Appendix 1

Investment Opportunities Protocol - Land & Property Sub Category

1. Introduction

1.1 This is the land and property sub category protocol which is under the overarching investment opportunities protocol, so as to provide specific guidance to officers dealing with property investment acquisitions. The protocol also provides guidance regarding retention of revenue producing property assets and guidelines for dealing with request by tenants or other parties to purchase or change the Council's interest in a property. It also considers the generation of income through property development or other property transactions and initiatives.

2. Background

2.1 With low rates of interest for deposited reserves the Council has recognised that land and property can generate a return on capital with the additional potential of capital and rental growth in the longer term. Retention of income producing properties and acquisition of carefully selected investment purchases has therefore become an important element of the Council's investment opportunity strategy. In line with this at its meeting of 3 February 2015, the Cabinet considered a report on the Council's Budget Spending Plans 2015-16 and resolved that "a new Investment Opportunities Reserve is created" (Paragraph 6.10). This now stands at £2,118,500 following Cabinet in February 2016 agreeing to add £1,296,400 to the fund. The potential for land and property investment purchases are not, however, restricted to the sum available from this reserve.

2.2 This report sets out the considerations that need to be made, and the procedures to be followed, with regard to future property investment and retention. The strategy aims to provide consistency of approach and transparency to the decision making process.

3. Scope (Terms of Reference)

3.1 A key aim of investing in land and property is for the enhancement of secured revenue income from capital investment above the levels obtainable from other forms of investment. This is part of the Council's objective of providing increased financial resilience in the context of decreased funding from central government.

3.2 Land and property acquisition and development is also a means of influencing regeneration and the economic development within the District. Therefore while one objective may be to increase the financial resources the Council has available, appropriate investment can also extend service delivery or provide community improvement generally.

3.3 For these reasons priority will be given to acquiring property in the Chichester District, albeit opportunities to acquire properties elsewhere shall not be excluded altogether if a justifiable case exists for doing so. Properties outside of the District area but close enough for officers to undertake the management of the property, should be considered, albeit with priority given to the purchase of investments within the District area.

3.4 Additionally the protocol recognises that the strategy does not stand alone but sits within the context of other corporate policies and plans to which due regard shall be given, such as:

- Planning Policies (Local Plan, Local development Schemes, Master Planning Strategic sites etc.)
- Economic Strategy
- Economic Development Action Plan
- Asset Management Plan
- Estates Service Plan – Chichester Enterprise Gateway, Barnfield Drive Development
- Medium Term Financial Plan – size and sources of available funds

3.5 This protocol will need to also consider any future strategies that may be developed over time and so the list stated in 3.4 is not exhaustive.

3.6 The investment strategy aims to acquire land and property for the longer term (10 years or more) to reap the benefit of sustained rental income and capital appreciation as land and property values recover from the effects of economic downturn in recent years.

3.7 From time to time the Council is approached by other parties seeking to obtain interests in Council property and it may not always be in the Council's interests to proceed with them. For example the Council has retained freehold ownership of most of the land at the Quarry Lane and Terminus Road industrial estates and it is not considered to be in the Council's interests to release this in a piecemeal fashion when requested by occupying tenants. Similarly the Council has been willing to extend leases where this facilitates regeneration or redevelopment but not where it is felt that this will prolong the retention of poor standard buildings. More generally the Council wishes to retain revenue earning properties and does not wish to sell to occupying tenants. It will assist officers in dealing with requests of this nature if there are underlying policies that they can refer to.

4. The Council's Legal Power to Acquire Land and Property

4.1 Generally, the Local Government Act 1972 empowers the Council to acquire any land and property or right which facilitates, or is conducive or incidental to, the discharge of any of its functions. Where necessary, the appropriate legal advice shall be obtained to ensure the legality of any proposed transaction before it is secured or obligates the Council.

