

# West Berkshire Council - Commercial Property Investment Strategy (revised)

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## 1. Introduction

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

This document supersedes both the original Investment Strategy adopted by the Council on 9<sup>th</sup> May 2017 and the revised Strategy approved by the Council at its meeting of 1<sup>st</sup> March 2018.

Embedded within the original strategy was a mechanism to review and revise the strategy, so as to ensure that WBC commercial property portfolio is aligned to WBC's investment objectives.

Whilst the original JLL strategy provided a robust launch point, and with the procured appointment of Montagu Evans (ME) to work with the council in both the acquisition of property and the ongoing management of the portfolio, it is prudent to periodically review the strategy to react to changes in the market, changing legislation and guidance to 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.

The WBC portfolio will seek to invest up to £100m which will likely equate to 12 to 14 properties in total (dependent on lot sizes).

## 2. 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 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)

### **3. 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-memoire of the investment framework to be referred to by the appointed Investment Advisor (ME) and the PIB.

### **4. 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
- 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)
- With an allocation of £100m and capital remaining to be spent of £37.4m, it is proposed to concentrate on the revenue income expectations. The yet to be acquired assets need to deliver gross rental income of £2.15m to keep in line with income of the fully invested portfolio. This is intended to offer gross rent of £5.8m for a fully invested portfolio, when fully let, at full rent (ie – with no voids or rent free periods), for a full financial year.
- No investment in speculative development
- No investment in areas within Flood Zone 3 or with a high land contamination risk

## 5. Section 2 – Investment Guidelines

This section provides criteria 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
<b>Prime</b>	<b>60%</b>	6% or lower	Net yield of 6% or lower, established location, very strong tenant covenant, unexpired lease term of 9 <sup>1</sup> years or more
<b>Good Secondary</b>	<b>40%</b>	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
<b>Industrial/Warehouse</b>	<b>Up to 40% (£40m)</b>	Logistics hubs, light industrial, trade parks
<b>Retail</b>	<b>Up to 30% (£30m)</b>	Small supermarkets, restaurants, retail warehouses, shops
<b>Offices, Alternatives and Others</b>	<b>Up to 40% (£40m)</b>	Offices, business parks, hotels, cinemas, petrol stations, wind farms

<sup>1</sup> 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
<p><b>Lot Size – up to £15m</b></p>	<p>Generally, no single asset should be over 15% (£15m) of the fully invested portfolio by value.</p>	<p>Risk - Exposure to single asset. Solution - by acquiring only longer income lots with a minimum 9-10 years unexpired lease term and a tenant covenant of 3A1 or higher on the Dunn &amp; Bradstreet rating.</p>
<p><b>Income risk – exposure generally restricted to £750k per tenant per annum</b></p>	<p>Manages income risk and security through tenant diversification and lease length.  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.  Solution – investment will be subject to the tenant having a Dunn &amp; Bradstreet rating of 3A1 or higher and with a minimum unexpired term of 9-10 years.</p>
<p><b>Location (borrowed £):</b></p> <ul style="list-style-type: none"> <li>• South East up to 60% (£60m)</li> <li>• South West &amp; Midlands up to 20% (£20m)</li> <li>• North up to 20% (£20m)</li> <li>• Scotland &amp; Wales NIL%.</li> </ul>	<p>Investing only within the district boundary of West Berkshire Council, in compliance with CIPFA ‘Prudential Property Investment’</p>	<p>Risk - Over exposure to locational risk where negative impacts of weak or low growth could affect total performance.  Solution – Whilst constrained, WBC district falls within the strong region of the SE.</p>
<p><b>Location (cash £):</b></p> <ul style="list-style-type: none"> <li>• South East up to 60% (£60m)</li> <li>• South West &amp; Midlands up to 35% (£35m)</li> <li>• North up to 35% (£35m)</li> <li>• Scotland &amp; Wales 35% (£35m).</li> </ul>	<p>With opportunity of the freedom to consider the wider geographical area, to spread risk across the portfolio.</p>	<p>Risk - Over exposure to locational risk where negative impacts of weak or low growth could affect total performance.  Solution - Focus on dominant SE market to increase exposure to suitable defensive investment opportunities, but with the scope to seek acquisition nationally.</p>

## 6. Quarterly and Annual Reporting

As good practice, the Property Investment Board (PIB) will receive and consider quarterly reports from Montagu Evans (ME) to convey both market updates, performance of the portfolio and any proposals (see guidance in the table below).

An annual review 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 reporting will cover:

Quarterly reporting	Annual reporting
<p><b>Investment:</b></p> <ol style="list-style-type: none"><li>1. Brief market update – investment trends, activity and forecasts</li><li>2. Brief update on the occupational markets</li><li>3. Review of current investment strategy</li><li>4. Report on performance of the portfolio and individual assets</li><li>5. Provide a review of portfolio activity and the added value created over the previous quarter</li><li>6. Update Work/Hold/Sell asset designation</li></ol>	<p><b>Investment:</b></p> <ol style="list-style-type: none"><li>1. Market update on investment trends, activity and forecasts</li><li>2. Update on the occupational markets</li><li>3. Review of current investment strategy</li><li>4. Re-confirm investment criteria and asset target weightings</li><li>5. Identify any re-alignment required to match market changes and forecasts</li><li>6. Benchmarking the existing portfolio and asset level investment returns</li><li>7. Report on performance of the portfolio and individual assets</li><li>8. Report on any KPI or performance criteria</li><li>9. Provide annual property business plans to evaluate added value opportunities</li><li>10. Provide a review of portfolio activity and the added value created over the previous 12 months</li><li>11. Update Work/Hold/Sell asset</li></ol>

	designation
<b>Management:</b>  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	<b>Management:</b>  12. Report on portfolio management performance including rent collection rates, bad debt provision and service charge reconciliations  13. Advise on all critical lease dates, break options, rent reviews and lease expiries  14. Report on any health and safety incidents and insurance claims  15. Report on dilapidations claims and status  16. Capital expenditure requirements over the preceding 12 months

