Appendix ~~B~~A – Updated WDBC Commercial Investment Strategy

This strategy replaces the Council's Commercial Property Acquisition Strategy which was approved ~~September~~ July ~~2018~~2019. This Strategy covers both commercial development on Council-owned land and commercial acquisitions. The tracked changes show the differences/changes from the Strategy approved in July 2019.

Overall Objectives:

The Council's Commercial Investment Strategy has multiple objectives as stated below:

- To support regeneration and the economic activity of the Borough, the LEP area and the South West Peninsula (in that priority order)
- To enhance economic benefit & create business rates growth
- To assist with the financial sustainability of the Council as an ancillary benefit
- To help the Council continue to deliver and/or improve frontline services in line with the Council's adopted strategy & objectives.
- Security and Liquidity

Desired Outcomes:

The following outcomes are desired by the application of this strategy. Each acquisition or development opportunity will be assessed on its fit with meeting the objectives stated above and should deliver one or more of the following outcomes (benefits):

- ✓ Job creation or safeguarding
- ✓ Health & Wellbeing
- ✓ Town centre regeneration
- ✓ Tourism / Increased footfall
- ✓ Business rate growth
- ✓ Improved asset utilisation
- ✓ A minimum Net yield of 1%
- ✓ Climate Change Mitigation

This Strategy will be achieved by developments on Council owned land and commercial acquisitions within the South West Peninsula. This will include the focussed acquisition of existing commercial property assets including renewable energy investments and the development on Council owned land of new properties which are to be let to third parties.

The following four types of investment are recognised in the Statutory Guidance on Local Government Investments (3rd Edition) (SGLGI):

1. Financial investments:

a. Specified investments - generally short term investments (para 31 and 32)

b. Loans - including to wholly owned companies (para 33 and 34)

c. Non-specified investments (e.g. shares) - generally longer term investments (para 35 and 36)

2. Non-financial investments (e.g. property) - non-financial assets, held primarily or partially to generate a profit (para 37 to 40)

As described above, this strategy therefore relates primarily to non-financial investments ie. Property. However, in the case of renewable investments it is possible that they may be classified as Financial Investments – Non specified investments. This strategy recognises that the purchase of Special Purpose Vehicles (SPVs) so as to own, operate or invest in renewable energy generation is a category of investment covered in this strategy.

Risk

- The risks of acquiring property may be mitigated through the acquisition of assets with secure, long income streams, although this risk will be weighed up against the social and economic benefits of acquisitions to support commerce and trade in the Borough and the wider South West Peninsula
- Acquisitions are to be made in a careful and controlled manner, with specific analysis of risk criteria carried out in the 'due diligence' stage prior to the completion of each purchase
- The Council's due diligence procedures are set out in detail in Section 5.3 of the Council's Investment Strategy. The Council's Investment Strategy also sets out Investment Indicators such as Debt to net service expenditure ratio and commercial income to net service expenditure ratio.
- The portfolio will be relatively risk-averse, targeting tenants of strong financial standing and minimum unexpired lease terms of four years at the date of acquisition. However, these criteria will be considered on a case by case basis and can be outweighed in order to meet the strategy objectives
- Risk of loss (Para 41 SGLGI) shall be assessed on a case by case basis as part of the acquisition due diligence and will be a criteria considered throughout the approval process. Risk of loss during the management phase of the investment shall be reported in accordance with the criteria below.
- In accordance with Para 23-25 of SGLGI, quantitative indicators or risk and portfolio performance will be reported to Audit Committee. The frequency of this reporting is anticipated to be every 6 months and will include the following indicators (as applicable):
    - Rental value by property
    - Rental value by tenant
    - Sector split by purchase price
    - Purchase price
    - Rental income profile
    - Tenant lease length
    - Gross Yield
    - Management, Maintenance and Risk Mitigation Reserve (MMRM) value
    - Current value
    - In the case of an SPV, relevant criteria shall be reported depending on the nature of the SPV.

Location:

- Wherever opportunities arise within the peninsula, in order to acquire good properties which deliver the Council's multiple objectives stated above and are deemed an acceptable risk. Where renewable energy investments are considered, subject to further legal advice, a UK wide geographic search will apply. This shall be the least preferable option, but is included as this Strategy recognises that due to the national grid, geography is not a barrier to investment in renewable energy directly for the Borough.

