Kettering Borough Council

Commercial Property Investment Strategy

2017 – 2022

1.0 Introduction

1.1 This Property Investment Strategy has been developed for the period 2017 to 2022 to reflect the aspiration of the current capital programme to invest in property assets to secure a long term return.

1.2 The property investment market is a crowded arena, particularly as local authorities, both locally and nationally appear to be seeking similar investment opportunities in prime locations with long leases and strong covenants.

1.3 This strategy is designed to provide a framework for Kettering Borough Council to compete in that market on an equal footing enabling the acquisition of properties for investment at pace whilst ensuring that governance processes are in place, full assessments are made and risks are minimised.

2.0 Background

2.1 The Council recognised, some time ago, that it needed to graduate towards a more commercial way of operating if it was to become more financially independent. To that end, the Flexible Resources Working Group was set up, which considered a number of things – the key ones being implementing revised professional management arrangements and agreeing new asset management arrangements.

2.2 Through the Executive Committee, the Asset Management Board (AMB) was established as an interim step, to help shape the Council's new asset management arrangements, by devising e f this new investment strategy. It is likely that the AMB will be superseded in time with governance arrangements around specific delivery vehicles, which will be better determined as the Asset Management Strategy and development of the asset portfolio progresses.

2.3 The AMB, or whatever arrangement supersedes it in due course, has the responsibility for overseeing the development of this investment strategy and, subsequently, for monitoring the performance of the investments at an aggregate level (i.e. the overall performance of the portfolio against an agreed benchmark of performance).

2.4 Investments will be made in line with the delegated authority arrangements that were previously approved by the Executive Committee (i.e. by the Council's S151 officer). These will be monitored by the A MB. It is not intended that individual investment decisions will be made by the AMB – indeed, depending upon the size of investments, Council approval may still be required. The AMB, as set out in its Terms of Reference will determine the investment parameters and the performance of the overall investment portfolio.

2.5 The AMB have indicated that the strategy should include the following location hierarchy,

Preference	Location
1	Kettering Borough
2	North Northamptonshire
3	Northamptonshire
4	UK

2.6 The ability to acquire suitable investment grade stock will be dictated by what is available in the market. Clearly the wider the geographic boundaries the greater the amount of potential investment opportunities.

2.7 The AMB has indicated that the strategy should, in assessing the merits of an investment, specifically test whether it involves the following activities:-

- Alcohol or tobacco production or sale
- Animal exploitation
- Armaments and nuclear weapons production or sale
- Environmentally damaging practices
- Gambling
- Human Rights Abuse / Oppressive regimes
- Pornography

These subject headings will inform the assessment but will not necessarily preclude KBC from investment in a property asset that has a link to these activities.

3.0 Key Objectives

3.1 The key objectives are to,

- ✓ Acquire properties that provide long term investment in accordance with the Councils corporate and financial objectives,
- ✓ Maximise return whilst minimising risk through the management processes as outlined in this strategy,
- ✓ Prioritise properties that yield optimal rental growth and stable income,
- ✓ Protect capital invested in acquired properties,
- ✓ Develop a governance framework that enables the Council to move at a timely pace in line with the market.
- ✓ Build a balanced property investment portfolio

4.0 Investment Portfolio Principles and Decision Making

4.1 As well as the assessment of the location hierarchy and ethical aspects of each asset acquisition opportunity further assessment will be undertaken against a matrix of criteria that includes,

1. Location
2. Covenant
3. Lot Size
4. Lease Length
5. Tenure
6. Repairing Obligations
7. Net Yield

For each property investment opportunity each will be assessed against the whole set of criteria and nothing will be considered in isolation. That assessment will be recorded for future reference.

4.2.1 Assessment - Location

Criteria	Excellent	Very Good	Good	Acceptable	Marginal
Location	Major Prime	Macro Prime	Major Secondary	Macro Secondary	Tertiary
Examples	This includes Central London followed by the other big six cities (Birmingham, Manchester, Bristol, Leeds, Glasgow and Edinburgh)	Macro Prime can be on the edge of Major Prime cities or central other major cities such as Nottingham, Sheffield or Newcastle.	Includes cities such as Leicester or major town centres.	Includes all other towns but still within an area of growth.	Relates to areas of little financial growth or investment.

