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## **Appendix 15: Property Investment Strategy**

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### **Purpose**

- 1 The purpose of the Property Investment Strategy is to identify the benefits, risks and approach to acquiring property in order to support the Council's priorities.

### **Definition of an Investment Property**

- 2 This strategy defines an investment property as "an asset acquired by the Council for the purposes of income generation and profit creation", in line with the definition in the Statutory Guidance issued under Section 15(1)(a) of the Local Government Act 2003. Through the acquisition there may be secondary benefits achieved, such as new jobs created or existing jobs safeguarded. However, the primary purpose of the acquisition as an investment will be to provide a source of income to the Council.

### **Introduction**

- 3 Over the past five years local authority investment within the commercial property market has grown, due to the return on investment opportunities presented by this market segment, and this was a strategy that the Government previously encouraged. As a result of the changing nature of budgets in local government, the Council, like many others, needs to assess opportunities within the market to support its overall priorities. More recently, there has been increased focus on these decisions and investments, where in some authorities the commercial risks take on has proved unsustainable.
- 4 To ensure that investment decisions in County Durham fit with the Council's requirements and are underpinned by robust risk assessment and a cautious approach, this strategy sets out the investment framework and policy to apply to the acquisition of any commercial property investments. This will ensure that any opportunities considered are evaluated against agreed criteria and the risks and returns associated with these investments are fully appraised as part of the decision making.
- 5 The overall aim of the strategy is to create a framework that ensures that all relevant issues are considered when the Council analyses a property investment opportunity. The Council will need to balance commercial risks against the opportunity to deliver sustainable revenue streams for the Council, together with potential for capital growth from investments. Investments could also help to generate economic growth and secure or protect jobs. The objectives of this strategy will ensure acquisition, management and returns relating to investments made continue to deliver against the Council's priorities throughout their lifespan.

- 6 Set against key objectives the strategy will not only cover the income opportunities for the Council, but also the wider regeneration benefits that will be delivered, particularly in relation to acquisitions within the County boundary.

## **Objectives**

- 7 The key objectives of the Property Investment Strategy are to consider investment opportunities which achieve the following:
  - (a) delivers a sustainable revenue stream;
  - (b) contributes towards a balanced investment portfolio;
  - (c) protects existing capital value or delivers capital growth opportunities, as the market dictates;
  - (d) maximises income within the agreed acceptable risk levels;
  - (e) Contributes to delivery of the councils vision, approach and ambitions

## **Investment Proposal**

- 8 The Council have already taken opportunities to invest in property located within the County, where this decision has met the wider council objectives. This consists of surplus freehold Council properties, that have been converted to successful commercial lets and leasehold properties sublet for income generation and to support regeneration.
- 9 Examples include the surplus Priory House, currently leased to Northumbria Water and the Council taking the head lease at Freemans Reach to support the retention of civil service jobs in Durham. Investment properties are defined separately for accounting purposes and will be identified as such within the asset register. Annex 1 provides a list of current properties held by the Council for investment purposes, which provide a rental income of approximately £540,000 per annum. This level of income is comparably small when compared with council gross expenditure of almost £1.3 billion.
- 10 This strategy forms the basis for the council investing in property on a balanced and risk assessed basis. The Council will consider acquiring investment interests in property, including the acquisition of head leases benefitting from the security of tenure the Council covenant can provide to investment institutions and developers. In addition freehold opportunities are not to be discounted, to provide the Council with flexibility should appropriate opportunities arise.

## Investment Criteria

- 11 In order to assess whether an investment meets the objectives set out in the strategy, clear criteria have been established that forms the basis of an initial appraisal. These are set out in Table 1 below:

**Table 1 - Investment Criteria**

<b>A. Strategic Alignment</b>	Any given investment must clearly align with the councils corporate objectives as detailed in the Council Plan
<b>B. Location</b>	The priority of the strategy is to invest in the geographical and administrative boundary of County Durham as this meets the key objectives and minimises risk to the Council, in addition to providing wider benefits to the County's economy. This could also include investment opportunities that sit on the periphery of the County boundary, where it is proven that they meet the key objectives.
<b>C. Economic Development</b>	Opportunities in relation to economic development require consideration for any investment, in order to understand the wider benefits to the County. This should take into account relevant factors, including but not limited to inward investment potential, job creation and the quality of jobs created.
<b>D. Sector</b>	<p>The consideration of sectors will be specific to each investment opportunity and will need to be appraised as such. Market performance, growth, alignment with key partners and supply and demand within sectors will need to be considered in terms of location within County Durham.</p> <p>To ensure an appropriate risk profile is achieved investments should be cross sector to enable diversification of risk and a spread across sectors. This will prevent over exposure in specific sectors.</p>
<b>E. Tenure</b>	The acquisition of head leases will be considered and fully appraised, although freehold opportunities will also be considered, should appropriate opportunities arise. The strategy will prioritise the opportunities for return on investment balancing commercial risk and regeneration benefits against commercial risk.

