

West Berkshire Council - Commercial Property Investment Strategy (revised)

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Contents

Introduction	3
Core Objectives	3
The portfolio	4
Investment management.....	5
Quarterly and Annual Reporting	6
Portfolio Valuation.....	7
Property Investment Board (PIB)	7
Managing risk	7
Appendix A – PIB Terms of Reference.....	8
Appendix B – Risk thresholds	11

Introduction

This document (The Strategy) has been prepared by Richard Turner, Property Services Manager, on behalf of West Berkshire Council (WBC).

This document supersedes both the original Investment Strategy adopted by the Council on 9th May 2017 and the revised Strategy approved by the Council at its meeting of 3rd March 2020 as an appendix to the Capital Strategy.

Embedded within the original strategy was a mechanism to review and revise the strategy, so as to ensure that WBC commercial property portfolio is aligned to WBC's investment objectives.

Whilst the original strategy provided a robust launch point, and with the procured appointment of Montagu Evans (ME) to work with the council in both the acquisition of property and the ongoing management of the portfolio, it is prudent to periodically review the strategy to react to changes in the market, changing legislation and guidance, to empower the WBC Property Investment Board (PIB), enhance flexibility and underpin the portfolio's long term performance.

As part of the HM Treasury response to the consultation on the use of the PWLB (Public Works Loans Board), the Treasury issued guidance including the below statement:

When applying for a new loan, the local authority will be required to confirm that the plans they have most recently submitted remain current and that the assurance that they do not intend to buy investment assets primarily for yield remains valid.

In light of this statement, this Strategy is proposing to cease all future acquisitions of investment assets primarily for yield to ensure that the Council maintains access to PWLB borrowing in the future in order to enable the financing of the Council's future service infrastructure needs.

Core Objectives

Set out below are the core objectives of the investment strategy:

- No further capital acquisitions are proposed, with the Strategy (revised 2021) to manage the current investment portfolio;
- To hold good quality commercial property to generate a sustainable and predictable income return;
- To hold and manage standing commercial property investments which generate sustainable income, through being let on commercial terms, or from properties which are contracted to be let;
- The desired income to provide a clear margin over the cost of capital, in a form which is sustainable, and has the potential to increase through future rental growth;

- An even balance of risk and return is achieved through portfolio diversification;
- To proactively and strategically manage the existing portfolio, through asset specific Asset Management Plans, including renewal of leases when opportunity presents, and planned capital expenditure to influence both lease and capital value.

The portfolio

Since its creation and Council adoption in March 2017, West Berkshire Council has invested in commercial property in accordance with the Property Investment Strategy.

This has resulted in the freehold ownership of a total of nine individual assets, across a number of sectors offering a balanced commercial portfolio.

With quarterly data as reported in October 2020, the portfolio has a running yield of 4.92%, weighted average unexpired lease term (WAULT) to break of 7.5 years and WAULT to end of lease of 9.8 years.

The investment is across sectors to offer a balanced portfolio, with 43% in retail (mainly food retail), 41% in office/alternatives, and 16% in warehouse/industrial.

Summary of the portfolio is as follows:

Purchase date	Property	Purchase price	*Annual rent
25/10/2017	Terminus Road, Eastbourne	£2.90m	£175,000
20/03/2018	High Street, Lincoln	£5.66m	£302,000
31/03/2018	Cleveland Gate, Guisborough	£6.05m	£350,456
27/04/2018	3 The Sector, Newbury	£9.76m	£650,773
27/04/2018	4 The Sector, Newbury	£8.00m	£nil
13/07/2018	Dudley Port, Dudley	£3.51m	£200,000
24/07/2018	Bath Road, Chippenham	£9.10m	£554,250
13/12/2018	Discovery House, Nottingham	£6.55m	£387,000
04/03/2019	High Street, Northallerton	£7.05m	£437,500

Additional capital costs	£3.50m	
Totals	£62.08M	£3.07m

* Note – annual rent is expressed as the gross rental income as at October 2020.

Investment management

The following will be undertaken to achieve or maintain the core objectives of the Property Investment Strategy (refreshed March 2021):

Strategic management

- Individual Asset Management Plans will be maintained for each asset which will include assessment of:
 - Review of tenant breaks and lease end dates;
 - Strategic plan for the asset giving regard to the tenant position;
 - Consideration of any lease re-gearing recommendation;
 - Planning of future capital expenditure
 - The context of the individual asset within the wider portfolio
- Planned capital expenditure will be directed to the existing property portfolio and will be driven by the continued long term income of each asset, and maintaining or improving both the rental value and capital value of the assets;
- Where required, assets will be marketed for the benefit of creating new leases. Any new lease will be created in accordance with the Council's constitution, having consulted the Property Investment Board (PIB);
- Strategic management of the commercial property portfolio will be reported quarterly to the Property Investment Board (PIB), see section below on quarterly reporting.

