Capital Investment Strategy (Non -Treasury) 2020-2025

Author: Sarah Longthorpe

Version: V0.5

Date: 04/03/20

1. Introduction

1.1 In April 2019 Bournemouth Christchurch and Poole Council (BCP Council) was created, becoming the 12th largest unitary Local Authority in England with an urban population of nearly 400,000 residents and a strong commercial and tourist economy.

1.2 The Council wishes to hold a portfolio of investment assets that reflect the Values and Priorities of the Councils Corporate Strategy including the following:

- promote the financial health of the organisation by generating a target return across the portfolio;
- make a positive contribution to the current or future delivery of services, in terms of scope, quality or cost;
- contribute towards a Sustainable Environment;
- deliver socio-economic benefits to the town; and/or
- create Dynamic Places through strategic regeneration or redevelopment opportunities.

1.3 This strategy should be viewed in the context of the Council's Corporate existing fixed asset base, which had a combined value of £794.2 million as at 31 March 2019. The new BCP Council Corporate Asset Management Plan will provide the framework for the management of the Corporate Estate with decisions taken in accordance with the Councils financial regulations.

1.4 The investment portfolio is included within this figure, with property investment assets valued at £121.9 million. This strategy focuses on investment assets only, not the wider Corporate Estate and builds on the effective asset management arrangements that have been embedded by the Council through the adoption of the Corporate Asset Management Plan, and follows the guidance provided by both Chartered Institute of Public Finance and Accountancy (CIPFA) and the Royal Institution of Chartered Surveyors (RICS).

1.5 This strategy will be implemented predominately though an Investment panel, acting in an advisory capacity with all decisions taken in accordance with the Councils financial regulations.

1.6 There are two sections to the Council's Capital Investment Strategy (Non – Treasury) known as the CIS.

Section 1 – Property Investment

- Commercial property, investment acquisition and disposal
- Acquisition of a portfolio of private rented sector residential properties

Section 2 –Property Development

- Commercial development opportunities

1.7 Section 1 deals with commercial and residential property investment as an integral part of the Council’s asset management function and is aligned with the medium term financial planning of the Council which requires the Council to diversify the revenue base by securing alternative sources of income to better support the budget position. The financial objectives are only part of the rationale for acquiring commercial property assets as an acquisition should also support other key corporate plan objectives such as economic development or regeneration.

1.8 Section 1 also supports the early delivery of the Council’s strategic housing ambitions through the acquisition of a portfolio of private rented sector residential properties. The Strategy will only apply to the Council’s General Fund.

1.9 Section 2 considers the scenario where the Council purchases commercial development opportunities which give the Council ownership of land or buildings in support of the delivery of the Council’s strategic aims and objectives.

1.10 Both sections of the CIS share a commonality of purpose but the principles and risk profile under which they each operate are different and will be explored separately under each section.

2. SECTION 1 – PROPERTY INVESTMENT

2.1 Principles and approach - Commercial Investments

The Council will take the following approach to acquisition, holding and disposing of commercial investment assets by adopting the following principles:

2.1.1 Investment will be in assets with a net revenue stream from tenants of good covenant strength (Multi – let investments may have an overall good covenant profile but individual tenants may fall below this standard), capable of contributing a positive sum to the MTFP for a sustained period, but for a minimum of 5 years. Investments will show good prospects for capital growth over an initial ten-year period.

2.1.2 The Council will aim to invest in a diverse portfolio across the traditional commercial sectors of offices, industrial, retail and leisure. The opportunity to diversify into hotels and hospitality, medical facilities, care homes, and car parks will not be ruled out. It is the aim of the Council to limit the investment in any particular sector to no more than 25% by value. This may not be possible to achieve until such time that the Council has acquired a larger portfolio of properties. The current spread by sector of the investments held by the Council is shown at Appendix 1.

2.1.3 The Council will be advised in the acquisition, disposal and performance management of investment assets, not only from its own in - house team of property professionals but from the external advice that it deploys. External advisors will be skilled in commercial investment property acquisition and will provide assurance to the Council that they are acting in accordance with the governance and code of conduct of their respective professional bodies.

2.1.4 Investments will be located in the Bournemouth, Christchurch and Poole conurbation. Investments outside of this geographic area will be considered in exceptional circumstances, particularly in relation to investing in sustainable and carbon offsetting initiatives.

2.1.5 Where appropriate the Council will move to a common procurement of its commercial managing agency services in order that it might take advantage of economies of scale.

2.1.6 The principle of investment in all types of property assets is to ensure it is done prudently at all times. The funding strategy for an acquisition will be considered on a case by case basis.

2.1.7 The Investment Panel will recommend an acquisition or disposal based on a triple bottom line evaluation approach considering the following impacts): -

- Economic
- Social
- Environmental

2.1.8 All decisions to acquire or dispose of investments will be made in accordance with the Financial Regulations of the Council and the financial thresholds it contains in determining the approval process required.

