Asset Investment Strategy

1. INTRODUCTION

1.1 The Council has decided to introduce a new strategy to invest in commercial property in support of its stated priorities as a means of income generation, for economic redevelopment and regeneration or a mixture of both.

1.2 Other local authorities are purchasing commercial properties and it appears that there are opportunities to secure good quality commercial property at a level that can generate a worthwhile yield albeit also recognizing the risks that are involved in such investments.

2. BACKGROUND

2.1 A Council priority set out in its Corporate Plan 2016 – 2020 is to help local businesses grow and to boost the economic viability of the District. In addition, the Corporate Plan states that the Council continually reviews activities and services to identify opportunities for savings and opportunities to generate income to address significant reductions in government funding, whilst at the same time maintaining services that are important to our customers.

2.2 The purpose of the Asset Investment Strategy is to make commercial property investments either for economic redevelopment or regeneration in the District, or for the purpose of income generation for the provision of services, or a mixture of both.

2.3 The Asset Investment Strategy includes continual evaluation of the investment portfolio to ensure that it is fit for purpose.

2.4 The February Medium Term Financial report covering the period 2017/18 – 2019/20 shows that, over that period, the Council has a projected cumulative budget shortfall of £496k, (or £896k excluding £400k savings currently allowed for but not yet identified). It is considered that a meaningful contribution towards ensuring continued delivery of the Council's key services can be achieved through investment in good quality income producing commercial property. The strategy is supplemental to other strategies being adopted by the Council that also aim to help close the Council's funding gap.

2.5 The Council already owns a limited number of investment properties. The management of these properties is undertaken by the Estates and Valuation Department in accordance with the Council's Asset Management Strategy. The Council's existing income from commercial property is generated from 23 properties with a total capital value of £9.6m. The gross rental income is £673k PA representing a gross yield of approximately 7%.

2.6 Other authorities, including many in Hampshire, make significant investments in commercial property. Investments could be funded either from the Council's own resources or by taking advantage of its ability to borrow at relatively low rates of interest from the Public Works Loan Board (PWLB) compared to the return on property assets.

2.7 Commercial property investment opportunities often arise unexpectedly and it is important to be nimble in order to take advantage of opportunities when they arise. To that end the Asset Investment Strategy is important to provide a framework and permit the Council to respond without delay when opportunities arise whether through the traditional route of a selling agent and bidding process, through auctions and even "off market" through direct approaches from prospective sellers who want to circumnavigate the formal marketing process in order to save time and risk of abortive costs. Receivers or administrators of distressed sellers may also seek offers for commercial property assets quickly. The Council therefore needs to be in a position to assess investment opportunities in a systematic manner but should also be able to move quickly when a compelling opportunity arises.

2.8 The management of the Council's cash is dictated within the Council's Treasury Management Strategy and is held within a variety of investment types. The average yield achieved as at December 2016 from these investments was 0.85%. The investment portfolio currently includes a modest sum (£4.4m) in pooled property and equity funds which are higher earning (5.35% achieved), with the majority of other funds being held with less than 1 year to maturity.

3. THE FINANCIAL STRATEGY AND BUSINESS CASE

3.1 The Council's adopted corporate plan covering 2016-20 includes several key aspects that can be related back to this strategy. The priorities identified include:

- Helping Local Business Grow
- Service Outcomes for the community
- Protecting the local character of the place

These are underpinned by the Council's values:

- Ambitious in our desire to work for and with our local communities
- To be financially responsible for public funds
- To be innovative and open in our approach

3.2 Local authorities are seeking to become more self-sufficient and not reliant on grant funding. An important issue when implementing the Asset Investment Strategy is the value of the property portfolio and the expected target net yield. It is recommended that a target for investment return aims to make a significant contribution towards the current forecast budget deficit mentioned in 2.4.

3.3 The experience of other local authorities indicates a gross yield of between 5% - 7% on the value of the investment is achievable on the types of commercial property likely to be of interest to a local authority. The resultant net revenue income would be compared against the cost of capital (i.e. either the cost of a loan or investment interest foregone, or a combination of both)

3.4 Although the Council's cash balances ranged between £54.7m and £86.1m to the 12 months to December 2016, they are forecast to decrease over the next few years. The level of usable General Fund reserves is currently around £18m.. It is envisaged that an internal borrowing arrangement would take place to initially finance any property purchase, until such a time when either the cost of external borrowing hits a threshold or when the time comes for the internal funds to be utilised for their originally intended purpose (in essence whichever comes first).

