

Investment Property Portfolio Policy for Governance and Portfolio Management

Introduction

1. As a result of the government's strategy to reduce the national budget deficit, councils have had significant reductions in their funding from government grants. To address this, Sutton Council identified £32m of savings through its Smarter Services Sutton (SSS) programme in 2014/15 but a funding gap of £38m is still projected by 2018/19.
2. The Council's property assets are significant and enable delivery of much of the Council's functions. The overriding requirement to reduce overall revenue expenditure is the main driver of the Council's Corporate Asset Management Strategy which covers the period 2015 to 2019. As a counterpoint to reducing revenue expenditure, the strategy also aims to significantly increase the income earned from property lettings through a focused approach towards the management of commercial property that meets the criteria set for inclusion in a portfolio of investment properties.
3. The purpose of this policy is to set out how the Investment Property Portfolio will be managed and covers the following matters:
 - Risks
 - Objectives and strategic priorities for the Investment Property Portfolio
 - Governance and performance reporting arrangements
 - Portfolio mix
 - Funding and financial performance of the portfolio
 - Investment evaluation criteria
 - Performance indicators for monitoring the portfolio
 - Acquisition procedure

Possible risks for the Council

4. Property investment has its own specific risks, the principal ones being property risks, financial risks and corporate risks. The arrangements set out in this policy are designed to help minimise these risks.
 - a) Property Risks – the property market is cyclical and is affected by the wider economic environment. There are also property risks that are specific to a building due to its location, condition and quality of tenants. Mitigation proposed in this policy for these risks include diversifying the portfolio (portfolio mix) to include investments that perform during different cycles of the economic cycle. The evaluation criteria, diversity of location, due diligence tests, approval processes and accountability for implementation are also proposed to address property specific risks.

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- b) Financial Risks – the primary financial risks are borrowing levels, interest rates movement, ongoing ability to service debts, the general investment market conditions and its effect on rental income. Proposals include the creation of a “trading account” for the IPP and a funding strategy that allocates debt and all associated costs to the IPP so that the net revenue benefits to the Council is transparent and can be benchmarked.
- c) Corporate Risks – effective operational delivery requires staff with the requisite expertise, effective arrangements for asset management and the recognition of the reputational risks that can come from inappropriate tenants, and from legal and environmental breaches. A statement of the Council’s intention to make ethical investments in property is proposed to guide the acquisition of property and management of relationships with tenants. Operational delivery will be managed through the accountability offered by an officer board and the reporting requirements on the performance of the IPP to the Strategy & Resources Committee.

Objectives and strategic priorities for the Investment Property Portfolio

- 5. The aims of the strategy for the Investment Property Portfolio are to:
 - a) to deliver a secure medium to long-term investment return in line with agreed criteria and
 - b) support the economic viability of the borough
- 6. In delivering the strategy over the next 4 years (2015-2019), the following priorities are to be used to guide the growth of the Investment Property Portfolio.
 - a) A major driver for acquisition of new investment property will be income generation. Properties that have a development potential would be referred to the Council’s new DevCo to lead on their development. The IPP could be involved in development schemes in the borough but that would be through the acquisition of the commercial elements of the development.
 - b) A target is to be set to increase the gross income from property investments by 50% by 2019. This is an increase of £1.6m over the current gross income of £3.2m.

Governance and performance reporting arrangements

- 7. The Strategy and Resources Committee will be responsible for approving the strategic priorities and the arrangements set out in this policy for the Investment Property Portfolio. There will also be an annual report to the Committee that will set out performance over the previous year and plans for the next.
- 8. Operational management, including acquisitions, is to be delegated to officers, acting within the delegated powers set out below.

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- a) That the Chief Executive is to be granted delegated powers to authorise acquisitions up to £5m
 - b) That the Urgency Procedure is to be used for acquisitions over £5m
9. An officer board (chaired by the Strategic Director of Resources) is to be accountable for the performance of the IPP and will be charged with making recommendations to the Chief Executive for acquisitions. The officer board to also include:
- Executive Head of Asset Planning, Management and Capital Delivery
 - Executive Head of Housing and Regeneration
 - Executive Head- Customers Commissioning & Governance
 - Executive Head of Economic Development, Planning and Sustainability
10. Disposal of assets in the IPP are to be undertaken in accordance with the Council's standing orders for asset disposals. The officer board will make recommendations to the appropriate officer where, due to disposal value, it is within officer delegated powers, and to the Strategy & Resources Committee where outside officer delegated powers.