2.2 Principles and approach - Residential Investments

The Council will take the following approach to acquisition, holding and disposing of residential investment assets by adopting the following principles:

2.2.1 The Council will consider strategic acquisitions where the reason for purchase is to contribute to Council objectives through the acquisition of a portfolio of private rented sector residential properties with the aim of supporting the Council's statutory housing functions and improving choice in the housing market.

2.2.2 As with commercial property investment, the principle of investment in residential assets is to ensure that it is undertaken prudently at all times.

2.2.3 The Council will aim to utilise its wholly owned trading subsidiary Seascape Homes and Property Limited for the letting and management of the residential investments that it holds.

2.2.4 Residential development and refurbishment works may be undertaken when works will result in enhanced incomes, more energy efficient/sustainable homes or market homes for sale.

2.3 Acquisition – Commercial Investment

2.3.1 For commercial acquisitions, detailed investment criteria are attached at Appendix 2. There are some circumstances when all the criteria will not be met but the acquisition should still be progressed. The rationale for departing from the adopted criteria will be captured in the business case for acquisition.

2.3.2 Each investment acquisition will be assessed on its own merits and in the context of its contribution towards a sustainable environment and the delivery of socio-economic benefits as well as the wider portfolio's financial position.

Assessed on a case by case basis; it will be subject to a rigorous financial appraisal which will identify: -

- Income from the investment

- Costs of purchase
- Costs of servicing the debt and managing the investment
- Cost of improving the efficiency of investment
- Resultant contribution to the MTFP

2.3.3 In making an investment decision, the Council will take a balanced portfolio approach. This means that it may acquire or develop assets that deliver lower financial returns, or even make a loss, if the overall benefits of individual investments, including the socio-economic factors, justify this approach. Such acquisitions will be subject to sufficient uncommitted financial cover being available within the portfolio. Alternatively, the Council may acquire high-risk, high-reward investments provided that the blended risk across the whole portfolio is considered prudent.

2.3.4 Some assets, such as care homes, are traded by selling the shares or in the use of Special Purchase Vehicles (SPV). They are typically sold as a "going concern" and will transfer the goodwill of the business, staff and other assets. However, they also transfer with the debts and liabilities of the company and therefore require additional due diligence.

2.3.5 The business case for the purchase of existing SPVs or "going concerns" will need to consider whether the purchase is made by the Council in its name, or whether there is a more advantageous ownership structure for which specialist advice will be sought.

2.4 Acquisition – Residential Investment

2.4.1 The same assessment principles of acquiring commercial investment properties outlined in 2.3 apply to the acquisition of residential property acquisition for investment purposes. The detailed guidelines and criteria are attached at Appendix 3.

2.4.2 The Council has established Seascape Homes and Property Limited (SHP) as a wholly-owned subsidiary of Seascape Group Limited (SGL). Unlike the Council, SHP can grant Assured Shorthold Tenancies which is the most appropriate form of tenure for the private rented sector market.

2.4.3 The establishment of SHP has the added benefit of improving the quality of the offer in the private rented sector and improving the range of housing choices of people who would not qualify for traditional Council housing.

2.5 Disposal of BOTH Commercial and Residential Investment Assets

2.5.1 Although the Council aspires to take a long-term view to its investment and development assets, it will consider the disposal of assets:

- to achieve a balanced portfolio
- to proactively manage risk
- to refocus investment activity on different market sectors and where they are under-performing against the criteria identified in Appendix 2 or for residential property Appendix 3
- to generate capital receipts to reduce debt exposure (gearing) or for reinvestment in Council priorities
- to contribute towards a sustainable environment
- deliver socio-economic benefits to the conurbation

2.5.2 Any disposals will be undertaken in accordance with the Council's Financial Regulations.

2.6 Financing and Funding of BOTH Commercial and Residential Property Investment Assets

2.6.1 It is intended that a new investment will be funded primarily through prudential borrowing.

2.6.2 Wherever possible (and prudent to do so) the Council will undertake to make an early repayment of the principal sum which will assist in reducing the debt to value ratio. In any event, loans from the Public Works Loan Board are conditional on a payback policy being implemented which is known as the Minimum Repayment Policy or MRP.

2.6.3 The Council may be in a position to make acquisitions without the need for borrowing. The opportunity cost of such purchasing and funding decisions needs to be fully understood in advance of a purchase.

2.6.4 In all purchases, the "exit strategy" should be considered as part of the business case for the acquisition. Whether this is higher alternative use, owner occupation or sale.

2.6.5 The Council will act prudently, and its investment activity will be affordable for future administrations. This means that the Council will be taking a progressive approach to investment and new borrowing will only be undertaken if the resultant investment portfolio is forecast to generate positive financial returns. The Financial Overview and Indicators in Appendix 5 expand on these principles.

2.7 Holding BOTH Commercial and Residential Investment Assets

2.7.1 Investment assets will be held if: -

- they continue to meet the Investment Criteria attached at Appendix 2 or Appendix 3 for residential investments.

- they continue to enhance the performance of the strategic aims and objectives of the Council.