3.5 Officers believe that the Council could currently potentially borrow funds with the PWLB at a rate of around 2.5% - 3.00%. The PWLB fixed interest rates are based on gilt yields and are published twice a day. The PWLB needs to be satisfied the Council is acting lawfully when borrowing funds.

3.6 One-off and on-going costs will be incurred to deliver the strategy, including:

- Finders Fees approx. (0.75%)
- Legal Fees approx. (0.5%)
- Survey and Valuation fees approx. (0.25%)
- Stamp Duty (5% on freehold purchases over £250K)
- Finance Costs
- Business Rates (tenants should be covering these)
- Repairs and maintenance (depending on lease type – probably covered in a service charge)
- Running costs of building, including building management (depending on lease type – again probably covered in a service charge)
- Additional Staff Costs (2 to 4 people) to manage the portfolio (non-recoverable)

3.7 Bids would allow for transactional costs (finder's fees, valuations, legal costs, stamp duty, etc.) when calculating the yield.

3.8 NFDC already has substantial loans of c£144M following the Housing Revenue Account resettlement. The Council's prudential indicators, which are agreed as part of the Treasury Management Strategy and Annual Budget 2017/18, include for example, a limit on external debt to £30m on top of the HRA resettlement figure. The agreed size, funding mix and anticipated timing of the acquisitions of the investment portfolio would need to be taken into account in the prudential indicators, to include an increase in the overall external debt limit.

3.9 It is necessary for the Council to take a prudent approach to the management of its financial affairs. When assessing investments taking a prudent approach, the Council will need to consider such factors as the security against loss, the liquidity of the investment, the yield, affordability of the loan repayments, change in interest rates and property values.

3.10 In short the Council must get right the balance between risk and reward in a prudent manner to ensure the cost of funding the Asset Investment Strategy does not fall on the tax payer.

Property Market Outlook

District market information

3.11 The New Forest District is positioned at a mid-point between the South East and South West regions of England. The major conurbations of Southampton and Bournemouth are beyond the District's boundaries to either side and linked by the M27/A31 south coast corridor. The District consists of small towns and villages. The region is a relatively prosperous part of the UK and is considered to have a good degree of economic resilience, perhaps demonstrated by the SE region being the first to in the South to buck the downward trend and see a 10% increase in property investment volume for Q3 2016 by comparison to the quarterly average for the last five years. The SW however experienced a sharp decline in property investment volume of -56%. This data is from CoStars property investment review and is referred to further below.

3.12 There is approximately 1.149M sqm of commercial floor space in the New Forest District (source: Valuation Office Agency May 2012). This is comprised of:

Retail	258,000 sqm
Office	113,000 sqm
Industrial	604,000 sqm
Other	174,000 sqm

3.13 The Enterprise M3 Commercial Property Market Study (2016) provides an estimate of vacancies at 3% of industrial and 3% for office.

3.14 The New Forest District, with its main sectors being leisure, tourism and marine industries is likely to have a lesser requirement for office space. The unique and rural nature of the District and its relatively poor accessibility and close proximity to other established office locations (Bournemouth and Southampton) will mean demand for office space is limited and perhaps largely restricted to local SME's. Accessibility to fast and reliable broadband and demand for flexible types of accommodation could be important, reflecting the large concentration of small and micro businesses in the area (Enterprise M3 Commercial Property Market Study 2016).

3.15 Like the office market, it is thought there is limited demand for industrial space in the District. The demand is likely to be for small scale manufacturing space, with little demand for logistics and distribution due to poor connectivity. The marine sector along the coastal areas may create demand however.

3.16 The District's has a number of shopping facilities within its towns and villages and may provide future investment opportunities. The retail property market continues to be in a state of flux due to the continued growth of internet shopping. However these towns continue to enjoy good levels of retail occupancy and the Council will be keen to play its part in maintaining their viability in situations where good propositions come forward.

3.17 Over time, opportunities should arise to acquire commercial property investments within the Council's District. Such acquisitions could bring opportunity to safeguard the economic vitality of locations within the District as well as present regeneration opportunities and/or income generation. Properties adjacent to existing Council holdings could be of particular interest where potential gains can be identified, either immediately or at a future date, by combining ownership interests.