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Tenant mix:

- Where possible, a mix of tenants will be sought to create a balanced portfolio
- The final decision over the appropriateness of any tenant would be reviewed at the time of acquisition
- WDBC owns a significant number of commercial units already within the Borough, mainly smaller units and tenants with relatively low credit ratings. This reflects the historic policy of supporting small start-ups which has proved successful and continues to be. Newer acquisitions are likely to be for larger units which may have single tenant occupancy.

Lease length:

- A minimum 4 years unexpired (mean unexpired term for multi-let properties) is preferable, however this is flexible if it helps achieve the strategy objectives
- For multi-let properties, a mix of lease expiry dates are preferred, thereby limiting void risk (unless the property is purchased with a view to re-development)
- Properties would preferably be let to sound tenants on leases with a preference for 'Full Repairing and Insuring' leases for single occupiers and through internal repair obligations and a service charge for multi-let properties. There may be overriding economic reasons to move away from this position and these will be considered on a case by case basis.

For all of the above:

The final decision over the definition of "good", "secure", "strong", "long", "careful", "controlled", "acceptable", "balanced" and "risk-averse" will be agreed between the property acquisition advisers (including legal due diligence) and the Officers delegated with the responsibility to conclude the acquisition of the properties. This discretion will be based on both the risk to the capital value of the asset and its fit with the Strategy objectives.

Yield:

- The Council will only acquire properties where the running cost does not require Council subsidy. Per acquisition, a minimum net yield (an ancillary benefit) of 1.0% is to be sought, after acquisition, management, maintenance, capital repayment and funding costs. However, the Council may opt to accept a net yield return of less than 1% if the benefits of job creation or safeguarding, tourism, town centre regeneration, business rate growth or effective asset utilisation are deemed more important than a purely financial return.

Value & Cost:

- Acquisitions and development initiatives will be funded using predominantly borrowing or any other unallocated or available Council reserve or capital receipt.
- Larger lot sizes are favoured - smaller size properties have disproportionately higher management costs and expose the Council to greater property void risks, but the economic and trade benefits of buying smaller units may outweigh this.
- Acquisition costs are forecast not to exceed 7% (Stamp Duty Land Tax (SDLT) / Legal / Agents / Due Diligence). These costs are to be contained within the overall strategy budget

Funding:

- This is to be secured on a case by case basis on the most commercially advantageous terms available predominantly through borrowing or any other unallocated or available Council reserve or capital receipt. The Council shall not borrow more than or in advance of need as part of the funding for investments of developments so as to benefit from the investment of the extra sums borrowed (para 46 & 47 SGLGI). There are no circumstances in which the Council would seek to disregard the prohibition on borrowing ahead of need, purely for profit. The investment in renewable energy generation (SPV) would be made with a view to reducing the Council's carbon emissions and to mitigate the climate emergency that has been declared by the Council and many local authorities across the UK.

- The Council will review from time to time the appropriate borrowing limits for commercial acquisitions and development on Council owned land.
- 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. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the Authority will spread its liquidity profile across its portfolio and also have a spread of the sector in which the Council invests. The Council also documents potential exit strategies as part of its due diligence checks.
- The term will not exceed the expected remaining life of the property, but as a rule, the Council wishes to secure borrowing over a maximum 50 year term. Liquidity will be a factor in determining the amount of rent set aside in the Maintenance Management and Risk Mitigation R ~~r~~eserve for each investment. This will be reviewed with the same frequency as the risk reporting procedure set out in this strategy.
- Capital repayments will seek to repay a minimum of 50% of the capital value of any acquired property.
- For non specific financial investments the period of the loans shall be linked to either the viable business case of the investment or the asset life whichever is the shortest as determined at the time of acquisition or investment.

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Tax Implications:

- Due to the Council holding the asset, it is not anticipated that there will be any corporation tax or income tax implications from this strategy
- Some properties may be VAT elected, meaning VAT must be charged to tenants. This will be dealt with on a case by case basis and will be covered by the due diligence connected with that acquisition. The Council is able to charge and recover VAT
- Capital Gains Tax would not apply to assets sold from Council ownership. This position may change if a company were to be used to hold the acquired asset.
- Where investments in companies (such as SPVs) are made in line with this strategy, all tax liabilities shall remain with the SPV.