2.7.2 Actions to be taken in support of the management of the existing portfolio will include: -

- undertaking an annual valuation (RICS Valuation and Professional Standards or "Red Book")
- the assessment of performance of the investment portfolio will be undertaken at least on an annual basis.
- reporting annually to the democratic entity with responsibility for oversight (e.g. an overview and scrutiny committee) with advice from internal or external investment advisors on:

    - the mix of assets within the portfolio
    - the rate of return on individual properties and across the whole portfolio
    - the risk profile and whether there is a heavy reliance on income that is derived from a single tenant or market sector
    - proposed acquisition and disposal plan to achieve a balanced portfolio
    - the adequacy of the provision for voids and bad debts, held as a reserve against future liabilities

3. SECTION 2 –PROPERTY DEVELOPMENT

3.1 The Development Property Strategy identifies opportunities for the Council to assemble a portfolio of developable assets which meet the fundamental criteria of:

- delivering socio-economic benefits to the conurbation.
- enhancing future strategic regeneration or redevelopment opportunities in pursuit of the council's corporate strategic objectives.
- and/or contributing to cost avoidance in relation to the provision of services.

3.2 Development Property: Principles and Approach

3.2.1 All decisions to acquire or dispose of development opportunities will be undertaken in accordance with the Financial Regulations of the Council and the financial thresholds it contains in determining whether delegated or Member Decisions are required.

3.2.2 The Council will engage in construction activity on existing or newly acquired development assets only when fully supported by a viable business case.

3.3 Acquisition and Disposal of Development Property

3.3.1 Strategic developable properties lend themselves to a detailed, "one – off" business case analysis and set criteria cannot be identified for both the acquisition and future disposal or strategic hold.

3.4 Financing and Funding of Development Property Assets

3.4.1 As a rule, assets purchased for development do not produce an income with which to service debt therefore it is more usual for the Council to find alternative means of funding in lieu of debt financing from the Public Works Loan Board.

4. SECTION 3 - LINKS TO OTHER EXISTING STRATEGIES

4.1. There are other Strategies and Plans with which this Capital Investment Strategy are aligned. These are: -

4.1.1 The Corporate Property Strategy and Plan – this is the overarching Strategy for all corporate property and asset management decisions and monitoring of which this Strategy forms part.

4.1.2 Medium Term Financial Plan - the Council is responding to the reduction in central government funding for local authorities by strengthening its funding base. The acquisition and management of investment portfolios to provide a commercial return will give the Council greater flexibility in its medium-term financial planning. This portfolio will provide additional revenue and capital income to underpin service provision, so long as the returns continue to exceed the cost of borrowing.

4.2. In addition, the CIS is linked to the new Council's emerging:

- Corporate Plan
- Corporate Asset Management Strategy
- Treasury Management Strategy
- Economic Development Strategy
- Housing Strategy
- Climate Emergency Agenda

5. SECTION 4 - GOVERNANCE

5.1. The Investment Panel will act in an advisory capacity only, any decisions in relation to investment assets will be made in accordance with the Councils Financial Regulations and approval sought accordingly.

5.2 The Investment Panel will be chaired the Chief Executive/Corporate Property Officer a statutory post in accordance with the scheme of delegation. Other attendees will include the Section 151 Officer, Monitoring Officer, Corporate Property Officer, Director for Regeneration and Economy, Director Development and will be attended by the Leader of the Council, Deputy Leader of the Council and the Cabinet Members with responsibility for Corporate Estates and Finance, or their nominated substitutes. The panel will oversee the implementation of this Strategy. Other officers may attend at the invitation of the Chair.

5.2 The Investment Panel will;

- be guided by the terms of this Strategy and any changes will need to be approved by Cabinet.

- meet at not less than quarterly intervals to consider new opportunities, monitor progress on the delivery of approved projects/investments, and review performance of the whole portfolio in accordance with this Strategy.

- consider recommendations for disposal of existing assets and consider the effectiveness of its property management arrangements. Appendices 2 and 3 of this Strategy contain detailed investment criteria to guide the Investment Panel in assembling and managing an investment property portfolio.

- review acquisitions purchased for development, as they arise, on a case by case basis.

5.3 Appendix 4 of this Strategy sets out the risks that the Panel should consider when recommending decisions to acquire, hold or dispose of non - treasury investments or development assets.

5.4 Any properties considered suitable for purchase by the Council will be considered first by the Investment Panel. The Investment Panel will determine whether an offer should be submitted. Any offers will be submitted by the Corporate Property Officer on a conditional basis.

Offers will be subject to contract and: -

- all necessary surveys
- an assessment of necessary capital works
- a formal “Red Book” valuation
- benchmarking with comparable transactions
- an agreed “exit strategy”
- legal due diligence
- financial due diligence including credit information for all tenants
- the requisite Council approvals

5.5 This means that the Council will not be legally committed to proceeding with the transaction by submitting an offer however, to be at pace with the market, the Council should use its best endeavours to complete necessary due diligence following acceptance of an offer and before proceeding to completion of a contract.