3.18 The Asset Investment Strategy may also consider acquisitions beyond the District boundary on a case by case basis. This could broaden the opportunity to acquire good quality investments covering the range of types and locations. It is considered that a radius of about 50 miles might be most appropriate for practical management reasons as properties should be within reasonable travelling distance of the Council offices, and in order to acquire within broadly familiar socio-economic conditions that apply to this Council's District. However, as mentioned below, such acquisitions may have to be made through a Council owned company if the Council makes such acquisitions using borrowed funds.

Summary of national real estate picture

3.19 Globally, political and market uncertainty is reported to be resulting in greater caution among investors, a leading form of property consultants, Savills (report dated December 2016), has considered which assets and sectors are likely to prove most popular, and which to avoid, in 2017. They express the view that assets with secure income streams which are insulated from supply and demand fundamentals will be most highly prized in 2017, they also speculate that this could benefit the UK, where high levels of transparency and stable legal structures could make real estate a "safety play"

3.20 It has also been suggested by Savills that greater risk will mean a strong focus on retirement housing, logistics and energy. Opportunistic investors will also look towards mixed-use development opportunities linked to infrastructure improvements, rather than distressed assets. A less crowded marketplace is predicted for the value-add investor, particularly if lender caution means tighter borrowing criteria for developments.

3.21 Total commercial UK investment property market returns are predicted to average approximately 5.6% per annum during 2017-2021, with a 0.4% five year capital growth forecast for office values and a 4.4% growth forecast for office income returns. Commercial property assets with long lease structures and strong rental covenants will continue to attract attention, while institutional investor appetite for large residential portfolios is expected to continue to grow. The relatively high yields and strong income flows from commercial property are expected to continue to attract strong demand.

3.22 With current global uncertainty, investors may turn to an income producing strategy in preference to higher risk strategies. Property assets could do well from this approach and result in prices rising for these assets. Savills note that there is opportunity to benefit from creating long-term secure income producing assets whether through developing or filling up voids to create product for those chasing these assets. The cost of borrowing is expected to remain cheap.

3.23 Savills made six key predictions for commercial property for 2017 and beyond:

- Brexit uncertainty will not stop people making commercial property decisions, at the same time there is a belief that the UK is riskier and that will create opportunities.
- Wellness will be the new sustainability, corporates are increasingly focused on creating buildings that keep staff well.
- Development activity will decline from an already low level.
- Brexit has brought falls in rents forward for some markets and sectors.
- Non-domestic investor interest in the UK will continue to rise, with the next five years likely to see record levels of international investment in assets outside London.
- The global hunt for income will drive income price rises in the UK.

3.24 There is a relatively up-beat tone to some of the above, this is perhaps not unrealistic bearing in mind that it is reported by CoStar that average property yields actually fell by about 0.27% in Q3 2016. However, this should be tempered by the fact that the same report points out that UK commercial property investment volume fell to a four year low in 2016 (average -35%), despite the emergence of Local Authorities as key buyers of commercial property investments, having invested £786m over the three month period, which exceeds the amount invested by local authorities in the combined preceding three years. The lower volumes are believed to reflect the impact of the 'Brexit' vote.

3.25 The property auctions market has seen a slowdown in sales during 2016, with data revealing a 13.3% on-year drop in the number of lots sold in July, this was partly due to an 8.7% fall in the number of lots offered for sale.

<u>Redevelopment opportunities in the New Forest District</u>

3.26 Whilst it is true to say the New Forest District is primarily rural in nature, the Council does expect opportunities to arise where commercial property investment can support redevelopment and provide economic benefits within the District, for income generation or a mixture of both. The District has a number of small towns and settlements, many small and medium sized enterprises and an economic emphasis on tourism, marine and leisure activities. There may be additional opportunities for larger enterprises for example in retail or services to seek opportunities in the District which the Council would wish to encourage and support through this strategy. In addition, the Council may invest in the redevelopment or improvement of its own landholdings under this Asset Investment Strategy.

<u>Local Authority Activity</u>

3.27 In preparing Asset Investment Strategy, officers have made enquiries about the activities of other local authorities investing in this market and their findings are summarised below. A number of key points emerge:

- Investment portfolio range £16M - £220M within neighbouring local authorities.
- Target yield 5 – 7%.
- Finders fees up to 1%.
- Some Local Authorities invest within their District, others more wide ranging (depends on whether investing own resources or PWLB loans and extent of local investment opportunities).

