Report to	Cabinet	**Item**
	12 December 2018	*18
Report of	Chief finance officer (Section 151 Officer)	
Subject	Commercial property investment strategy	

KEY DECISION

Purpose

The report sets out the Commercial Property Investment Strategy for Norwich City Council and highlights the changes proposed to the current strategy which was agreed by Cabinet in April 2017.

Recommendations

Cabinet is asked to:

1) approve the revised commercial property investment strategy.

2) increase the delegated authority to purchase commercial property investments under this strategy by £10m so that the maximum lot size for an individual acquisition is £20m.

3) recommend to council, as part of the overall budget setting process in February 2019, to approve:

    a) a departure from DHCLG's (Department for Housing, Communities and Local Government) Investment Code as set out in paragraphs 4.11 to 4.15 of the strategy.

    b) the setting aside of 20% of the net new income achieved from the investment into the commercial property earmarked reserve as set out in paragraph 2.17 of the strategy.

Corporate and service priorities

The report helps to meet the corporate priority value for money services.

Financial implications

The implementation of the strategy has implications for the Council's capital expenditure budget and the General Fund revenue budget. The approval of the Commercial Property Investment Fund capital budget, and the resultant impacts on the revenue budget, will be explained and sought from Council annually in February as part of the overall budget setting process.

Ward/s: All Wards

Cabinet member: Councillor Kendrick - Resources

Contact officers

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Background documents

None

Report

Background

1. Previous reports to Cabinet in July 2016 and April 2017 set out the council's approach to commercial property investment up to this point in time. The need for Cabinet to consider a revised commercial investment strategy arises from:

   - A desire to have the council's rationale, investment principles, and the acquisition process undertaken described in one document to provide a fuller and complete guide for council stakeholders.

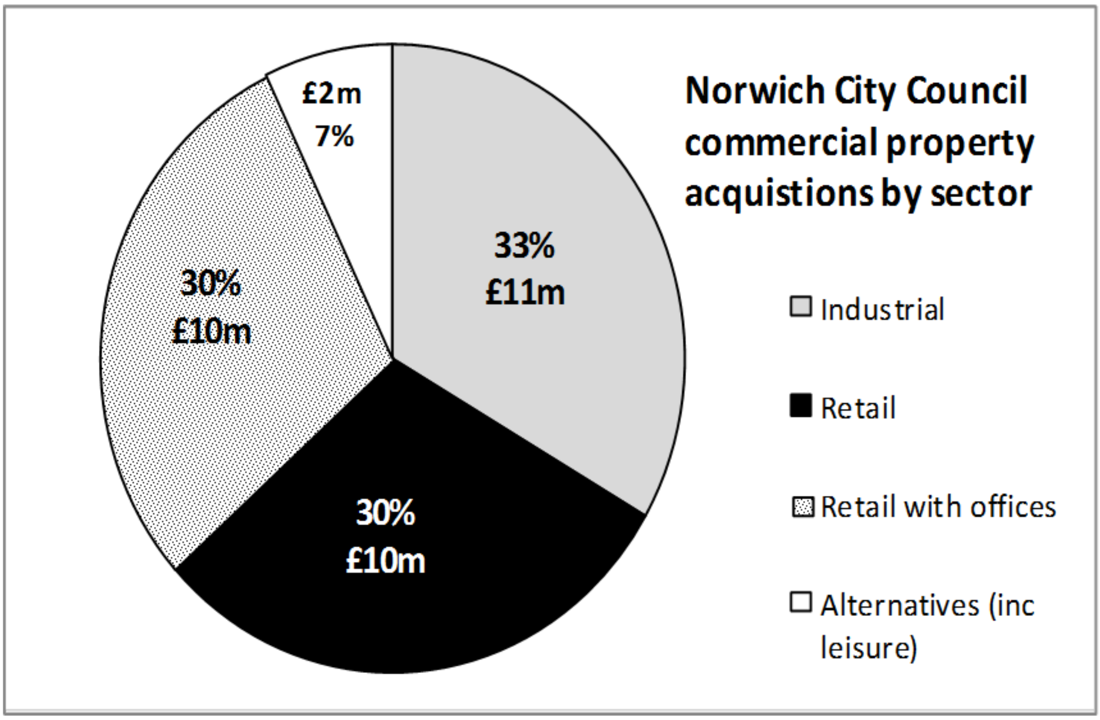
   - The requirement to now consider DHCLG's (Department for Housing, Communities and Local Government) revised Investment Code within the council's strategy.