5.6. The Investment Panel will make recommendations on any amounts to be set aside as a provision for voids and bad debts, which will be a first call on the income after the Council, has met its borrowing costs. In making its recommendations, the Panel will review the monies set aside from previous years and, if appropriate, recommend the release of any over-provision. These monies will then be available for distribution via the MTFP and reported in annual performance management of the strategy by the relevant committee with democratic powers of oversight.

5.7 All decisions to acquire or dispose of property assets are recommended by the Investment Panel but they are to be taken in accordance with the Council Financial Regulations.

Appendix 1 - Analysis of current Investment Portfolio

The Investment portfolio has been realigned to consist of only the key assets acquired or held solely for investment purposes and includes legacy Bournemouth, Christchurch & Poole assets.

Assets which are considered to fall under the remit of this strategy will be reviewed regularly to determine the suitability of their inclusion.

The previous CIS approved by the Shadow Authority referenced other legacy authority assets which generated an income such as finance leases and ground rents. These fall into the business as usual estate management remit and will be managed in accordance with the Corporate Asset Management Plan.

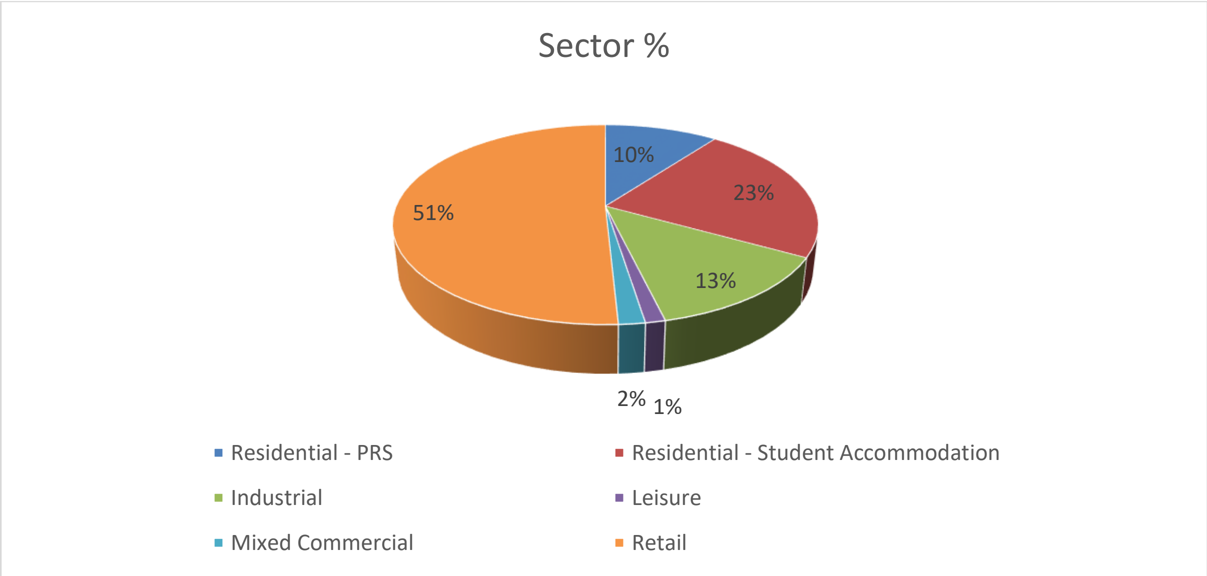
Portfolio Analysis – Value £m as at 30/09/2019

SECTOR	£m	%
Residential - PRS	£12,083,000	10%
Residential - Student Accommodation	£27,000,000	23%
Industrial	£15,475,000	13%
Leisure	£1,500,000	1%
Mixed Commercial	£1,995,986	2%
Retail	£59,955,000	51%
	£118,008,986	**100%**

The Residential Sector which totals 33% contains a commitment to a residential sector private rent scheme acquisition at St Stephens Road* which is under construction and due for completion in October 2020.

It should be noted this total differs from Table 2 in Appendix 5 which is as at 31/3/19 and does not include the St Stephens Road PRS scheme.

Sector Analysis as % of Portfolio



Appendix 2

GUIDELINE INVESTMENT CRITERIA FOR COMMERCIAL PROPERTY PORTFOLIO	
Performance	• To achieve a NET return on assets of circa 1.5% or more per annum (net of the costs of borrowing) in the first five-year period of ownership.
Income yield	• Maintain the portfolio income NET yield of at least 1.5% per annum over the costs of borrowing in the first five years of ownership. • To focus on maintaining a low void rate and a resilient income yield. • Ensure held properties / new acquisitions have reasonable capital growth prospects.
Property type	• Target core property holdings in primary or good secondary sectors with a balanced proportion of exposure to properties that will allow active management to generate improved performance.
Geographic allocation	• Within BCP Council area. Investments outside of this geographic area will be considered in exceptional circumstances, particularly in relation to investing in sustainable and carbon offsetting initiatives
Sector allocation	• To spread investment across a range of commercial sectors. • No more than 25% by value will be held in any one sector, once the investment portfolio has been assembled.
Investment size	• Ideally, no single asset will comprise more than 20% of the value of the investment portfolio. However, it recognised that this will not be the case whilst the portfolio is being assembled.
Tenants	• In a mature portfolio, to ensure that the rent from any single tenant is 10% or less of rental exposure at point of decision. It is acknowledged that in assembling an investment portfolio, this will be exceeded temporarily. • The Council will endeavour to target assets where the cost of borrowing is covered by tenants with a minimum financial/credit rating of “good” dependant utilising the Council’s financial credit rating tool and risk analysis as well as an analysis of the tenant company’s financial statements.