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Exit Strategy:

- The Council is not looking to actively trade commercial property within the first 5 years of ownership of any acquired property, however this is flexible if required to meet this strategy's objectives
- If it is determined that the most prudent action is to sell an individual asset, this will be considered on a case by case basis and will be decided by the Council's Head of Paid Service and Section 151 Officer in consultation with the Invest to Earn Committee Chairman and the Leader of the Council.

- It is proposed that the majority of investments shall be non – financial investments (properties) and as such will be held as Council Assets. Investments such as Special Purpose Vehicles (SPVs) shall be owned through the purchase of shares. ~~It is proposed that all properties will be held as Council Assets. This may change if the Council were to set-up a trading company and it was found to be commercially advantageous for such a vehicle to hold the asset~~

- It is important to note that there would be early repayment charges if borrowing used to acquire or develop a commercial property was repaid before the end of the loan term. However, Public Works Loan Board (PWLB) lending is not secured against property, so would not inhibit the asset being traded during the loan period. An alternative asset could be purchased (& held) with any sale receipt.

Governance Arrangements:

Commercial Acquisitions

Acquisitions must conform to the adopted Commercial Investment Strategy. Any deviation from the agreed Strategy will require Council approval.

The Council's Senior Leadership Team will initially consider each proposal (development or acquisition of property or renewables) as an initial step and recommend that the proposal proceeds in principle.

The Invest To Earn Committee will consider and evaluate (in accordance with this Strategy) proposals for commercial acquisition of assets on a case by case basis, and will make any necessary recommendations to the Head of Paid Service and Section 151 Officer who will make a decision in consultation with the Leader of the Council and Chairman of the Invest to Earn Committee

Specialists will be commissioned to act on behalf of the Council to source suitable properties and manage the acquisition due diligence process.

The Council will consider debt proportionality (the amount borrowed to date against the ~~agreed total borrowing cap~~ net service expenditure ratio) on a case by case basis for each acquisition as part of the decision making process, with information provided to the Invest to Earn Committee Members, the s151 officer, the Head of Paid Service and the Leader of the Council. Investment Indicators are set out within the Council's Investment Strategy. Table 2 of the Council's Investment Strategy shows the aggregate of commercial property income and treasury income as a percentage of the Council's gross service expenditure.

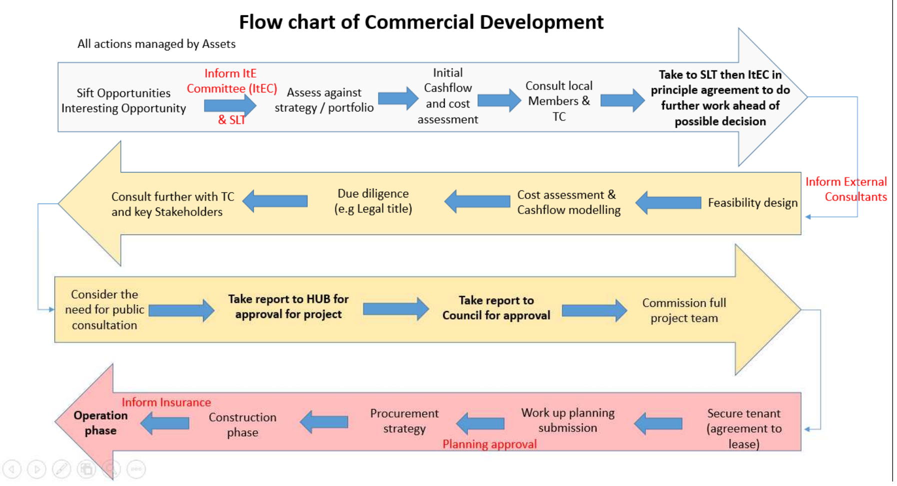
The Council undertakes sensitivity analysis of the interest repayments on its borrowing requirements as a percentage of its available reserves to ensure there is sufficient coverage in the event that rental income is below that forecasted, or if energy prices are below that forecasted in the case of a solar farm. The Council also put 10% annually of all rental income and income from energy prices into a Maintenance, Management and Risk Mitigation (MMRM) Reserve. This is part of the Council's contingency arrangements.

Before a final decision is made to proceed with a commercial acquisition local ward members will be briefed and be able to share their views with the Invest to Earn Committee.