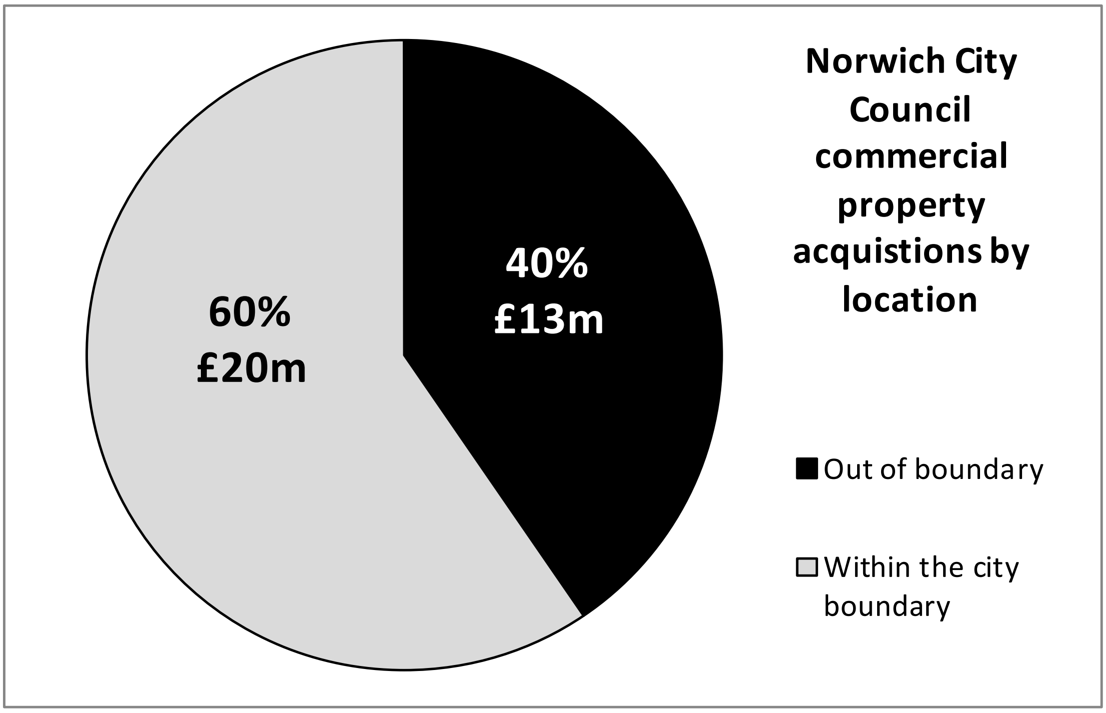
   - Proposals to change certain aspects of the current process arising from practical experience and learning over the last year.

Commercial property investments made by the council

2. Whilst the council has held commercial property for decades, it has over the last year been purchasing new property investments in line with cabinet's approvals in July 2016 and April 2017 and within the council's approved capital expenditure budget for this investment activity.

3. To date, £33m of new investments have been made, generating gross initial income of £2.1m and net initial income (after taking into account the financing costs of the acquisition) of £0.972k (a net initial return of 2.9%).