Lease length portfolio	• Target new assets where the lease expiry profile fits with the existing profile of the investment portfolio. • Seek to maintain lease expiries in any one year below 10% of the fund's lease income.
Development to enhance income	• Development may be undertaken where the major risks can be mitigated, and the risk/reward profile is sufficient to justify it.
Debt	• Up to100% debt funded. • This will improve year on year as repayments reduce the underlying debt (see MRP policy Appendix 5). • Other sources of funding may be utilised, where possible. E.g. Income strips. • Structure of debt to be based on Bournemouth, Christchurch and Poole Council's Treasury Management strategy.
Triple Bottom Line Evaluation Economic, Environmental and Social Governance	• Assets that deliver wider socio -economic benefits will be targeted, either in terms of capacity to deliver new jobs or to drive redevelopment, either now or in the future. • The Council will seek to promote energy efficiency and sustainability in its portfolio to contribute towards a sustainable environment. In particular, it will invest to improve Energy Performance Certificate ratings where it is financially viable.

Appendix 3

GUIDELINE INVESTMENT CRITERIA FOR RESIDENTIAL PROPERTY PORTFOLIO	
Performance	• To achieve a return on assets that fully covers the costs of borrowing in the first five-year period of ownership. Income growth at greater that inflation.
Income yield	• To focus on maintaining a low void rate and a resilient income yield. • Ensure held properties / new acquisitions have strong capital growth prospects
Property type	• Target core property holdings in sustainable locations • To prioritise acquisition of freehold and long leasehold studio, 1, 2 and 3 bedroom flats; 2, 3 4 and 5 bedroom houses and HMO's/hostels
Geographic allocation	• Within BCP Council area, any deviation from this can only be done with a decision substantiated with a business case.
Sector allocation	• Sector to not exceed 25%, once the investment portfolio has been assembled.
Investment size	• Ideally, no single asset will comprise more than 20% of the value of the investment portfolio. However, it recognised that this will not be the case whilst the portfolio is being assembled.
Tenants	• Mix of tenant types proposed, from tenants reliant on housing benefit to private rental sector which is unsupported. • Homeless clients will be accommodated within properties acquired specifically for the Homeless Housing programme in order to assist the Council to discharge its statutory homeless duty; this is separate to this investment strategy for the residential portfolio.
Lease length/terms	• New leases/subleases to be granted to Seascape Homes and Property Limited, typically for periods of 25 years. • SHP to grant Assured Shorthold Tenancies. • The Council will retain FRI responsibilities for these leases.
Development to enhance income	• Development may be undertaken where the major risks can be mitigated, and the risk/reward profile is sufficient to justify it.
Debt	• Up to 100% debt funded

	• This will improve year on year as repayments reduce the underlying debt (see MRP policy in Appendix 5) • Other sources of funding will be utilised, where possible • Structure of debt based on Bournemouth, Christchurch and Poole Council's Treasury Management strategy
Triple Bottom Line Evaluation Economic, Environmental and Social Governance	• Assets that deliver wider socio -economic benefits will be targeted, either in terms of capacity to deliver new jobs or to drive redevelopment, either now or in the future. • The Council will seek to promote energy efficiency and sustainability in its portfolio to contribute towards a sustainable environment. In particular, it will invest to improve Energy Performance Certificate ratings where it is financially viable.

Appendix 4 - Commentary on Investment Property - Risk and Returns

1. At its simplest, property is an investment in a piece of land or a building giving the investor a return as rental income and/or capital value growth. Capital growth may come through time either by holding the asset and/or be driven by asset management initiatives and development.

2. Risks and returns in property investment come both at a market level and from individual asset choice. The choice of location and the choice of property sector influence the risks and returns associated with the investment. At an individual asset level, there are asset specific risks and opportunities. The owner has the opportunity to add value through initiatives to improve buildings and manage the tenant roster. Asset specific events, such as the loss of an important tenant, illustrate the risks at an asset level.

3. The rental income returns from property have, historically, shown little volatility. Over the last 25 years the rental growth has never exceeded 10% in any one year nor has fallen by more than 5%. (Source: IPD1 UK monthly index)

4. However, this is the position at the macro level and this can mask a degree of volatility at a local level. In a rising economy, most market sectors tend to perform well with rent increases matching or outpacing inflation. However, in recession the adverse effects are most keenly felt in secondary locations. As leases come to an end, either by effluxion of time or as a result of tenant business failure, liability for business rates and other costs associated with empty property drives landlords of investments with little tenant demand to re-let them at whatever price they can achieve in order to defray these costs. This not only drives down rental income but also has an adverse effect on the investment yields used to capitalise these rental flows.