<p><b>F. Tenant Performance</b></p>	<p>Head lease and freehold options would result in the Council subletting in order to raise income. The initial appraisal will need to review the quality of tenants and the ability to observe rental commitments. This tenant risk profiling exercise is essential as it directly affects the risk profile of the investment.</p> <p>Full legal and financial due diligence will be required as part of the appraisal process. In addition, the activities undertaken by the tenant will need to be reviewed by the Council to ensure they are considered appropriate for public investment.</p>
<p><b>G. Occupier's Lease Length</b></p>	<p>The length of lease agreements is a key consideration for any investment decision and the Council will need to consider the risks associated with potential void levels and the ability to attract good quality tenants at appropriate rental levels. Shorter lease lengths and break clauses further compound this, although this should be reflected in the rental level received.</p> <p>In terms of risk profile the principle of the longer the lease the more secure the investment applies. However, this should consider break options that may exist in the agreement, alongside the financial status of the tenant.</p>
<p><b>H. Rental Income</b></p>	<p>Rental income will be considered alongside lease length and covenant strength as part of the appraisal. This will need to take into account cost of voids, rental levels, rent reviews and break clauses.</p>
<p><b>I. Building Quality</b></p>	<p>Consideration of the building age and specification is a deciding factor in any investment as it can determine the lifespan, condition and capital expenditure levels required to ensure it remains available for let. An initial appraisal of this will be completed to consider the quality of the building against the proposed length of the Council's tenure.</p> <p>In addition, any acquisition of new build will need to consider the track record of the developer and main contractor, together with the security of warranties and contractual arrangements.</p>
<p><b>J. Repairing Obligations</b></p>	<p>Leases in the market can vary in terms of the repairing responsibilities that the landlord retains. In terms of initial appraisal, lease terms that transfer the repairing obligation to the tenant are more favourable, than those that require the landlord take more responsibility.</p>

<p><b>K. Yield / Return</b></p>	<p>Yield will be considered as part of the initial appraisal and will be directly impacted by a number of the other appraisal criteria. This will inform the return anticipated on the investment, which would need to be considered acceptable in order to progress further.</p>
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## **Governance Arrangements**

- 12 All investment opportunities will need to be subject to an initial appraisal. The initial appraisal will be carried out at officer level and if considered appropriate will be then progress to a full business case. The business case will set out the detailed due diligence work, risk assessment and confirm that the investment meets the key objectives in order to establish the suitability of the investment. In some cases, the appointment of an external investment advisers may be required, where additional advice is necessary.
- 13 The completed full business case will need to be submitted to the Head of Corporate Finance and Commercial Services who will be required to work with service, property, legal and technical experts to assess the opportunity. The current constitution requires that any decision on investment will then need to go to Cabinet for approval. However due to the fast paced nature of the investment process delegated powers may need to be utilised on occasion with full consultation with Portfolio Holders. All acquisitions will be subject to a building survey, valuation and completed business case.

## **Management Arrangements**

- 14 All investment properties held by the Council will be subject to appropriate management, monitoring and review throughout the financial year. Any variation from budgeted performance will be reported as part of the quarterly forecast of outturn reports to Cabinet and Scrutiny. If performance is lower than originally forecast considerations will be given to opportunities to improve performance. Active management of the portfolio on a day to day basis will be undertaken by the council's Corporate Property and Land and Finance Teams, in line with the proposed Corporate Landlord model.
15. If an investment is considered to be underperforming, or no longer meets the key objectives then an exit strategy will be prepared.

## Annex1 – Existing Investment Properties

<b>UPRN</b>	<b>Asset Name</b>	<b>Acquired by DCC</b>	<b>DCC Tenure</b>
50621S01	Durham Wearside House (National Savings)	28/01/15	Leasehold
50658S01	Durham Freemans Reach (Passport Office)	18/03/16	Leasehold
50659S01	Durham Freemans Reach Kiosk	18/03/16	Leasehold
50660S01	Durham Freemans Reach Hydro-Turbine	28/01/15	Leasehold
3372S01	Northumbria House, Aykley Heads, Durham	Transferred to investment 01/11/14	Freehold
3230S01	Priory House, Pity Me, Durham	Transferred to investment 04/07/16	Freehold