

West Berkshire Council - Property Investment Strategy (revised)

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January 2018

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Introduction

This document has been prepared by Dean Fischer on behalf of West Berkshire Council (WBC).

This document supersedes the original Investment Strategy, prepared by JLL during March 2017, and adopted by WBC on 9th May 2017. Embedded within the original strategy was a mechanism to review and revise every twelve months, so as to ensure that WBC commercial property portfolio is tightly aligned to WBC's investment objectives.

Whilst the JLL strategy has provided a robust launch point, it has become evident that there is a need to fine-tune the investment framework so as to suitably empower the WBC Property Investment Board (PIB), ensure increased exposure to appropriate opportunities, enhance flexibility during acquisition and underpin the portfolio's long term performance.

Mindful of the above, WBC requested its appointed property consultants, Montagu Evans (ME), to review and revise the existing strategy where appropriate, so as to ensure exposure to a wider range of suitable properties, whilst creating a defensive, balanced commercial property investment portfolio, from which to derive a long term, sustainable revenue stream.

The WBC portfolio will seek to invest in the region of £50m which will likely equate to 8-12 properties in total (dependent on lot sizes).

Yields referred to in this report (unless otherwise stated) are net of purchase costs and exclude the cost of debt.

Core Objectives

Set out below are the core objectives of the investment strategy:

- To invest in good quality commercial property to generate a sustainable and predictable income return
- To acquire standing commercial property investments which generate an immediate income, through being let on commercial terms, or from properties which are contracted to be let
- The desired income yield (return) to provide a clear margin over the cost of capital, in a form which is sustainable, and has the potential to increase through future rental growth
- An even balance of risk and return is achieved through portfolio diversification

- To acquire investment grade properties possessing characteristics that retain liquidity and preserve capital (notwithstanding market movement)

Investment Strategy

The strategy is defined in two sections:

Section 1 – details the revised core strategic investment policy to be adopted by WBC.

Section 2 – an Aide Memoir of the investment framework to be referred to by the appointed Investment Advisor (ME) and the PIB.

Section 1 – Investment Policy

The WBC property investment framework is structured according to the following core principles:

- Acquisitions to be made in direct commercial real estate
- UK wide target market (to include WBC area)
- Generally, investments to be purchased freehold, with good and assignable legal title. Leaseholds considered where held under long leases (100 years plus) at a peppercorn rent
- To acquire institutional grade income producing investments, let on conventional lease terms and secured against good to strong covenants (Dunn & Bradstreet rating 3A1 – 5A1)
- Target portfolio net yield of 6.0% (once fully invested)
- Asset level internal rate of return (IRR) averaging not less than 5.0% p.a. over an assumed 5 year hold period
- No investment in speculative development
- No investment in areas within Flood Zone 3 or with a high land contamination risk

Section 2 – Investment Guidelines

This section provides a ‘hand-rail’ which will help guide the decision making process when assessing investment opportunity. Its principles are to create a defensive and balanced commercial property investment portfolio with intrinsic risk diversification.

Portfolio Structure

Categories	Target Weighting	Target Yield	Asset Profile
Prime	60%	6% or lower	Net yield of 6% or lower, established location, very strong tenant covenant, unexpired lease term of 9 ¹ years or more
Good Secondary	40%	6% or higher	Net yield of higher than 6%, good location, strong tenant covenant, unexpired lease term commensurate with prevailing market conditions

Sector Weightings

Sector	Target Weighting	Asset Profile
Industrial/Warehouse	Up to 40% (£20m)	Logistics hubs, light industrial, trade parks
Retail	Up to 40% (£20m)	Small supermarkets, restaurants, retail warehouses, shops
Offices, Alternatives and Others	Up to 35% (£17.5m)	Offices, business parks, hotels, cinemas, petrol stations, wind farms

¹ Note 9 years to allow access to stock which has recently been let on a ten year term so will have slightly less than ten years after allowing for marketing and legal process.