5. It is this link between rents and yields, the latter being driven by market confidence and returns available elsewhere that mean the capital growth component of property returns is variable. Real property prices do not show the rapid price fluctuations of quoted equities but on a longer time scale, price movements can be just as significant. Long term UK capital growth component hides years of significant fluctuations, both up and down, and a policy of a long-term hold should mean that the investments will be less affected by fluctuations in the general property market as the assets can be held to meet a rising market.

6. Effective asset management can help smooth out these peaks and troughs. However, they cannot be eradicated completely, and any property investment involves an acceptance of the risks attached to such activities.

7. Capital values of commercial property are very dependent upon the covenant strength of the tenant and the unexpired term of the lease. An asset with a financially secure tenant occupying under a significant unexpired term with no

break options will command strong values, even in a difficult market. However, poorer quality tenants and/or shorter leases will detrimentally affect the asset value.

8. The value of an investment can fall as much as 30% if a tenant decides not to renew a lease. Correspondingly, it will rise again if a new long-term tenant is signed up. An effective business model aim should be to deliver short-term capital growth. An established private equity property strategy is to seek out buildings that are vacant or with short leases, to refurbish some parts, re-let and re-gear the leases, then sell realising the capital appreciation arising from the new longer leases. However, a typical first-time investor would seek to acquire more stability than this with strong covenants and long leases in place.

9. In practice, property investment can be structured to create a range of different risk/reward profiles from stable annual income performance to volatile, high risk/reward development returns. They can also be structured to ensure that any foreseeable lease renewals or voids across the entire portfolio are evenly spaced so avoid a significant impact in any one financial year.

10. Acquisition Risks:

10.1 The current low yields from traditional investments, such as bonds, mean that there is strong competition in the property market for investment opportunities. It follows that it is highly likely that there will be several bidders for any good-quality asset. One factor that is increasingly emerging is competition amongst local authorities looking to invest on a nationwide basis. This increased competition means it is inevitable that some bidders will be an unsuccessful and it also raises the possibility of local authorities distorting the investment market, driving up prices fuelled by the availability of low-cost borrowing.

10.2 Due to the nature of the property market, decisions may need to be taken quickly in order to put offers forward. Of course, offers can be subject to conditions and due diligence before exchange of contracts.

11. Cost Risks:

11.1. Abortive costs, including legal costs, survey fees, professional adviser's fees, and officer time, may be incurred in connection with initial feasibility investigations and unsuccessful bids. It is also possible that issues will be identified during due diligence that will prevent a transaction from progressing.

12. Property Market Risks:

12.1 Property has a different risk profile from other investments because of its physical characteristics, which need to be managed and maintained. Whilst most property sectors have historically demonstrated good long-term returns, particularly in relation to underlying capital growth, fluctuations in the market or local economy and tenant/property-specific issues can affect short-term returns. The property market is not a certain market and the Council may not always achieve its target returns.

12.2. Many investment transactions happen without being offered for sale in the market. These are known as off-market transactions. Information is key and getting to know about properties for sale is important and as it becomes known that a purchaser is active in the investment market, many such opportunities are presented by agents seeking a finder's fee, usually a maximum of 1% of the purchase price. Alternatively, the investor can be proactive by contacting property owners and agents directly. Consideration can also be given to engaging a specialist investment agent to act on the investor's behalf.

12.3. Lack of suitable sites/buildings – the local property market is restricted and is dominated by secondary or tertiary assets that may not be of the quality the Council would acquire. There may therefore be a shortage of suitable stock in the conurbation.

12.4. **Liquidity:** Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. The investments made to date are either historic properties held by the Council for a number of years or are new investments with a view to retention for the foreseeable future. Although liquidity is important, no investments made to date affect the ongoing liquidity of the organisation.

13. <u>Capacity, Skills and Culture</u>

13.1 **Statutory officers and Elected members:** The Investment panel consists of statutory officers and is attended by elected members. Their role will be to look at potential investments as well as manage the current portfolio. The board will make recommendations to Cabinet and Council for any future investments.

13.2 **Commercial deals:** Specialist staff are employed by the Council to ensure the knowledge and skills are held in house when dealing with significant commercial deals. The Council also consults with specialist firms for further independent advice. At all-times officers from the Council ensure that all commercial deals follow the principles of the prudential framework and of the regulatory regime within which Local Authorities operate.

14. **Corporate governance:** This has been covered in Section 4.

Appendix 5 – Financial Overview and Indicators

This appendix has been developed to cover the requirements of the 2018 Ministry of Housing, Communities and Local Government (MHCLG) Investment guidance, including investment indicators. It also has regards to recent guidance issued by in CIPFA's Prudential Property Investment.

Introduction

The Authority invests its money for three broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as **treasury management investments**),
- to support local public services by lending to or buying shares in other organisations (**service investments**), and
- to earn investment income and generate other benefits such as employment and regeneration to the local area (known as **commercial investments** where this is the main purpose).