4.2 The protocol will apply to all acquisitions of land and property for investment purposes. For the purpose of this protocol, an acquisition is defined as acquiring a legal interest in land and property, namely the taking of a freehold, leasehold or licence in land and property for investment purposes. The Strategy also applies to investment by way of commercial property development and partnership schemes.

5. Local Property Market & Investment Opportunities

5.1 The Council's existing property portfolio generates income of approximately £2.5 million per year (as in 2015/16 financial year) for the General Fund revenue account.

5.2 This income comprises rents and licence fees principally from 49 industrial units, 72 commercial and industrial ground leases, 40 shops, 17 offices, 27 lettings to sports, community and voluntary organisations, 7 kiosks and concessions (including the Chichester Traders Market), miscellaneous lettings such as the crematorium and bus station, 17 commercial access agreements and 84 residential access agreements.

5.3 Signs of gradual improvement in property markets in the South East following the aftermath of the 2008 financial crisis and economic downturn in the UK and other European countries for the years that followed mean that it is in the interests of the Council to make further acquisitions as early as possible before property values increase further.

5.4 Investment Opportunities are likely to take 3 main forms.
(a) Freehold or Long Leasehold Purchases
(b) Commercial development of property with the Council retaining ownership and receiving rental income.
(c) Partnerships where another party undertakes the development and the Council (as landowner) receives a proportion of the rental value.

5.5 The Council will pursue a mix of land and property investments for leasing or rent (e.g. industrial, retail or office related units etc.) subject to satisfying the decision criteria specified in Section 6 below. Ideally we are looking for a balanced portfolio but with investment opportunities in the District so limited and the number of investment purchases to date also limited, this is unlikely to be a major consideration.

5.6 Within the Chichester District area investment opportunities are limited and potential acquisitions must be considered as they arise. Retail, industrial and commercial properties are the properties most likely to meet the Council's criteria for investment acquisition. Commercial development provides an alternative means of property investment. Current projects include the Enterprise Gateway and the proposed development of Plot 21 Terminus Road. The development at Barnfield Chichester is an example of a partnership opportunity.

5.7 The Investment Opportunities Reserve currently (at June 2016) holds funds of £2,118,500 but the Council will consider using General Reserves should funds in the Investment Opportunities Reserve be insufficient to acquire a property deemed to be of significant importance or value. Additionally, the Council may consider the possibility of Prudential Borrowing to meet the shortfall providing the outcomes specified in Section 6 below are satisfied and the Council would not exceed its Prudential Borrowing Limits (See Financial Implications below). The use of general reserves is likely to be preferred to borrowing if funds are available.

6. Investment Decision Criteria

6.1 The following matters will be taken into account either in isolation or in combination (e.g. as part of an appropriate evaluation matrix) in assessing the suitability of an investment. It is intended that each investment shall be looked at on its own merits, and the criteria are to be treated as a guide rather than there being a requirement for compliance with every condition.

As a first priority acquisitions should be within the Chichester District Council Area, or, as a second priority sufficiently close by for the asset to be managed by the Council:

Acquisition will be preferred if a community or economic development benefit is achieved through Council ownership, and the acquisition assists in strengthening the local economy. Properties with existing income producing tenancies or pre-lets are likely to be preferred to vacant properties. The suitability of the tenants from an ethical point of view will be considered as part of the evaluation of any investment opportunities. The strength of tenant covenants, length remaining on leases and terms of leases will also be taken into consideration (ideally seeking acquisitions, pre-let to tenants of good covenant on fully repairing and insuring terms, with an unexpired term of at least 5 years and how secure the tenant is);

The acquisition is to provide an acceptable rate of return compared to placing the funds on deposit for an equivalent period, and meet other benchmarks of performance for a similar investment. The rate of return required will vary according to the type of land or property interest being acquired. In the market secure income produces a lower yield than riskier investments but both may be acceptable if the return reflects the circumstances, risk and level of landlord involvement.