## 7. 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.

## 8. Property Investment Board (PIB)

Acquisition and disposal of property in accordance with the Commercial Property Investment Strategy is delegated to the Head of Legal and Strategic Support in consultation with and having received agreement from the Property Investment Board up to a maximum of £15 million per transaction.

All proposed acquisition and disposal of property held within the commercial property investment portfolio is brought before the Property Investment Board (PIB).

The terms of Reference and Membership for PIB is as described in the appendix below:

## Appendix PIB Terms of Reference

Purpose:	To establish the revised agreed Terms of Reference for the Property Investment Board (PIB).
Release Date:	<b>March 2020</b>
Author:	Richard Turner      Property Services Manager

<b>1</b>	<b>Background</b>
<p>At a full meeting of West Berkshire District Council on 9<sup>th</sup> May 2017 (C3283) the Council approved the Property Investment Strategy.</p> <p>The Property Investment Strategy:</p> <ol style="list-style-type: none"><li>1. Is an addendum to the Council's Investment and Borrowing Strategy 2017/2018;</li><li>2. Delegates to the Head of Legal and Strategic Support in consultation with and having received agreement from the Property Investment Board to purchase investment property in accordance with the Strategy up to a maximum of £15m per transaction;</li><li>3. Delegates to the Head of Legal and Strategic Support in consultation with and having received agreement from the Property Investment Board to dispose of property in accordance with the above Strategy up to a maximum of £15m per transaction;</li><li>4. To delegate to the Head of Finance and Property in consultation with the Portfolio Holder with responsibility for Property, authority to appoint suitable consultants in accordance with the Contract Rules of Procedure (Part 11 of the Constitution).</li></ol> <p>West Berkshire Council will invest up to £100 million of capital in commercial property to</p>	
<b>2</b>	<b>Purpose</b>
<p>The members of the Property Investment Board (PIB) or their substitutes will collectively be responsible for the recommendations made by them having received reports related to the acquisition (or disposal) of commercial property.</p> <p>The PIB will play a critical role in the governance of the property investment strategy including ongoing monitoring of performance in order to make informed decisions.</p>	

<b>3</b>	<b>Terms of reference</b>
<p>The PIB terms of reference are:</p> <ol style="list-style-type: none"><li>1. To make recommendation to approve or reject the proposal to progress with the acquisition of an individual property by way of delegated authority by the Head of Legal and Strategic Support, having received a report from Property Services.</li><li>2. In circumstances where a report proposes the acquisition of a property known to be outside the scope of the Delegated Authority criteria, to make recommendation(s) to approve or reject the proposal to progress with the acquisition to the Executive.</li><li>3. To make recommendation(s) to approve or reject the proposal to progress with the disposal of an individual property by way of delegated authority by the Head of Legal and Strategic Support, having received a report from Property Services.</li><li>4. To receive quarterly performance reports (including an Annual Review report) conveying information on acquisitions, costs, total capital commitment and performance of the investment.</li><li>5. To consider exception reports produced by Property Services.</li></ol>	
<b>4</b>	<b>Membership</b>
<p>The PIB is to be a joint Officer and Member board formed from the following:</p> <ol style="list-style-type: none"><li>1. Corporate Director – Place (or substitute) (Chair);</li><li>2. S151 Officer (or substitute)</li><li>3. Head of Legal and Strategic Support (or substitute);</li><li>4. Executive Portfolio Holder for Internal Governance (or alternative Executive member);</li><li>5. Executive Portfolio Holder for Finance (or alternative Executive member).</li></ol> <p>Reporting Officers to the PIB will be the Property Services Manager (or substitute) and the external consultant property agent.</p>	

<b>5</b>	<b>Roles and responsibilities</b>
<p>The members of the PIB will collectively be responsible for the recommendations made by the PIB, having given regard to the knowledge and expertise brought by individual members (such as legal, financial or political).</p> <p>Strategic Support will:</p> <ul style="list-style-type: none"><li>• Produce agendas and minutes to record the meetings</li></ul> <p>The Property Services Manager will:</p> <ul style="list-style-type: none"><li>• Arrange meeting dates, venue;</li><li>• Produce formal reports (for individual acquisition/disposal or reviews);</li><li>• Produce formal reports for quarterly reporting/monitoring and annual reviews;</li><li>• Record and maintain property data for acquired property;</li><li>• Attending PIB meetings;</li><li>• Liaising with WBC colleagues within relevant teams sufficient to conclude proposals and the satisfactory outcome of recommendations made by the PIB.</li><li>• With the input of WBC appointed Property Investment Adviser, monitoring performance of the investment, including identifying any issues with the property portfolio.</li></ul>	
<b>6</b>	<b>Meetings</b>
<p>Scheduled quarterly PIB meetings will be arranged to monitor the implementation of the strategy and performance of investments. Additional ad hoc meetings will be arranged when required as a property acquisition or disposal is proposed.</p>	