- Some Local Authorities can buy “opportunistically” when attractive opportunities are presented.
- Some Local Authorities have adopted a structured scoring basis to give a preliminary indication of the strength of investment propositions.
- Mainly commercial property (industrial, retail, office) is acquired, with tenancies of between 5 – 10 years.
- “Better” investments (strong tenants, minimum 10 year unexpired leases, fully let, good quality building) likely to be more expensive and generate lower yield (5% region).
- Invest in staff to take on more management intensive property and increase yield.
- Sevenoaks District Council claims to be the first self-sufficient local authority in the country.

3.28 A recent market report (UK Commercial Property Investment Review Q3 2016 prepared by The Costar Group) indicates Local Authorities have invested over £786M in Q3 2016, more than in the previous 3 years combined. Spelthorne BC has recently invested £350M in the BP Campus Sunbury on Thames at an initial yield of c4.25%.

3.29 Costar’s report says there has been a decline in UK commercial property activity over recent quarters, with an acute drop in Q3 2016 after the Brexit vote. In that respect the entry of local authorities into the market stands out. There appears to be cautious optimism in the longer term with yields from commercial property remaining attractive compared to other assets, low levels of vacancy and a large pool of capital (especially from overseas) available for investment. It may be that once valuations have stabilized the market will improve.

Holding property investments

3.30 The Council may hold property assets either directly or indirectly. Direct property investment gives the Council full control over the property and responsibility for its management.

3.31 Indirect property investment (excluding pooled funds held through a Treasury Management Strategy) could take the form of either setting up a trading company or forming a joint venture with another property investment company.

3.32 Consideration of indirect property investment would be necessary if the Council wishes to borrow funds to acquiring property solely for the purpose of income generation. Local authorities are required to undertake such commercial activity through a company.

3.33 The holding of property assets in a property company would enable greater freedom and flexibility of the decision making process and the ability to trade the assets. This could potentially deliver higher levels of net returns. However, there are potential risks and set up costs involved, the company would be subject to corporation tax and incur higher financing costs than if the investment acquisition programme is undertaken directly. Although there is the potential for higher returns, there is also the potential for significant losses.

Criteria for selecting investment assets

3.34 The Council will select properties for the purpose of income generation, economic development or a mixture of both. The Council will acquire and hold properties directly where possible and appropriate. The Council will also retain the discretion to make investments outside the District as mentioned in this strategy and to invest in the redevelopment or improvement of its own landholdings for these purposes.

3.35 Investment property acquisitions need to be subject to the agreed parameters of the Council's Asset Investment Strategy. Officers recommend that the Council's initial selection of an asset be assessed on two main criteria on a pass or fail basis.

I. The Council will need to ensure a satisfactory level of return on its investments and may decide to evaluate purchases on a balance between income yield and economic redevelopment and regeneration. In order to achieve the minimum evaluation requirement, the yield required from an income generation purchase should exceed a minimum level of 1.5% above the most up to date PWLB lending rate For a redevelopment and regeneration purchase, the yield required should exceed a minimum of 1.25% above the most up to date PWLB lending rate

II. Leases should be classified, for accounting purposes, as an operating lease rather than finance lease, to ensure that all rental income can be treated as revenue income (rather than a mix of capital receipt and revenue income). Operating leases are those where the risks and rewards of ownership are retained by the lessor (the Council) and must meet certain criteria. The main criteria being that the lease term should not be for the major part of the property's economic life unless the price paid is underpinned by the sites redevelopment potential and at the start of the lease, the total value of minimum lease payments (rents) should not amount to a significant proportion of the value of the property.

3.36 Any asset meeting these first two criteria will pass to the next stage for consideration. Subject to paragraph 3.41 below, the Council will not consider any properties that do not meet the two main criteria.

3.37 For assets that pass the first two criteria, officers will evaluate any prospective property against a comprehensive set of defined property specific criteria.

3.38 To form an initial view on the strength of a given investment proposition, officers will score the property against the scoring criteria shown in the table set out in Appendix 1. The minimum score should be at least 106 out of a maximum score of 176; this is equivalent to at least the 60th percentile of the maximum score. There will, however, always be a trade-off between the level of return and the score. A property which scores "unacceptable" for any of the scoring criteria in the table will be rejected.