Any risks associated with the investment opportunity should be identified and any mitigation actions should be identified in order to ensure that any residual risks are not contrary to the risk appetite of the Council.

Other considerations

- Acquisition will expedite existing agreed Council strategies, plans or priorities;
- Acquisition supports partnering arrangements beneficial to the Council and the local community;
- Acquisition will consolidate the Council's existing land holding portfolio to facilitate larger developments;
- Acquisition will assist in the modernisation of the District's business infrastructure and/or encourage inward investment, re-location or business start-up;
- Acquisition is not in conflict with strategic planning policies;
- Acquisition will not increase the Council's ongoing revenue costs in the longer term;

- Acquisition should generally be good quality commercial land and property but not necessarily limited to traditional sectors, e.g. retail, office and industrial and consideration will also be given to innovative land and property opportunities;

6.2 Investment Purchases

(a) Use of the following table will provide further guidance for the evaluation of prospective properties against a scoring matrix with a minimum score required of least 100 out of a maximum score of 168 (60th percentile). There may however be sound reasons for acquiring a property that does not meet the score and the matrix should be treated as guidance rather than mandatory.

	Score	**4**	**3**	**2**	**1**	**0**
SCORING CRITERIA	**Weighting Factor**	**Excellent**	**Very Good**	**Acceptable**	**Marginal**	**Unacceptable**
Location	12	Major Prime	Micro Prime	Major secondary	Micro secondary	Tertiary
Tenancy strength	10	Single tenant with strong financial covenant	Single tenant with good financial covenant	Multiple tenants with strong financial covenant	Multiple tenants with good financial covenant	Tenants with poor financial covenant strength
Tenure	9	Freehold Lease	125 years plus Lease	between 50 & 125 years Lease	between 20 & 50 years Lease	less than 20 years
Occupiers lease length	5	Greater than 10 years	Between 7 and 10 years	Between 4 & 7 years	Between 2 & 4 years	Less than 2 years; vacant
Repairing terms	4	Full repairing & insuring	Internal repairing - Remainder 100% recoverable	Internal repairing - Remainder partially recoverable	Internal repairing - Remainder non recoverable	Landlord
Lot size	2	Between £2m and £4m	Between £1m & £2m	Between £500,000 & £1m	Under £500,000 or over £4 million	N/A

(b) The net initial yield[1] range should be between 5.0% and 9.0% although exceptions may be made in special circumstances. Generally a lower yield will reflect a more secure investment requiring less management so a high yielding property may not necessarily be a good investment. The Council seeks to achieve a return above the 4.7% minimum rate of return based on the CCLA property fund.

(c) All costs in relation to the purchase and management of the property to be included in assessing the return on the Investment (ROI)

(d) Due diligence checks to generally be made before an acquisition is referred to Cabinet. There may be cases where a quick decision to purchase is required to avoid the property

[1] [Net Initial Yield is defined as the revenue income generated by the investment as a percentage of the property acquisition costs.]

being lost to competitors and here a more limited due diligence may be acceptable before review by Cabinet, with some aspects of more detailed due diligence may in those cases necessarily be undertaken between making an offer and contracting to purchase.

Due diligence checks to include:

- Check lease(s)
- Check condition of property/arrange survey
- Check status of tenant(s)
- Check rents/outgoings have been paid
- Market research – is price/yield appropriate
- Market research – could property be re-let if vacant.
- Title checks – not undertaken until solicitor appointed

6.3 Property Development

(a) Specialist advisers to be employed to provide advice and act for the Council.

(b) Assess costs and future income as accurately as possible. Seek to minimise risks where possible by pre-let agreements, fixing construction costs and avoiding/minimalizing variations.

(c) Seek rate of return no less than return expected on property acquisitions.

6.4 Partnership Transactions

(a) Specialist advisers to be employed to provide advice and act for the Council.

(b) Generally seek income as a percentage of rack rent aiming at between 15% and 20%. Additionally seek premium if maximum rental share that can be agreed does not represent the full land value.