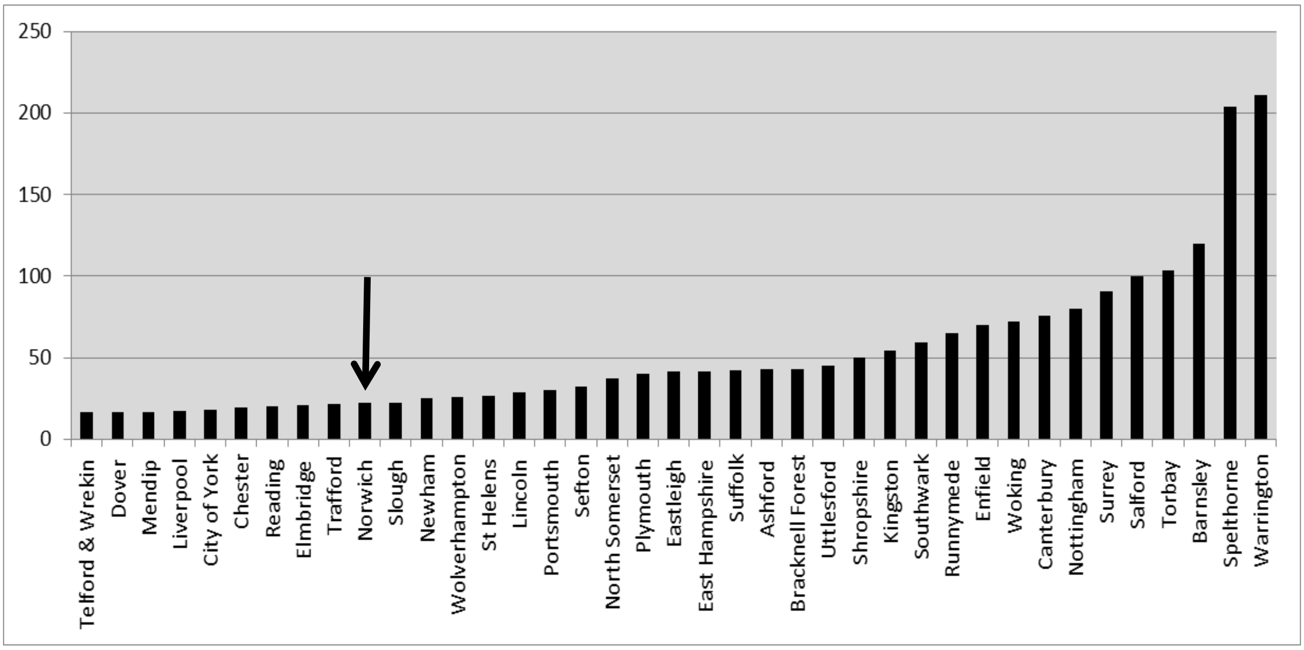


Local government investment in commercial property

4. Local government's investment in commercial property has increased significantly in the last three years and Norwich City Council is certainly not alone in seeking to generate new income streams through the purchase of commercial property.

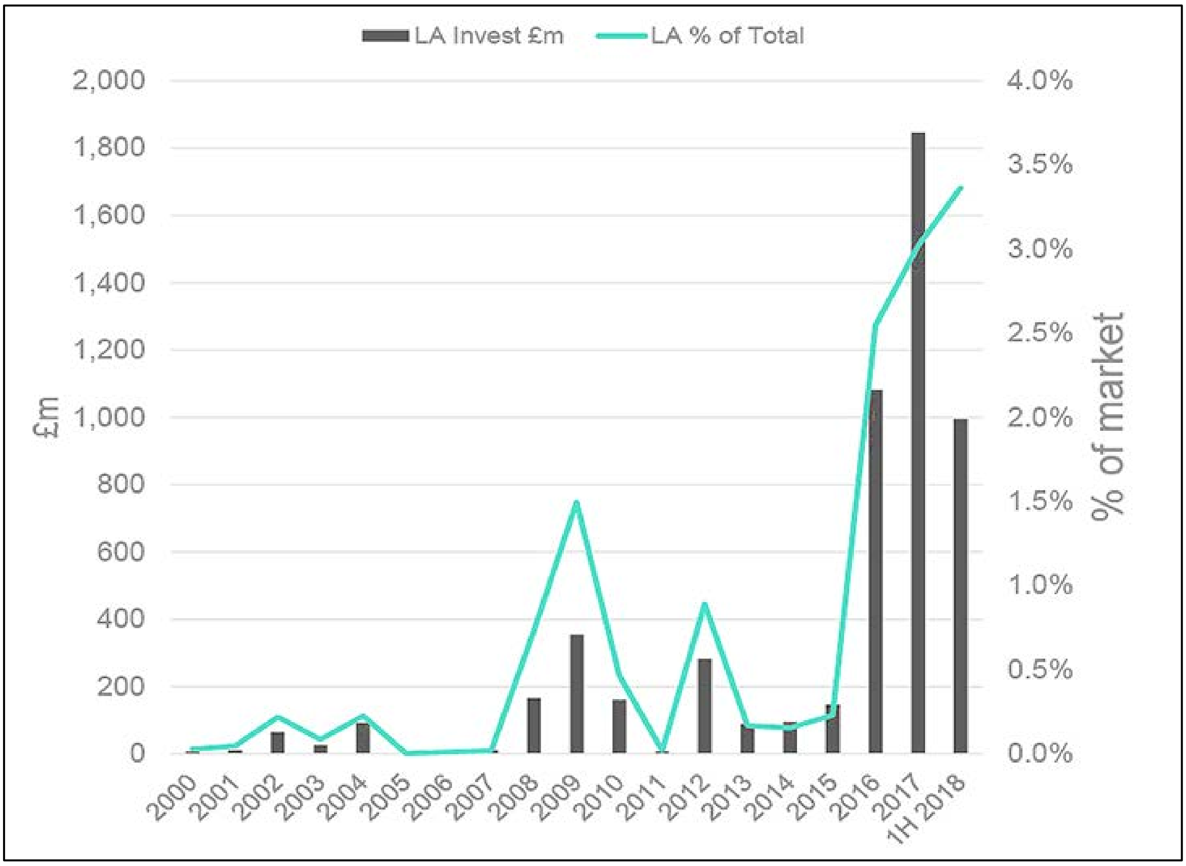
5. A total of £2.5bn was invested by local government in commercial property during the last financial year 2017/18. This involved 91 individual councils with 164 purchases being made.