This appendix will focus on the second and third of these categories.

Treasury Management Investments

The Authority typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of Central Government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy.

Contribution: The contribution that these investments make to the objectives of the Authority is to support effective treasury management activities.

Further details: Full details of the Authority's policies and its plan for 2019/20 for treasury management investments are covered in a separate document, the treasury management strategy.

Service Investments: Loans

Contribution: The Council lends money to its subsidiaries, local business and residents to support local public services and stimulate local economic growth.

The most significant loan is to the Bournemouth Development Company LLP of £3.4m which was a loan to purchase a building situated on the proposed Winter Gardens development. The other partner in the partnership has also provided a matched £3.4m loan to the partnership. The loan supports the Council's long-term ambitions within the Bournemouth Town Centre Vision.

Security: The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Authority, upper limits on the outstanding loans to each category of borrower have been set as follows:

Should the Council want to increase the approved limits in the table below, relevant reports detailing the value and reason for these loans would go through the appropriate Cabinet and Council democratic process which in turn and following approval would adjust these limits accordingly.

Table 1: Loans for service purposes

Category of borrower	31/03/18 actual			31/03/19 actual			2020/21
	Balance owing £'000	Loss allowance £'000	Net figure in accounts £'000	Balance owing £'000	Loss allowance £'000	Net figure in accounts £'000	Approved Limit £'000
Bourenmouth Development Company LLP	3,400	0	3,400	3,400	0	3,400	3,400
Wholly owned Council Companies	550	0	550	425	0	425	1,000
Local Business	105	(46)	59	63	(46)	17	63
Local charities and trusts	220	0	220	100	0	0	100
Housing associations	42	0	42	40	0	40	40
TOTAL	**4,317**	**(46)**	**4,271**	**3,928**	**(46)**	**3,882**	**4,603**

Accounting standards require the Authority to set aside a loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Authority's statement of accounts from 2018/19 onwards will be shown net of this loss allowance. However, the Authority makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

Risk assessment: The Authority assesses the risk of loss before entering into and whilst holding service loans.

The loans made to the Council's wholly owned subsidiaries were to ensure that the working capital for the companies can be maintained. The loans are given at a rate that is compliant with EU regulations in respect of State Aid and reflect the level of risk involved. These working capital loans are being reduced year on year as the companies establish themselves. As the companies are wholly owned and managed by the Council an assessment of risk is carried out as part of its normal financial processes.

The following bullet points cover the further areas the Council would consider as part of its risk assessment:

- State Aid considerations to establish the minimum interest rate and compliance with State Aid criteria.
- Assessment of cash flow forecasts and relevant income streams – if available
- Consideration of the company structure. Any limitations which may affect the distribution of assets, company control and distribution of surpluses from the entity
- A review of the company accounts, business plan and cash flows to assess the risks of the company's key sources of income (including volatility and consistency of any forecast income).
- An appraisal of the loan terms to determine if the implicit rate in the agreement is at a commercial/market rate to ensure there are no state aid issues associated with the arrangement
- A full assessment of the ability of the entity to service the finance agreement and their underlying credit quality and risk of default.
- Assessment of the collateral which is provided as security for the loans.
- Assessment as to whether the Market Operator Principle can be applied to the loans proposed
- A review of the relevant credit references, existing charges and debt obligations.
- Advice on the level and/or value of the relevant loan covenants and an explanation for the levels and associated risk.
- The identification of any relevant matters of a legal or accounting nature which may have implications for the manner in which it is proposed to make the loan.
- The identification of alternative powers that may be relied upon by the Authority to support the making of the loan, together with a detailed explanation of factors that would enable an alternative power to be considered and adopted by the Authority.

The Council would also look to consult with its external Treasury Management advisors to help support the items above.

Commercial Investments: Property

MHCLG defines property to be an investment if it is held primarily <u>or partially</u> to generate a profit.

Contribution: The Council invests in local commercial and residential property with the intention of making a profit that will be spent on local public services.

The most significant property investment to date was in the Mallard Retail Park in Bournemouth at a cost of circa £49m. This property investment was driven by not only providing a sound investment for the Council but also ensuring the safeguarding of a key employment and economic site within Bournemouth. It is projected to provide an extra £400k (net of borrowing and other costs) a year towards helping to safeguard existing services for residents and businesses.

Table 2: Property held for investment purposes

Property	Actual Purchase cost £'000	31/03/19 actual Gains or (losses) £'000	31/03/19 actual Value in accounts £'000
Mallard Road Retail Park	49,065	(2,190)	46,875
Madeira Road Student Accommodation	18,734	8,266	27,000
Citrus Building, ground floor Turtle Bay	1,338	162	1,500
Wessex Trade Centre	9,960	940	10,900
Parkway House	1,996	0	1,996
Dolphin Centre	Historic	0	11,690
Saxon Square	Historic	0	1,380
Airfield Industrial Park	Historic	0	4,575
TOTAL	**81,093**	**7,178**	**105,916**

Security:

In accordance with government guidance, the Authority considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

A fair value assessment of the Authority's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment. Should the 2019/20-year end accounts preparation and audit process value the portfolio of properties below the total portfolio purchase cost, then an updated investment strategy will be presented to full council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom. (For information the Mallard Road total purchase cost also included Stamp Duty Land Tax and other due diligence fees which are over and above what is taken into account for valuation purposes and show as a downward loss until the asset is revalued in future years based on rent receivable.)