For example, a high return would reflect higher risk and consequently a lower score; conversely, a lower level of return would reflect a lower level of risk and a higher score.

3.39 The table in Appendix 1 shows the suggested scoring criteria to be applied when considering an investment property.

3.40 As an example, the ideal property investment would be a freehold in the town centre, let to a tenant with a strong financial covenant for a long term on a full repairing and insuring lease. An investment of this nature would score very highly under the above criteria.

3.41 The Council will reserve discretion to acquire commercial property assets that may fall outside the investment criteria outlined above if a strong case can be made that the target property provides an exceptional opportunity to promote the Council's main priorities and values as described in this report.

Acquisition process and governance

3.42 A team will be formed from suitably experienced officers from Finance, Estates & Valuations and Legal Services to prepare initial assessments and recommendations concerning suitable properties. It is important that the Council's approval procedures work swiftly in order to ensure that opportunities to acquire are not lost to rival purchasers.

3.43 To complement the governance arrangements that already exist, officers recommend that acquisitions are subject to the following process being completed in the following stages:

- Maintain officer and member awareness of future investment acquisition programme via the Executive Management Team
- Source the asset
- Inform Portfolio Holder for Finance & Efficiency, Executive Head of Governance and Regulation and S151 Officer of prospective asset
- Pre-offer stage: circulate template of information on full details and cash flow of the potential acquisition to key individuals and services to ensure the legal and financial implications of purchase are fully understood;
- Request approval to enter into bidding process from the Portfolio Holder: Finance & Efficiency, Executive Head of Governance and Regulation and S151 Officer
- Finalise Heads of Terms where bid is successful and commission independent surveys, purchase report and valuation
- Request approval to accept offer subject to contract from the Portfolio Holder: Finance & Efficiency, Executive Head of Governance and Regulation and S151 Officer
- Approvals to be given as set out in paragraph 7.5 below

Purchaser's costs

3.44 Any direct property acquisition would be subject to purchaser's costs, typically these would include the following:

Stamp Duty	5.0%
Legal Fees	0.5%
Agent, Survey & Valuation Fees	1.0%
Total Acquisition Fees Circa	6.5%

Total Acquisition costs = 6.5% of the property purchase price.

3.45 This level of acquisition costs is the industry standard and all commercial property yields quoted are generally net of purchaser's costs.

Financing Costs

3.46 A investment portfolio in the order of £30m would be funded approximately 20% from usable General Fund reserves, with the remaining 80% being financed through internal borrowing / external loan. The actual amount of GF reserves used will depend on the overall balance available, and the decision as to whether the Council will borrow externally and at what point in time is a treasury management decision and not directly linked to the purchase of the asset or this strategy.

3.47 The requirement to borrow externally requires assessing through the Council's prudential indicators to ensure that the overall level of debt is suitable in relation to its standard operating cash flows

Timescales

3.48 In view of the commercial property market in the District and the property selection criteria, it is envisaged that implementation of the Asset Investment Strategy will take in the region of 24 – 36 months to come to fruition.

3.49 The Council and officers should take a long term view with the intention of applying the Asset Investment Strategy over a period of at least 25 years.

4. RISK MANAGEMENT

4.1 There are a number of risks the Council should consider, all of which could have an impact on the net return to the Council. These include:

- Capital values and rental values can fall as well as rise.
- Borrowing costs could increase.
- Vacancies (voids) in the portfolio will reduce average yield. As well as lost rental income on vacant units, the Council could find itself liable for a share of on-going costs which a tenant would normally pay such as empty property rates.
- Disputes with tenants. Common disputes include ongoing maintenance and repair costs of buildings and the ability to recover those costs from tenants.
- Tenant default, and that financing costs could rise.
- External factors. Property investment, whether direct or through pooled funds, is subject to factors the Council cannot control, e.g. failure of tenants, poor building management, changes in perception of what is a good location, economic downturn etc.
- How long before Government intervenes to restrict such strategies?

4.2 The overall investment value and range of properties being acquired needs to represent a good mix and spread of risk across differing sectors. If the size of the investment is too small, then an adequate mix cannot be established.

4.3 It is important that the Council maintains an adequate level of reserves and balances to ensure it can manage any down turn in the property market and limit the impact it will have on revenue income. There is a risk that substantial expansion of the asset portfolio may result in a lower credit rating.

