquidity

The process of buying and selling commercial property, in relation to some other forms of investment, is complex and can result in transactional delay and uncertainty which carries risk from market shift, abortive transactional costs and in-ability to realise "sale" capital quickly.

This can be managed and improved through good portfolio management and where possible by adopting the IPF's best practice "Readiness for sale - A guide for streamlining commercial property transactions".

7.3 Opportunity

The availability of stock is generally limited; there will be times where lack of or lost opportunities through negotiation and competition will frustrate the process. This is often exacerbated by a general lack of transparency and openness in the market creating barriers to entry. It is therefore a possibility that a proportion of the fund remains un-invested during these periods.

To counter this; the role of the manager tasked with acquisitions and portfolio management will be to seek out as many appropriate opportunities as possible, build relationships and communicate to the market the council's requirement and ability to perform.

7.4 Management

The portfolio will have the risk of void periods in occupation or tenants may default on payment of rent. The loss of income is a direct result however voids create further holding (and re-letting) costs which if vacant for a prolonged period of time can be substantial. Active portfolio management will be undertaken during the holding period to reduce such risks where possible.

7.5 Reputational risk

The Council carries the risk that properties owned by the Council are used in contravention of the Council's sanctions list. The Council will need to include regular property visits as part of its property management arrangements.

7.6 Regulatory Compliance

The Council should ensure it operates within the applicable regulatory framework and takes steps to review that framework regularly.

Local authorities have powers allowing them to invest and to borrow, for purposes relevant to the performance of any of their functions or generally for the prudent management of their financial affairs (s1 and s12 of the Local Government Act 2003).

They may also acquire property located either inside or outside of their borough for the purposes of any of their functions, including their investment functions, or otherwise for the benefit, improvement or development of their area (s120 of the Local Government Act 1972).

Lastly, they may also take any action (whether or not involving the expenditure, borrowing or lending of money or the acquisition or disposal of any property or rights) which facilitates or required to discharge of any of their functions, which would again include their investment functions (s111 of the Local Government Act 1972).

The council will need to ensure that when utilising its investment and borrowing powers in order to acquire investment properties that any actions are reasonable and proportionate and for proper purposes consistent with the Council's prudential regime and its investment strategy. Investment decisions also need to be taken in light of the council's fiduciary duties to ensure the sound management of the public finances.

Should through the course of on-going asset management the decision be taken to dispose of an asset the on any sale of an investment property the Council will be required to obtain best consideration in accordance with s123 of the Local Government Act 1972.

8.0 PERFORMANCE MANAGEMENT

Asset and Portfolio performance, recording, analysis and reporting will be managed through the Council's existing and evolving performance management systems.

Assets acquired under this strategy will be subject to a Fair Value assessment annually by reference to an external, independent valuation.

9.0 PROPERTY MANAGEMENT

Assets will be managed through existing asset management arrangements in place within the Council.

Assets with service charge arrangements will be managed by an external agent if required.