6. The value of the Council's 2017/18 investments is compared to that of other councils in the graph below. (This only shows purchases over £10m).



7. Data released by the Department of Housing, Communities and Local Government (in November 2018) showed that councils spent £4.6bn on commercial property during the four quarters up to September 2018, as compared to £2.9bn for the previous year and £2bn spent in the four quarters to September 2016.

8. Savilles has also observed that local government is likely to exceed 2017 investment levels this year (website: Saville's UK: UK commercial market in minutes August 2018). They also comment on the fact that, despite the increase in investment expenditure, local government still accounts for only 3.4% of the total market (see graph below taken from Savilles website).



Proposed key changes to the strategy

9. Apart from bringing the investment strategy together in one document, and giving a detailed description about the process undertaken in deciding whether to invest in a particular property, the key changes proposed to the strategy are described below:

    a. An increase of £10m in the amount that can be purchased under the delegated approval process bringing the maximum individual lot size that can be acquired to £20m. This gives the council more flexibility and the opportunity of making a few larger purchases whilst taking account of the investment principle stated in 2.12 namely that "the council will invest within a range of lot sizes so that one (large) investment does not dominate the entire portfolio holding".

b. A recommendation to set aside 20% of the net new rental income into the commercial property earmarked reserve to fund future void periods, rent free periods, and landlord expenses.

c. Changes to the scoring matrix that guides the decision making for an individual purchase. The new matrix gives more weighting on the security of the income stream as compared to the current matrix in use.

d. The inclusion in the scope of the strategy of investment in commercial property that the council currently owns, investment in pooled property funds, and the explicit inclusion of acquiring “alternatives” (leisure, horticulture, hotels, GP surgeries, and renewable energy).

e. A recommendation that, whilst investing out of borough is a sensible approach to risk mitigation, no more than 40% of the value of the Council’s total commercial investment portfolio will be invested outside of the City Council’s boundaries. This percentage to be a medium term target rather than it being applied for a particular financial year.

f. An explicit acknowledgement that ethical and reputational issues are taken into account when making a commercial property investment decision.

g. Limiting, over the medium term, the amount of investment in retail property to 20% of the overall value of the total commercial property portfolio.

h. A recommendation that the council departs from DHCLG’s (Department for Housing, Communities and Local Government) Investment Code and prioritises security followed by yield above the liquidity of the investment. (This is explained in paragraphs 4.11 to 4.15 in the strategy. It is a requirement of the Investment Code that the council discloses any departures from the guidance given in the Code).

Regulatory framework and context

10. HM Treasury has become increasingly concerned about the scale of commercial property acquisition funded by external borrowing (primarily from the Public Works Loan Board). Their concerns are twofold: first the impact on the overall national debt levels of such borrowing by local government, and second the level of risk that councils maybe exposed to.

11. As a consequence, DHCLG (Department for Housing, Communities and Local Government) issued revised investment guidance in February 2018 to local government. The revised guidance defines the acquisition of commercial

property (and lending to third parties such as wholly-owned companies) as "non-financial investments" (as opposed to financial investments such as deposits in banks and building societies). This change has also been mirrored in the revised Prudential Code, issued in December 2017, by CIPFA (the Chartered Institute of Public Finance and Accountancy).

12. The revised Investment and Prudential Codes require a number of disclosures about the council's non-financial investments which will need to be given as part of the 2019/20 budget setting process. In addition the Codes require self-assessed limits on the amount the council will borrow for non-financial investments, the amount it will lend to third parties, and the proportion of the budget that will be funded from commercial income. The aim is that councils ensure that their investment decisions are consistent with the requirements of fiscal sustainability, prudence and affordability.

13. DHCLG's Investment Code emphasises that councils must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. This guidance was introduced after some councils incurred losses arising from the collapse of the Icelandic banks. However, as the definition of investments has now been extended to include "non-financial investments", the guidance would also seem to apply to borrowing to fund investments in commercial property, particularly those made outside of a council's boundary as it is likely that the only policy objective for undertaking such an investment is to make a commercial return.