(c) Enter into a development Agreement that looks to the developer partner to bear a share of risks and seeking to minimise the risks to the Council.

7.0 Guidance for Land and Property retention, development and other property initiatives

- The Council will retain revenue producing property assets and will usually reject requests by tenants and other interested parties to acquire the Council's freehold interest.

- Property development (such as the Enterprise Gateway) may be an alternative way of generating revenue income from land and property. There will also be a regeneration/economic development interest arising from this.

- Other property initiatives such as site assembly, taking lease surrenders or buying subordinate leasehold interests will be pursued to improve the Council's property holdings and revenue income.

- Re-gearing of leases, particularly at Quarry Lane and Terminus Road, where existing leases are not on modern terms with modern rent review patterns will be carried out when the opportunity arises. However this is to be used as an incentive to tenants to redevelop sites or substantially refurbish outdated premises and there will be an assumption that extended or re-geared leases will not be granted where a tenant is only seeking a more secure term without undertaking the redevelopment or refurbishment.

- Where a property has strategic value to the Council, some of the above criteria may be relaxed e.g. land capable of development or required to enable development.

8. Property Investment Procedure

8.1 In all cases where the acquisition of an interest in land or property is being considered, the acquisition must be carried out and negotiated by the Estates Service (or otherwise to be determined and agreed).

8.2 The Council will usually appoint an agent who has introduced a potential acquisition to act on behalf of the Council in the negotiations. As part of that instruction the agent will usually be expected to provide a purchase report and valuation. Otherwise, with respect to significant acquisitions (over £750,000), a valuation will be commissioned by the Council from an appropriately qualified third party.

8.3 When a property is identified as a potential investment, it is proposed that the following “Acquisition Protocol” is applied:

ACQUISITION PROTOCOL

1. Potential land or property for acquisition is identified by the Estates Team, and Legal & Finance staff informed.
2. Estates Team in consultation with other officers evaluate each potential land or property acquisition in accordance with the decision Criteria (Section 6 above).
3. If the potential investment meets the decision criteria the Estates Team refer the proposal & evaluation to Senior Leadership Team (or Commercial Programme Board) for approval to report to Cabinet/Council.
4. If the Senior Leadership Team (or Commercial Programme Board) approves the proposed investment the Recommendation is referred to Informal meeting of Cabinet and SLT (or Group of members appointed to consider investment proposals) to give initial approval for provisional offer to be made and due diligence to proceed. Due diligence to be undertaken as far as possible before Cabinet consideration.
5. Prepare report to Cabinet / Council. If approval is obtained, Legal Services are instructed by Estates Team to proceed with formalising the acquisition (Estates Team to assist Legal Services throughout the process until completion).

To ensure that investments meeting the Council’s decision criteria are not lost when time is limited, it is recommended that the Head of Commercial Services in consultation with and approval of the Head of Finance and Governance and Cabinet Member for Commercial Services, be given delegated authority to proceed to negotiate “subject to contract” after Point 2 above has been completed. In some cases it may be necessary to proceed ahead of a programmed Cabinet meeting and to obtain authority from the urgent matters Sub- Committee to contract to purchase a property. No final or binding commitment shall be made by any Council Officer unless all the protocols have been satisfactorily fulfilled.

9. Possible Risks for the Council

9.1 The Strategy recognises that any form of investment is not without risk since property values and rental streams may vary over time, especially where the property is to be retained over many years. Property values and rentals can rise over time but tenancy issues such as need for repairs and voids can also occur and could affect the income received from a property. Accordingly, the strategy operates within the context of the following identifiable risks that the Council consider to be acceptable.

- Acquisition Risk – the property market has been in recession, with less institutional activity, but has signs of increased competitive activity from smaller property companies. This means it is likely that the Council will be one of several bidders for any good-quality properties and may be an unsuccessful bidder on a number of occasions.