Asset Management

- The property portfolio will be managed on behalf of WBC by the procured consultant property agents, in consultation with WBC Property Services team. These services include:
 - Receiving rental income on behalf of WBC from tenants;
 - Pursuing tenants for rent where late or not received;
 - Rent scheduling and monitoring;
 - Dealing with tenant issues;
 - Managing the budgets and appointment of service contractors for services charges (normally in shared buildings) and other tenant costs
- Asset Management of the commercial property portfolio will be reported quarterly to the Property Investment Board (PIB), see section below on quarterly reporting.

Quarterly and Annual Reporting

As good practice, the Property Investment Board (PIB) will receive and consider quarterly reports from the council’s property agents (Montagu Evans – ME) to convey both market updates, performance of the portfolio and any proposals (see guidance in the table below).

An annual review between WBC and ME will be held so as to ensure that the portfolio does not under-perform the market or its risk profile increase due to changes in both the macro and micro-economic position around the real estate market.

This will provide WBC with a clear understanding of the portfolio’s position and management, its risk and return profile and any latent value that can be driven out through strategic asset management.

A regular review of the five year cash flow is important to understand any future working capital requirements, as well as assessing the accuracy of the predicted rental income.

The quarterly and annual reporting will cover:

Quarterly reporting	Annual reporting
<p>Investment:</p> <ol style="list-style-type: none"> 1. Brief market update – investment trends, activity and forecasts 2. Brief update on the occupational markets 3. Review of current investment strategy 4. Report on performance of the portfolio and individual assets 5. Provide a review of portfolio activity and the added value created over the previous quarter 6. Update Work/Hold/Sell asset designation 	<p>Investment:</p> <ol style="list-style-type: none"> 1. Market update on investment trends, activity and forecasts 2. Update on the occupational markets 3. Review of current investment strategy 4. Identify any re-alignment required to match market changes and forecasts 5. Benchmarking the existing portfolio and asset level investment returns 6. Report on performance of the portfolio and individual assets 7. Provide annual property business plans to evaluate added value opportunities 8. Provide a review of portfolio activity and the added value created over the previous 12 months 9. Update Work/Hold/Sell asset designation

<p>Management:</p> <ol style="list-style-type: none"> 7. Report on portfolio management performance including rent collection rates, bad debt provision and service charge reconciliations 8. Advise on all critical lease dates, break options, rent reviews and lease expiries 9. Report on any health and safety incidents and insurance claims 10. Report on dilapidations claims and status 11. Capital expenditure requirements over the preceding quarter 	<p>Management:</p> <ol style="list-style-type: none"> 10. Report on portfolio management performance including rent collection rates, bad debt provision and service charge reconciliations 11. Advise on all critical lease dates, break options, rent reviews and lease expiries 12. Report on any health and safety incidents and insurance claims 13. Report on dilapidations claims and status 14. Capital expenditure requirements over the preceding 12 months
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Portfolio Valuation

An annual external valuation is undertaken to enable WBC to benchmark the property portfolio/asset performance as well as ensure that current book values are in line with prevailing market values, in accordance with the requirements of WBC’s external auditors.

Property Investment Board (PIB)

The Property Investment Board (PIB) acts as the Governance for the ongoing strategic management of the commercial property portfolio, and will receive quarterly and annual reports as described in this document.

The Terms of Reference for PIB are attached in appendix A.

Managing risk

Through the creation of a balanced portfolio, WBC has a strong portfolio of commercial property.

The practices within this Property Investment Strategy offers a system and process which reinforces and protects the income as best as possible for the long term continued income from the commercial property portfolio.

Within the reporting to PIB, a master risk register is maintained which forms part of the quarterly reporting.

In addition to this a series of thresholds have been agreed which identifies tasks and issues which are dealt with as ‘business as usual’ by the property management team, and the thresholds beyond which that business as usual requires escalation. Copy of the schedule related to this is in appendix B.

Appendix A – PIB Terms of Reference

Release Date:	March 2021
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1	Background
<p>1. At a full meeting of West Berkshire District Council on 9th May 2017 (C3283) the Council approved the Property Investment Strategy. The Strategy is regularly reviewed and was updated at the March 2020 meeting. The Property Investment Strategy is an appendix to the Capital Strategy 2020/21 to 2022/23;</p> <p>2. Delegates to the Service Director : Strategy and Governance in consultation with and having received agreement from the Property Investment Board to dispose of property in accordance with the above Strategy up to a maximum of £15m per transaction where it would not be expedient for the Executive to make this decision;</p> <p>3. Delegates to the Service Director: Strategy and Governance to inform the next available Executive of any disposal decision;</p> <p>4. Delegates to the Head of Finance and Property in consultation with the Portfolio Holder with responsibility for Property, authority to appoint suitable consultants in accordance with the Contract Rules of Procedure (Part 11 of the Constitution);</p> <p>5. West Berkshire Council will pause investment at the investment levels as at 31.3.2020 following the outcome of the PWLB consultation on its use¹</p>	
2	Purpose
<p>The members of the Property Investment Board (PIB) or their substitutes will collectively be responsible for the recommendations made by them having received reports related to the acquisition (or disposal) of commercial property.</p> <p>The PIB will play a critical role in the governance of the property investment strategy including ongoing monitoring of performance in order to make informed decisions.</p>	