4.2.2 Assessment - Covenant

Criteria	Excellent	Very Good	Good	Acceptable	Marginal
Covenant	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 Average Financial Covenant
Examples	The 'covenant' of the tenant(s) is considered in terms of both financial strength and risk of business failure. The financial standing of the tenant is considered, utilising Dun & Bradsheet whom are an internationally recognised financial referencing agency.				

4.2.3 Assessment - Lot Size

Criteria	Excellent	Very Good	Good	Acceptable	Marginal
Lot Size	£6m - £12m	£4m - £6m £12m - £18m	£2m - £4m £18m - £20m	£1m - £2m £20m - £25m	<£1m >£25m
Examples	The lot size will depend on how much we are willing to pay for an investment. A single 'large lot' investment (i.e. £25m or above) could satisfy the investment requirement for the year in one purchase Conversely a range of smaller lots could satisfy the investment requirement for the year. A balanced portfolio of investments, is likely to include various lot sizes.				

4.2.4 Assessment - Lease length

Criteria	Excellent	Very Good	Good	Acceptable	Marginal
Lease Length	> 10 Years	7 – 10 Years	4 – 7 Years	2 – 4 Years	< 2 Years
Examples	The length of the tenant's / occupier's lease will determine the fixed term of guaranteed rental income. The longer the term remaining, in most cases, the better and more secure the investment. Break option dates need to also be considered as if they were the lease end date.				

4.2.5 Assessment - Tenure

Criteria	Excellent	Very Good	Good	Acceptable	Marginal
Tenure	Freehold	Long Leasehold 125 years minimum	Leasehold < 125 years > 75 years	Leasehold < 75 years	Leasehold < 50 years
Examples	Freehold possession creates the best possible interest in the property and would be in perpetuity.	The period of the leasehold can range from > 125 years to < 50 years. Considerations on the leasehold periods are liquidity and how marketable properties are as time progresses.			

4.2.6 Assessment - Repairing obligations

Criteria	Excellent	Very Good	Good	Acceptable	Marginal
Repairing Obligations	Full Repairing and Insuring (FRI)	Internal Repairing 100% Recoverable	Internal Repairing Partially Recoverable	Internal Repairing Non Recoverable	Landlord Repairs
Examples	The tenant has responsibility for all external and internal maintenance, decorations and repairs as well as the liability for insuring the building.	The tenant will have a narrower liability for maintenance, decorations, repairs and insurance confined to the internal parts of the property they occupy. Such costs can then be recoverable through a service charge dependent on the IRR agreement. The landlord retains responsibility for structural and external repairs without reimbursement.			The landlord is responsible for all external and internal repairs

4.3 Assessment - Net Yield

4.3.1 NET Yield - All investments considered must initially provide income (yield) at a positive net rate of return defined by the cost of capital borrowing for purchase. The acquisition costs where relevant will include Stamp Duty, Investment Acquisition Agents Fees and legal acquisition advice and will form part of the purchase cost.

Criteria	Excellent	Very Good	Good	Acceptable	Marginal
Net Yield	**5%+**	**4% – 4.99%**	**2.5% - 3.99%**	**>1 % - 2.49%**	**<1%**
Examples	The Net Return is determined by subtracting the borrowing costs (interest and MRP) as a percentage from the Net Yield (quoted % return on investment). The Yield is determined by the quality of the investment and is a factor of location, property type, tenant covenant, lease term and repairing responsibilities as well as the demand for the specific type of investment . The more desirable the investment typically the lower the yield. **The level of return will be heavily influenced by two factors: (a) the cost of capital (i.e. borrowing), and (b) the regulatory requirements of the minimum revenue provision (MRP).** The net returns of any project need to be sufficient to have a positive net return.				