Risk assessment:

The Authority assesses the risk of loss before entering into and whilst holding property investments by identifying the key risks associated with these type of investments:

Acquisition Risks:

The current low yields from traditional investments, such as bonds, mean that there is strong competition in the property market for investment opportunities. It follows that it is highly likely that there will be several bidders for any good-quality asset. One factor that is increasingly emerging is competition amongst local authorities looking to invest on a nationwide basis. This increased competition means it is inevitable that some bidders will be an unsuccessful and it also raises the possibility of local authorities distorting the investment market, driving up prices fuelled by the availability of low-cost borrowing.

Due to the nature of the property market, decisions may need to be taken quickly in order to put offers forward. Of course, offers can be subject to conditions and due diligence before exchange of contracts.

Cost Risks:

Abortive costs, including legal costs, survey fees, professional adviser's fees, and officer time, may be incurred in connection with initial feasibility investigations and unsuccessful bids. It is also possible that issues will be identified during due diligence that will prevent a transaction from progressing.

Property Market Risks:

Property has a different risk profile from other investments because of its physical characteristics, which need to be managed and maintained. Whilst most property sectors have historically demonstrated good long-term returns, particularly in relation to underlying capital growth, fluctuations in the market or local economy and tenant/property-specific issues can affect short-term returns. The property market is not a certain market and the Council may not always achieve its target returns.

Many investment transactions happen without being offered for sale in the market. These are known as off-market transactions. Information is key and getting to know about properties for sale is important and as it becomes known that a purchaser is active in the investment market, many such opportunities are presented by agents seeking a finder's fee, usually a maximum of 1% of the purchase price. Alternatively, the investor can be proactive by contacting property owners and agents directly. Consideration can also be given to engaging a specialist investment agent to act on the investor's behalf.

Lack of suitable sites/buildings – the local property market is restricted and is dominated by secondary or tertiary assets that may not be of the quality the council would acquire. There may therefore be a shortage of suitable stock in the conurbation.

Liquidity:

Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. The investments made to date are either historic properties held by the Council for a number of year or are new investments with a view to retain for the foreseeable future. Although liquidity is important, no investments made to date effect the ongoing liquidity of the organisation.

Capacity, Skills and Culture

Elected members and statutory officers: The Council operates an Asset Investment board which consists of elected members and statutory officers. Their role will be to look at potential investments as well as manage the current portfolio. The board will make recommendations to Cabinet and Council for any future investments.

Commercial deals: Specialist staff are employed by the Council to ensure the knowledge and skills are held in house when dealing with significant commercial deals. The Council also consults with specialist firms for further independent advice. At all-times officers from the Council ensure that all commercial deals follow the principles of the prudential framework and of the regulatory regime within which Local Authorities operate.

Corporate governance: This has been covered in the preceding Asset Investment Strategy.

Investment Indicators

The Authority has set the following quantitative indicators to allow elected members and the public to assess the Authority's total risk exposure as a result of its investment decisions.

Total risk exposure: The first indicator shows the Authority's total exposure to potential investment losses. This includes amounts the Authority is contractually committed to lend but have yet to be drawn down and guarantees the Authority has issued over third party loans.

Table 3: Total investment exposure

Total investment exposure	31/03/18 Actual £'000	31/03/19 Actual £'000	31/03/20 Forecast £'000
Treasury management investments	68,997	51,356	65,000
Service investments: Loans	4,271	3,982	3,600
Commercial investments: Property	79,097	83,049	83,049
TOTAL INVESTMENTS	**152,365**	**138,387**	**151,649**
Commitments to lend	0	0	0
Guarantees issued on loans	0	0	0
TOTAL EXPOSURE	**152,365**	**138,387**	**151,649**

How investments are funded: Government guidance is that these indicators should include how investments are funded. Since the Authority does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by borrowing. The remainder of the Authority's investments are funded by usable reserves and income received in advance of expenditure.

<u>Table 4: Investments funded by borrowing</u>

Investments funded by borrowing	31/03/18 Actual £'000	31/03/19 Actual £'000	31/03/20 Forecast £'000
Treasury management investments	0	0	0
Service investments: Loans	0	0	0
Commercial investments: Property	73,710	75,375	75,375
TOTAL FUNDED BY BORROWING	**73,710**	**75,375**	**75,375**

<u>Table 5: Other investment indicators</u>

Indicator	2019/20 Forecast	2020/21 Forecast
Debt to net service expenditure ratio	36%	34%
Commercial income to net service expenditure ratio*	1%	1%

**Commercial Income is only in relation to properties which have required borrowing to fund initial purchase.*