- Cost Risk – Abortive costs, including legal costs, survey fees, officer time, all may be incurred in abortive transactions including costs for initial feasibility investigations.

- Lack of suitable sites/buildings –the 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 locality.

- Property market risk – property is an inherently riskier asset than other asset classes because of its physical characteristics, which need to be managed and maintained. This is compensated for by increased returns. However, the property market is not a certain market and the Council may not achieve its target returns if market conditions deteriorate in future years following acquisition.

- Transactions may occur prior to a property ever coming to the market. Obtaining prompt information to identify properties for sale is vital. This can be done through the Estates Team maintaining close contacts with property owners and agents in the locality, but may not always result in a successful acquisition.

- Reputational risk – Risk of damage to the Council's reputation as a consequence of the Council's involvement with a particular property or tenant.

9.2 Accordingly, the Council shall evaluate risks of acquisition on each occasion in order to mitigate the likelihood of the risks occurring, or to minimise abortive costs.

9.3 The risks associated with an investment opportunity once identified, along with any mitigation actions, must also then be assessed or considered against the whole property portfolio. The rate of return normally reflects the perceived risk of an investment opportunity or acquisition (i.e. the higher the risk the higher the rate of return), so it is necessary to ensure that the portfolio is balanced and has a wide range of the rates of return in order to manage the risks.

10. Financial Considerations

10.1 Land and property Investments are likely to produce a higher return than interest received on bank deposits but there are potential risks and costs.

10.2 The Council presently (2016/17) has sufficient reserves to fund limited land and property acquisitions. Future disposals will provide additional potential capital and a new Investment Opportunities Reserve has been established – this being a capital fund derived from a transfer from revenue resources to fund capital expenditure.

10.3 Should funds fall below the amount necessary to achieve a beneficial acquisition that meets the decision criteria in Section 6, the Head of Finance & Governance may consider the option of Prudential Borrowing (within the Council's approved limits for Prudential Borrowing) if the return on investment is equal to or exceeds the cost of borrowing plus the anticipated rate of return. Use of existing reserves is however likely to be preferred if funds are available. The principals contained in the Council's Financial Strategy should be considered when identifying funding sources.

10.4 Accounting guidelines define Investment Properties as properties held "solely for rental or capital appreciation". However, in practice the majority of the Council's income derives from a much broader property portfolio (see Para 5.2).

10.5 Consequently, for any proposed acquisition the Estates Team and Legal Services shall provide Accountancy Staff with the information necessary to ensure properties are correctly classified for financial reporting and accounting purposes, including a comprehensive assessment of the revenue and capital implications.

10.6 In particular, where properties are acquired for leasing to third parties, an assessment shall be required to ensure the leases arising may properly be treated as an operating lease – as this will ensure that revenue budgets may receive the full benefit of the income generated. With this aim in mind, an important consideration is that the lease term is not for the major part of the property's economic life. Furthermore, at the start of the leases, the net present values of future lease payments must not amount to substantially all of the fair value of the properties concerned.

10.7 Expenditure on Council owned property could also impact on the Council's additional VAT allowance (i.e. Partial Exemption Limit). Therefore, it is likely to be in the Council's interests to waive the exemption and opt to tax on new properties acquired, if that option has not already been exercised by the previous landlord. The status of tenants and their ability to reclaim VAT will be an influence to determining whether to opt to waive the VAT exemption. Where development is undertaken it is likely that the VAT exemption will be waived so that the Council can recover VAT on development costs.

11. Other implications.

11.1 The Property Investment Strategy described in this report is intended to be applied in accordance with the Council's prevailing Standing Orders and Financial Regulations, and therefore is not a substitute.

11.2 Accordingly, the procedures for procurement of supplies and services, appraisal of contractors and contracts, and other incidental tasks relating to the acquisition and retention of properties for investment shall follow standing arrangements.

11.3 Any investment opportunity must also adhere to the capital prioritisation assessment protocol.