4.4 All forms of investment carry an element of risk and the acceptance of a risk factor is rewarded by the potential for financial return. The Council will be investing from the public purse and will therefore be seeking investments at the more secure end of the risk spectrum.

4.5 Once finance costs start to rise, the net returns may become less attractive and there is a risk that the Council will be forgoing cash investment returns over the period of the lease if cash interest rates rise above the returns generated on our property investments. There will also be refinancing costs associated with external borrowing. Officers will prepare a detailed cash flow model for each prospective investment in order to appraise the cash flow risk and the internal rate of return of the investment.

5. ONGOING MANAGEMENT OF THE ASSETS

5.1 Property management varies between properties. Managerial issues include rent collection, service charge calculation and collection, building maintenance, security, dealing with tenants, re-letting empty units, negotiating terms of rent reviews, dilapidation claims and the general miscellany of property management.

5.2 The means of ongoing management of acquired commercial property investments will be determined on a case by case basis. In some management intensive cases, such as multi-let properties, day to day management fees may be largely recoverable by way of service charge, provided an external firm is used. However, there does remain a ‘client side’ management function for all owned properties and the time commitment will increase relative to the number and type of properties acquired.

6. ONGOING PERFORMANCE REVIEW

6.1 The Estates and Valuations team will be responsible for providing regular reports on management issues and the performance of the Councils property investment portfolio.

6.2 The Council’s Executive Management Team (EMT) will review all investment assets every six months. EMT will monitor both the individual asset management plans as well as the overall asset investment portfolio against expectations at the time of purchase and performance against prevailing market conditions.

6.3 Regular reports to be provided to a new Property Investment Panel consisting of the Portfolio Holder - Finance and Efficiency, Chairman of the Corporate Overview and Scrutiny Panel, the Chief Executive, Executive Head Governance and Regulation and s151 Officer. Such reports would be in addition to the usual reporting requirements to the Corporate Overview and Scrutiny Panel in respect of progress against the Strategy.

7. FINANCIAL IMPLICATIONS

7.1 The Council currently holds property leased out on commercial terms, with a book value of c£10m. The Estates and Valuations team deal with the leases and rent reviews, and are responsible for ensuring that all income due to the Council is collected.

7.2 It is envisaged that additional resources will be required, either in-house or via an external management contract (or possibly a combination of both depending on purchases identified) to manage the Portfolio. These costs are envisaged to be in the region of £100k PA, representing a relatively small percentage of the £30m anticipated Portfolio size.

7.3 The following table illustrates the summary financial modelling that would be applicable to a new investment portfolio totaling £30m, taking into account the outline financing and purchase costs as included in previous sections:

		EVENTUAL BORROWING		INTERNAL FUNDS		TOTAL ASSESSMENT
Asset Acquisition Fund		£24,000,000		£6,000,000		£30,000,000
Acquisition Costs	6.50%	£1,560,000	6.50%	£390,000	6.50%	£1,950,000
NET CAPITAL EXPENDITURE		**£22,440,000**		**£5,610,000**		**£28,050,000**
Financing Costs	3.00%	£720,000	0.85%	£51,000	2.57%	£771,000
Repayment Costs	0.89%	£212,700	2.00%	£120,000	1.11%	£332,700
Administration Costs		£80,000		£20,000		£100,000
Net Revenue Income	**2.17%**	**£520,000**	**2.17%**	**£130,000**	**2.17%**	**£650,000**
Total Rent Required	6.39%	£1,532,700	5.35%	£321,000	6.18%	£1,853,700

7.3.1 The internal funding element demonstrated at 20% allows for interest foregone of 0.85%, representing the average yield on investments as at December 2016, and an MRP charge of 2%, being the repayment of capital funds via a charge into revenue based on a 50 year useful life period.

