

Investment Property Portfolio Policy for Governance and Portfolio Management

Introduction

1. The purpose of this policy is to set out how the Investment Property Portfolio will be managed and covers the following matters:
 - Objectives and strategic priorities for the Investment Property Portfolio
 - Risks
 - 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

Objectives and strategic priorities for the Investment Property Portfolio

2. The twin aims of the strategy for the Investment Property Portfolio are to:
 - a) support the economic viability of the borough; and
 - b) deliver a secure medium to long-term investment return to help sustain the delivery of council functions.
3. In delivering the strategy, the following priorities are to be used to guide the growth of the Investment Property Portfolio.
 - a) acquisitions that help attract and sustain economic activity and investment in the borough
 - b) arrangements that help manage risks and contribute towards achieving a balanced portfolio, including acquisitions in or out of the borough.

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 differently over 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.

- 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 special reserve 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. The council has adopted a statement on ethical investments 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.

Governance and performance reporting arrangements

5. 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 on the performance of the portfolio.
6. Operational management, including acquisitions, is delegated to officers, acting within the delegated powers set out below.
 - a) That the Chief Executive is granted delegated powers to authorise acquisitions up to £5m
 - b) That the Urgency Procedure is to be used for acquisitions over £5m
7. An officer board (chaired by the Strategic Director of Resources) is to be accountable for the performance of the IPP and is charged with making recommendations to the Chief Executive for acquisitions. The officer board is to also include:
 - Assistant Director, Asset Planning, Management and Capital Delivery
 - Assistant Director, Housing and Regeneration
 - Assistant Director, Customers Commissioning & Governance
 - Assistant Director, Economic Development & Programme Director London Cancer Hub
8. Disposal of assets in the IPP is 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

9. The current weighting of the classes of property in the IPP, by rental income, is (October 2018) Industrial 28%, Retail 25%, Offices 42%, and Leisure 4% with most of the Council's property located within the borough and a few just across the borough boundaries with neighbouring authorities and one out of the borough.
10. Over the life of the strategy, a balanced and diversified portfolio will be achieved by:
 - a) Selling low value assets and reinvesting capital receipts in directly managed property with good rental growth potential
 - b) Acquiring properties inside the borough, and also outside the borough where a case can be made that it is in the best interests of the council to seek lawful departure from the requirements of the Statutory Guidance on Local Authority Investments and the CIPFA Prudential Code (where such acquisitions are funded through borrowing).
 - 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

11. Acquisitions are to be funded using cash reserves and long-term borrowing, with borrowing costs reflected in the reporting of returns achieved by the IPP.
12. All new acquisitions are to achieve a minimum of 2% return over the life of the investment, net of borrowing, minimum revenue provision and others costs associated with the acquisition.
13. The capital receipt from sale of properties in the IPP is to be reinvested in the portfolio.
14. The annual report to the Strategy & Resources Committee to contain all the disclosure and reporting requirements of the Statutory Guidance on Local Government Investments that apply to commercial property.

Investment Evaluation Criteria

15. 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 and other costs over the life of the investment 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) Case for lawful departure from Statutory Guidance and Prudential code, where required.
- k) Strategic context of acquisition – some of the above criteria may be relaxed if property is of strategic value to the Council

Statement of Ethical Investment in Property

16. The following statement was approved by the Strategy & Resources Committee of the 28 September 2015 for its investments in commercial property.

“Ethical investment considerations underpin the London Borough of Sutton’s decisions when making property investments. The Council is mindful that it should avoid undermining its community leadership role through profiting from, or by providing capital for activities that are inconsistent with its vision of building a community in which all can take part and all can take pride”

Acquisition Process

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

Activity	Acquisition Stage and Timeline
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 Stage

<p>c) If positive, obtain desktop valuation from suitably qualified and experienced valuer</p> <p>d) Review the valuation against the cost of borrowing with Head of Financial Strategy and Planning (HoFSP)</p> <p>e) HoFSP to undertake search of tenant to ascertain the company's current financial status</p> <p>f) HoFSP to produce initial financial appraisal</p> <p>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</p> <p>h) Valuation provided</p> <p>i) Notify Lead Member for Resources of the property and of intention to refer to Officer Board for consideration</p> <p>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</p> <p>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</p>	<p>2 to 3 Weeks</p>
<p>l) Make offer for property, subject , where appropriate to any of the following:</p> <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 	<p>Under Offer</p> <p>3 to 4 weeks</p>

<ul style="list-style-type: none"> ● Structural and mechanical and electrical surveys ● 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>	<p>Exchange</p>
<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>	<p>1 to 2 weeks</p>
<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>	<p>Completion</p> <p>1 day</p>