¹ <https://www.dmo.gov.uk/media/17136/pwlb-guidance-for-applicants.pdf>

3	Terms of reference
<p>The PIB terms of reference are:</p> <ol style="list-style-type: none"> 1. In circumstances where a report proposes the acquisition of a property known to be outside the scope of the Delegated Authority criteria, to make recommendation(s) to approve or reject the proposal to progress with the acquisition to the Executive; 2. To make recommendation(s) to approve or reject the proposal to progress with the disposal of an individual property to the Executive. Where it would not be expedient for the Executive to consider a proposal to dispose of an asset authority be delegated to the Service Director Strategy and Governance in consultation with the portfolio holder(s) with responsibilities for finance and property, having received a report from Property Services to do so; 3. To receive quarterly performance reports (including an Annual Review report) conveying information on acquisitions, costs, total capital commitment and performance of the investment. 	
4	Membership
<p>The PIB is to be a joint Officer and Member board formed from the following:</p> <ol style="list-style-type: none"> 1. Executive Director (Resources) (Chair) 2. Service Director: Strategy and Governance (or substitute) 3. Executive Portfolio Holder for Internal Governance (or alternative Executive member) 4. Executive Portfolio Holder for Finance (or alternative Executive member). 5. Head of Finance & Property services <p>Reporting Officers to the PIB will be the Property Services Manager (or substitute) and the external consultant property agent.</p>	

5	Roles and responsibilities
<p>The members of the PIB will collectively be responsible for the recommendations made by the PIB, having given regard to the knowledge and expertise brought by individual members (such as legal, financial or political).</p> <p>Strategy and Governance will:</p> <ul style="list-style-type: none"> • Produce agendas and minutes to record the meetings <p>The Property Services Manager will:</p> <ul style="list-style-type: none"> • Arrange meeting dates, venue; • Produce formal reports (for individual acquisition/disposal or reviews); • Produce formal reports for quarterly reporting/monitoring and annual reviews; • Record and maintain property data for acquired property; • Attending PIB meetings; • Liaise with WBC colleagues within relevant teams sufficient to conclude proposals and the satisfactory outcome of recommendations made by the PIB. • With the input of WBC appointed Property Investment Adviser, monitoring performance of the investment, including identifying any issues with the property portfolio. 	
6	Meetings
<p>Scheduled quarterly PIB meetings will be arranged to monitor the implementation of the strategy and performance of investments. Additional ad hoc meetings will be arranged when required as a property acquisition or disposal is proposed.</p>	

Appendix B – Risk thresholds

Liaising with property managers regarding operational estate management duties including:		Liaising with property managers regarding operational estate management duties including:	
1.1	Rent collection	1.1	When rent arrears exceed 5% of total rent threshold approx £145K or if tenant enters administration.
1.2	Service charge budget administration and collection	1.2	When arrears Exceed 5% of income threshold or legal challenges issued.
1.3	Insurance renewals and claims	1.3	If claims involve substantial damage to building or could affect income revenue.
1.4	L & T relations minor repairs etc	1.4	When tenants in breach and possession proceedings being considered.
1.5	Enforcing repairing covenants and tenant's obligations	1.5	When tenants in breach and possession proceedings being considered.
1.6	Approving or rejecting assignments and sub-letting	1.6	If covenant strengths of tenants are affected causing a change of category of an asset within the portfolio.
1.7	Tenants alterations	1.7	Only when significant changes are sought which may affect strategy or life cycle of the asset.
1.8	Works or improvements to the areas of buildings landlords responsible for.	1.8	If capital expenditure exceeds £50K or 50% of annual sinking fund provision.

Appointing and liaising with specialist professional services		Appointing and liaising with specialist professional services	
2.1	Rating appeals on vacant space / considering vacant strategy to minimise rate liability	2.1	When liability exceeds £100K and or cost of minimisation strategy exceed £50K or 50% of annual sinking fund provision.
2.2	Marketing agents for vacant space - agreeing HOT rent levels and terms	2.2	If marketing could potentially change the asset plan for a building.
2.3	Lease advisory teams for rent reviews lease renewals- Expert witness/ Arbitration / PACT	2.3	If renewal negotiations affect the asset plan for an asset or if review or renewal incurring significant fees in excess of £50K.
2.4	Capital Expenditure for landlord	2.4	Only when capital expenditure is anticipated to exceed £100K or 50% of annual sinking fund provision, whichever is less.
2.5	Planning consultants for change of use applications or added value approved strategies	2.5	If advice received is not in line with expectations of previously agreed PIB strategy.
2.6	Values for annual valuations	2.6	If values change by + or - 15%
2.7	Building surveys for insurance valuations.	2.7	If reinstatement costs change by + or - 20%
2.8	Values for dilapidations claims	2.8	When dilapidations claims have significant revenue value or strategic implications.
2.9	Bailiffs debt collection agencies	2.9	If bailiffs appointed
2.10	Legal specialists for Landlord and Tenant or other	2.10	If costs are becoming significant in excess of £50K.