7.3.2 As principal loan repayments are made, NFDC's equity share in the property portfolio increases, resulting in an increase in the value of NFDC Net Assets visible on the balance sheet. This is demonstrated by the 'Repayment Costs' line within the table. Over time, the weighting of interest costs in comparison to principal repayments would change

7.4 In line with the 24-36 month implementation estimate per paragraph 3.48, the following table illustrates the potential cash flows that would occur based on purchases half way through the year:

	Yr 1 (2017/18)	Yr 2 (2018/19)	Yr 3 (2019/20)	Yr 4 (2020/21)	ONGOING TOTAL
Asset Acquisition Fund		£15,000,000	£15,000,000		£30,000,000
Acquisition Costs		£975,000	£975,000		£1,950,000
NET CAPITAL EXPENDITURE	**£0**	**£14,025,000**	**£14,025,000**	**£0**	**£28,050,000**
Financing Costs		£192,750	£385,500	£192,750	£771,000
Repayment Costs		£83,175	£166,350	£83,175	£332,700
Administration Costs	£50,000	£30,000	£20,000	£0	£100,000
Total Rent Receivable		-£463,425	-£926,850	-£463,425	-£1,853,700
Net Revenue Cost / Income (-)	**£50,000**	**-£157,500**	**-£355,000**	**-£187,500**	**-£650,000**
CUMULATIVE REVENUE POSITION	£50,000	-£107,500	-£462,500	-£650,000	

7.5 Where the criteria for investment outlined in this report are met, officers recommend that:

7.5.1 The Chief Executive, the Executive Head Governance and Regulation and the S151 Officer, in consultation with the Portfolio Holder for Finance and Efficiency and the Chairman of the Corporate Overview and Scrutiny Panel, shall have authority to make asset purchases and investments up to £5million;

7.5.2 Cabinet shall have authority to make asset purchases and investments above £5million.

7.6 The total internal reserves that will be available to support purchases should total no more than 33% of the total General Fund Usable Reserves. On current values based on 80/20, this would equate to a gross value of £30m. Any expansion of the portfolio beyond this point would require more than 80% internal borrowing/external financing. Minimum revenue generation criteria would still apply, even though the cost of capital would at that point be increased.

7.7 As outlined above, the delivery of Asset Investment Strategy will require an additional revenue resource budget of £100,000 PA. An investment portfolio totaling £30m is deemed as reasonable in the balance of risk verses reward, and is sought as a supplementary estimate to the Council's Capital budget. The indicative eventual level of revenue to be generated is in the order of £650,000 PA. Expenditure and income budgets will be added to the budget at the appropriate time, when properties are identified and purchased.

8. CONCLUSION

8.1 The purpose of the Asset Investment Strategy is to invest in commercial property for the purpose of income generation for provision of services, for the purpose of economic development or regeneration within the District or a mixture of both.

8.2 The Strategy details the financial and business case to support the Asset Investment Strategy and sets out the criteria required for selecting investment properties, an assessment of the risks and whether it is appropriate to carry out the asset acquisitions directly or through a trading company.

8.3 The Strategy summarizes the risks associated with investment in commercial property and the acceptance of a risk factor is rewarded by the potential for financial return.

8.4 The Strategy also provides discretion for the Council to invest in commercial property outside the District. Such investments are likely to be made through a property holding company.

APPENDIX 1

SCORING CRITERIA	Score / Weighting Factor	4 Excellent / very good	3 Good	2 Acceptable	1 Marginal	0 Unacceptable*
Location	12	Major prime	Micro prime	Major secondary	Micro secondary	Tertiary
Tenancy strength	10	Single tenant with strong financial covenant	Single tenant with good financial covenant	Multiple tenants with strong financial covenant	Multiple tenants with good financial covenant	Tenants with poor financial covenant strength
Tenure	6	Freehold	Lease 125 years plus	Lease between 75 & 125 years	Lease between 20 & 75 years	Lease less than 25 years
Occupiers lease length	6	Greater than 15 years	Between 10 and 14 years	Between 9 & 6 years	Between 3 & 5 years	Less than 2 years or vacant
Repairing terms*	4	Full repairing & insuring	Internal repairing - 100% recoverable	Internal repairing - partially recoverable	Internal repairing - non recoverable	Landlord
Building Quality/ Obsolescence	4	Newly Built	Recently Refurbished	Average condition and likely to continue to be fit for current use for 25+ years	Aged property with redevelopme nt potential	Nearing end of useful life/use unlikely to continue when lease expires
Lot size	2	Between £2m and £5m	Between £6m & £10m or £15m & £20m	Between £750k & £2m or £21m & £25m	Between £11M and 15M or £26M and £30M	Less than £750K or more than £30m

* A property recording an "unacceptable" in any of the scoring criteria will be rejected