Asset Risk Diversification – Guidelines

Attribute	Why	Risk/Solution
Lot Size – up to £15m	Generally, no single asset should be over 40% (£15m) of the fully invested portfolio by value.	<p>Risk - Exposure to single asset.</p> <p>Solution - by acquiring only longer income lots with a minimum 9-10 years unexpired lease term and a tenant covenant of 5A1 on the Dunn & Bradstreet rating.</p>
Income risk – exposure generally restricted to circa. £750k per tenant per annum	<p>Manages income risk and security through tenant diversification and lease length.</p> <p>Provides the potential to acquire a stable, long income asset around which to structure a portfolio of complementary assets.</p>	<p>Risk - Exposure to tenant failure, voids and potential negative cash flow.</p> <p>Solution – investment will be subject to the tenant having a Dunn & Bradstreet rating of 5A1 and with a minimum unexpired term of 9-10 years.</p>
<p>Location:</p> <ul style="list-style-type: none"> • South East up to 60% (£30m) • South West & Midlands up to 35% (£17.5m) • North up to 35% (£17.5m) • Scotland & Wales up to 35% (£17.5m) 	Spread of risk through investment diversification in different micro-locations	<p>Risk - Over exposure to locational risk where negative impacts of weak or low growth could affect total performance.</p> <p>Solution - Focus on dominant SE market to increase exposure to suitable defensive investment opportunities.</p>
Sector (retail/office etc.) No more than 40% held in a specific sector at any time	To create greater portfolio balance with different sectors holding different risk v return profiles	<p>Risk - Over exposure to an under-performing sector.</p> <p>Solution - Focus on dominant SE market to increase exposure to suitable defensive investment opportunities</p>

<p>Regional Weighting No more than 40% (60% in SE only) held in a specific region at any time</p>	<p>To provide a spread of risk to balance performance from regional spread. Different regions within the UK often perform (grow) at different rates and at different times within an economic cycle</p>	<p>Risk - Exposure to regional under-performance through lower economic growth.</p> <p>Solution - Focus on dominant SE market to increase exposure to suitable defensive investment opportunities.</p>
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Quarterly & Annual Review

During November 2017 ME were instructed by WBC to review the overall strategy to ensure its suitability and resilience in relation to the size of financial resource committed and the prevailing market conditions. The basis of that review forms the backbone of this document. The investment criteria, guidelines and performance will remain under regular review.

As good practice, quarterly and an annual reviews between WBC and ME will be held so as to ensure that the portfolio does not under-perform the market or its risk profile increase due to changes in both the macro and micro-economic position around the real estate market.

This will provide WBC with a clear understanding of the portfolio’s position and management, its risk and return profile and any latent value that can be driven out through strategic asset management.

A regular review of the five year cash flow is important to understand any future working capital requirements, as well as assessing the accuracy of the predicted rental income.

The quarterly and annual strategy review will cover:

Quarterly	Annual
<p>Investment:</p> <ol style="list-style-type: none"> 1. Brief market update – investment trends, activity and forecasts 2. Brief update on the occupational markets 3. Review of current investment strategy 4. Report on performance of the 	<p>Investment:</p> <ol style="list-style-type: none"> 1. Market update on investment trends, activity and forecasts 2. Update on the occupational markets 3. Review of current investment strategy 4. Re-confirm investment criteria

<p>portfolio and individual assets</p> <ol style="list-style-type: none"> 5. Provide a review of portfolio activity and the added value created over the previous quarter 6. Update Work/Hold/Sell asset designation 	<p>and asset target weightings</p> <ol style="list-style-type: none"> 5. Identify any re-alignment required to match market changes and forecasts 6. Benchmarking the existing portfolio and asset level investment returns 7. Report on performance of the portfolio and individual assets 8. Report on any KPI or performance criteria 9. Provide annual property business plans to evaluate added value opportunities 10. Provide a review of portfolio activity and the added value created over the previous 12 months 11. Update five year cash flow forecast 12. Update Work/Hold/Sell asset designation
<p>Management:</p> <ol style="list-style-type: none"> 7. Report on portfolio management performance including rent collection rates, bad debt provision and service charge reconciliations 8. Advise on all critical lease dates, break options, rent reviews and lease expiries 9. Report on any health and safety incidents and insurance claims 10. Report on dilapidations claims and status 11. Capital expenditure requirements over the preceding quarter 	<p>Management:</p> <ol style="list-style-type: none"> 13. Report on portfolio management performance including rent collection rates, bad debt provision and service charge reconciliations 14. Advise on all critical lease dates, break options, rent reviews and lease expiries 15. Report on any health and safety incidents and insurance claims 16. Report on dilapidations claims and status 17. Capital expenditure requirements over the preceding 12 months

Portfolio Valuation

An annual external valuation is to be undertaken to enable WBC to benchmark the property portfolio/asset performance as well as ensure that current book values are in line with prevailing market values.