5.0 Full Risk & Return Assessment Matrix

Criteria	Excellent	Very Good	Good	Acceptable	Marginal
Location	Major Prime	Macro Prime	Major Secondary	Macro Secondary	Tertiary
Covenant	Single Tenant Strong Financial Covenant	Single Tenant Good Financial Covenant	Multiple Tenants Strong Financial Covenant	Multiple Tenants Good Financial Covenant	Tenants Average Financial Covenant
Lot Size	£6m - £12m	£4m - £6m £12m - £18m	£2m - £4m £18m - £20m	£1m - £2m £20m - £25m	<£1m >£25m
Lease Length	> 10 Years	7 – 10 Years	4 – 7 Years	2 – 4 Years	< 2 Years
Tenure	Freehold	Long Leasehold 125 years minimum	Leasehold < 125 years > 75 years	Leasehold < 75 years	Leasehold < 50 years
Repairing Obligations	Full Repairing and Insuring (FRI)	Internal Repairing 100% Recoverable	Internal Repairing Partially Recoverable	Internal Repairing Non Recoverable	Landlord Repairs
Net Yield	**5%+**	**4% – 4.99%**	**2.5% - 3.99%**	**>1 % - 2.49%**	**<1%**

5.1 Given the varied sector dynamics the criteria for each asset will vary but should follow the core principles of,

1) Individual properties will be fully financially and physically appraised using the risk and return matrix. This will be specific to each and every property proposed for purchase.

2) Minimising management and risk. Preference will be given to single occupancy investments although multi-let properties or multi-unit schemes will still be considered.

3) Location will be dictated by opportunity to acquire investments that meet this strategy.

4) Inclusion in the Borough of Kettering or the impact on the economy of the Borough of Kettering will be a deciding factor when all other attributes are equal.

5) Lease length will be determined by market forces but the premise will be to maximise.

6) Market Rent (MR) should be equal to or above passing rent.

7) Market sectors and locations with rental growth and good letting prospects will be actively sought.

8) Further performance measures, portfolio analysis and valuation, as required, will be undertaken to allow for a purchase/not purchase decision.

5.2 Further performance measures, portfolio analysis and valuation, as required, will be undertaken to allow for a purchase or not purchase decision. For example these could include,

- The fabric or structural condition of the property
- The ground conditions
- The surrounding land uses
- Planning approvals of that and any other surrounding developments , in situ- or proposed

All of the above could have a bearing on value and on whether or not the opportunity is one to pursue.

6.0 Added Value

6.1 The Council will maximise the “added value “ of its position as a local authority. This will take the form of;

- Being an excellent commercial landlord
- Providing financial assurance
- Building credibility that we are an excellent organisation to do business with
- Being a key local stakeholder
- Growing our businesses – providing a supply chain of appropriate space/units

7.0 Holding & Managing Property Assets

7.1 This strategy recognises that as the portfolio grows the skills and the capacity of the property team will need to change to ensure that it can satisfy the requirements as outlined in section six above.

7.2 It will also be important to bring in specialist property investment advice, and other specialist advice as and when required.

7.3 Appendix 1 to this strategy outlines the acquisition process to be undertaken.

Appendix 1 - Property Acquisition Flow

Pre-Commitment to Purchase

Heads of Terms	Opportunity identified	Acquisition costs up to £3 million, delegation to the S151 Officer.
	Fully appraise against matrix	
	Offers & Counter offers	
	Agree HOT	
	Secure Source of funds	
Pre – Contract	Instruct Legal Team	Acquisition costs from £3 to £10 million, delegation to the S151 Officer in consultation with the Finance Portfolio Holder.
	Investigate Title	
	Conduct surveys & reports	
	Negotiate contract	
Exchange	Pay deposit (if required)	Acquisition costs from £10 to £20 million, delegation to the S151Officer in consultation with the Asset Management Board. Acquisitions costs above £20 million would be outside the budgetary framework and would be determined by Executive and/or Council.

Committed to Purchase

Pre Completion	Pre completion searches	
	Finalise draw down of funds	
Completion	Pay completion	
	Assume liability for property	
Post Completion	Land registration	
	Collation of property information	
	Portfolio Management	