Governance: In area developments on Council owned land

Development proposals on Council owned land must conform to the objectives of this Strategy. Unlike commercial acquisitions however, they shall not benefit from the same scheme of delegation. Instead, approvals must be sought through the HUB committee and Full Council process. Decisions on in area development shall consider, as appropriate, the views of the local members and key stakeholders (Town Council / Parish Council) as one of many aspects of any projects brought forward.

The flow chart below sets out the approvals process as well as the main steps for in area development.



Running / Review

If the management of the acquired or developed assets cannot be managed in-house by existing resources, it will be outsourced to property professionals. The cost of this management is to be deducted before calculating the net yield.

Regular reports will be made to the appropriate body on portfolio composition and performance (Invest to Earn Committee, Hub Committee and/or the Audit Committee) as ~~required~~set out above.

Disposal

Once acquired, decisions relating to the ownership of any acquired properties will be dealt with in-line with the Council's Scheme of Delegation.

Disposal will be considered if the portfolio breaches the approved Strategy. Decisions to be made in consultation with the Invest to Earn Committee Chairman , Leader of the Council, S151 officer and Head of Paid Service.

Resources:

The work to filter, appraise and recommend investment and development opportunities will be undertaken within the Assets Head of Practice (HoP). This will be supplemented by specific consultant advice as required and associated costs built into the business case for each project. The Assets HoP has strong relationships with a number of local and national consultants who will be required to support the projects. Examples of this include (but are not limited to): CCD Properties (development specialists), Arcadis (building technical due diligence), Womble Bond Dickinson (legal due diligence) and Savills (commercial property investment advice).

Risk assessment and due diligence
The Authority assesses the risk of loss before entering into and whilst holding property investments/property opportunities by carrying out appropriate due diligence checks and implementing mitigation measures in managing risk:

- The tenants need to be of good financial standing (this is assessed using Dun & Bradstreet credit rating reports and annual accounts). The number of tenants e.g. sole tenant or multi tenanted will be assessed.
- The property condition such as date of construction and any imminent or significant refurbishment or modernisation requirements (forecast capital expenditure).
- How the property investment or financial, non specified investment meets the Council's multiple objectives as set out in the Council's strategy e.g. Liquidity, renewable energy, economic regeneration, business growth.
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- The lease must meet certain standards, such as being in a commercial popular location and have a number of years left on the lease providing a certain and contractually secure rental income stream into the future. Any break clauses will be assessed along with the number of unexpired years, bank guarantees and rent reviews.
- The location will be either within West Devon Borough Council's boundary, the LEP area or the South West Peninsula (in that priority order), as set out in the Commercial Investment Strategy (apart from renewable energy investment which may have a wider geographic spread). The population of the catchment area, the economic vibrancy and known or anticipated market demand as well as proximity to travel infrastructure and other similar properties will be assessed.
- Rental income paid by the tenant must exceed the cost of repaying the borrowed money from the Public Works Loan Board (which is itself funded by the Government). The surplus is then an ancillary benefit which supports the Council's budget position and enables the Council to continue to provide services for local people.
- The gross and net yield are assessed against the Council's criteria.
- The prevailing interest rates for borrowing at the time.
- Debt proportionality considerations.
- The life and condition of the property is assessed by a valuer and the borrowing is taken out over the life of the asset. The amount of management and maintenance charges are assessed as well as the ease of in-house management. 10% of all rental income (or an amount as deemed prudent) is put into a Maintenance, Management~~ ~~and Risk M~~anagement~~Mitigation Reserve to cover any longer-term maintenance issues.
- The potential for property growth in terms of both revenue and capital growth will be assessed.
- The risks are determined by the property sector e.g. office, retail, industrial, associated with specific properties and the mix of sectors within the Council's portfolio.

- Details of acquisition costs e.g. stamp duty land tax, legal costs
- The documented exit strategy for a purchase/new build.
- The legal and technical due diligence checks will also identify any specific problems such as anomalies in the title deed, restrictive use classes, indemnities, local competition, construction or refurbishment requirements.
- The Council engages the use of external advisors to assist in undertaking elements of the due diligence checks such as technical, legal, accounting, property and taxation advice.
- The Council undertakes sensitivity analysis of the interest repayments on its borrowing requirements as a percentage of its available reserves to ensure there is sufficient coverage in the event that rental income is below that forecasted. This ensures that the Council has the available reserves to enable service delivery to be maintained in the short to medium term, whilst alternative solutions are implemented.