Portfolio Mix

11. The current weighting of the classes of property in the IPP, by income, is Industrial 46% (mostly ground rent including Imperial Way), Retail 21%, Offices 21%, and Leisure 9% with most of the Council's property located within the borough and a few just spanning the boroughs boundaries with neighbouring authorities.
12. Over the 4-year life of the strategy, the aim would be to:
- a) Sell low value assets and re-invest all capital receipts in directly managed property with good rental growth potential
 - b) Acquire properties both inside and outside the borough in areas with strong sustainable economic activity i.e. areas with the environment and business activities capable of providing an economy whereby capital and rental growth over the mid to long term was possible
 - c) Achieve a balanced portfolio where no single class of property is larger than 60% and none smaller than 10%.

Funding and financial performance of the portfolio

13. Acquisitions are to be funded using long-term borrowing, with borrowing costs reflected in the reporting of returns achieved by the IPP.
14. All new acquisitions are to achieve a minimum of 2% return net of borrowing and others costs associated with the acquisition.



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- 15. The capital receipt from sale of properties in the IPP is to be reinvested in the portfolio.
- 16. Separate accounts are to be kept for income and expenditure in connection with the IPP and are to be included in the annual report to the Strategy & Resources Committee.

Investment Evaluation Criteria

- 17. The following criteria are to be used to make decisions on acquiring new investment properties:
 - a) Fit with the council’s statement of ethical investment in property
 - b) Acquisition type and fit with portfolio
 - c) Quality of property
 - d) Covenant strength of tenant and unexpired lease term
 - e) Valuation showing a yield greater than borrowing costs plus 2%
 - f) Fit with prudential borrowing powers
 - g) Each investment to be justifiable on its own merit
 - h) Legal advice on powers of acquisition
 - i) Resource implications
 - j) Strategic context of acquisition – some of the above criteria may be relaxed if property is of strategic value to the Council

Acquisition Process

- 18. Acquisition of new investment properties is to follow the following process:

Activity	Acquisition Stage and Timeline
<ul style="list-style-type: none"> a) Property identified as a potential investment by Asset Management or by agents b) Head of Asset Management to notify the Chief Executive and members of the officer board of potentially suitable property and seek views 	Initial Review



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Activity	Acquisition Stage and Timeline
c) If positive, obtain desktop valuation from suitably qualified and experienced valuer	Stage
d) Review the valuation against the cost of borrowing with Head of Financial Strategy and Planning (HoFSP)	2 to 3 Weeks
e) HoFSP to undertake search of tenant to ascertain the company's current financial status	
f) HoFSP to produce initial financial appraisal	
g) Head of Asset Management to determine whether to proceed to appoint external agent to carry out valuation of property to include structural, mechanical, electrical and measured survey and other due diligence investigations	
h) Valuation provided	
i) Notify Lead Member for Resources of the property and of intention to refer to Officer Board for consideration	
j) Officer Board Chaired by Strategic Director for Resources requested to consider proposal to acquire property. Board to consider recommendations from Head of Asset Management, HoFSP, and where appropriate Head of Shared Legal services. Report considered to include outcome of assessment against the Investment Evaluation Criteria	
k) Unanimous decision of the Officer Board is required before recommendation to acquire is made to the Chief Executive, if under £5m, and through the Urgency Procedure if over £5m	
l) Make offer for property, subject , where appropriate to any of the following: <ul style="list-style-type: none"> • Contract • Approval by Chief Executive or via Urgency Procedure • Searches • Receipt and analysis of all leases to determine any landlord's financial obligations • Disclosure of freehold title and review to ensure clear of any onerous restrictions • Structural and mechanical and electrical surveys 	Under Offer 3 to 4 weeks



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Activity	Acquisition Stage and Timeline
<ul style="list-style-type: none"> • Internal inspection • Energy performance certificate • Disability Discrimination Assessment, if appropriate • Environmental desktop study if search suggests one is appropriate • Asbestos survey • Resolution of any TUPE transfer implications • VAT • Insurance requirements • Tax implications <p>m) If appropriate, based on any of the above, propose adjustment to purchase price to reflect the monetary value of any issues discovered</p> <p>n) Instruct legal services to deal with contract documentation for acquisition</p>	
<p>o) Complete any outstanding surveys/ M & E reports and resolve any outstanding contractual matter</p>	Exchange
<p>p) Following agreement of terms, and before instructing exchange of contract, prepare Record of Officer Delegated Decision and advise Leader of the Opposition and Ward Councillors, if located in the borough, prior to publication date.</p>	1 to 2 weeks
<p>q) Exchange contracts, if not simultaneous with completion of purchase</p> <p>r) Arrange for transfer of funds</p>	
<p>s) Complete purchase. Documents and management handed over to Asset Management. Insurance cover arranged</p>	Completion 1 day