14. However, the Local Government Act 2003 (section 16) gives a definition of capital expenditure which explicitly includes the acquisition of property. The same act gives councils a statutory ability to borrow to fund capital expenditure. Consequently the guidance contained within the revised Investment and Prudential Codes is not at all clear and councils have continued to purchase commercial property outside of their administrative areas (as has this council).

15. This has prompted the president of CIPFA to issue a statement to local government (18 October 2018) stating that CIPFA:

    a) Considers that, where the scale of commercial investments including property is not proportionate to the resources of the authority, this is unlikely to be consistent with the requirements of the Prudential Code.
    b) Shares the concerns raised in relation to the recent continuation and (in a small number of cases) acceleration of the practice of borrowing to invest in commercial property.

16. CIPFA consequentially intends to issue more guidance in the near future on this issue, and have stated that they might include defining what borrowing in advance of need is, what proportionality looks like, and what the appropriate ratios are for commercial income compared to the financial size of the council.

17. Local Authorities are required to **have regard to** the Prudential Code by regulations 2 and 24 of the *Local Authorities (Capital Finance & Accounting) (England) Regulations 2003 and* to the Investment Code under the Local Government Act 2003.

18. Local Authorities can choose to disregard these Codes **but** must explain why they are doing this.

19. Any further changes to these codes that may impact on the proposed Commercial Property Investment Strategy will be bought back to cabinet for further consideration.

Integrated impact assessment

The IIA should assess **the impact of the recommendation** being made by the report
Detailed guidance to help with the completion of the assessment can be found here. Delete this row after completion

Report author to complete	
Committee:	Cabinet
Committee date:	12 December 2018
Director / Head of service	Chief Finance Officer
Report subject:	Commercial Property Investment Strategy
Date assessed:	23 November 2018

	Impact			
Economic (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Finance (value for money)	☐	☒	☐	The objective of the investment strategy is to generate new sustainable income streams with clear margins exceeding the cost of borrowing
Other departments and services e.g. office facilities, customer contact	☒	☐	☐	
ICT services	☒	☐	☐	
Economic development	☐	☒	☐	Where suitable opportunities arise, the investment strategy will contribute to the council's objective of supporting an inclusive economy
Financial inclusion	☒	☐	☐	
Social (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Safeguarding children and adults	☒	☐	☐	
S17 crime and disorder act 1998	☒	☐	☐	
Human Rights Act 1998	☒	☐	☐	
Health and well being	☒	☐	☐	

	Impact			
Equality and diversity (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Relations between groups (cohesion)	☒	☐	☐	
Eliminating discrimination & harassment	☒	☐	☐	
Advancing equality of opportunity	☒	☐	☐	
Environmental (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Transportation	☒	☐	☐	
Natural and built environment	☒	☐	☐	
Waste minimisation & resource use	☒	☐	☐	
Pollution	☒	☐	☐	
Sustainable procurement	☒	☐	☐	
Energy and climate change	☒	☐	☐	
(Please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**

	Impact			
Risk management	☐	☐	☒	Owning commercial property does involve risk. These are highlighted in paragraph 4.18 in the strategy. The council holds a commercial property earmarked reserve to fund the most likely financial risks involved i.e. void periods, rent free periods and landlord expenses. The strategy proposes that 20% of the net new income is credited to the earmarked reserve to help mitigate these financial risks.

Recommendations from impact assessment
Positive
Finance (value for money) and economic development
Negative
Risk management
Neutral
Issues

APPENDIX 1

2018/19 to 2020/21

Commercial property investment strategy

NORWICH
City Council

Contents

1. Introduction

This strategy sets out, in a transparent and open way, our approach to buying commercial property investments and the process and due diligence that is undertaken. We are often asked why we are investing in these assets. Councillor Paul Kendrick, portfolio holder for resources, gives the following reasons:

To generate a new net income stream and thereby help protect services that would be at risk of being cut or reduced

Like all local authorities, Norwich City Council is facing further cuts to the money it gets from the government. The council has to make £10m of savings in the next four financial years from a total gross budget of £57m - this is in addition to £33m of savings already made in the last 8 years.

We know the government's revenue support grant is disappearing and further austerity is likely to continue for district councils. Therefore we must ensure that we are a forward-thinking council with a proactive and ambitious appetite for income generation so that we can help maintain the services that matter most to local people – that is the basis for the commercial property investment strategy.

This commercial approach means the council will be able to lessen the required cuts to council spending and help protect services that would otherwise be at risk.

The council is unable to use the money it is spending on commercial properties to spend directly on services. The property investments will be funded by borrowing money; the law says the council can only spend borrowed money on assets with a life of more than one year and where it is going to make a profit or save on existing costs, meaning some of the money generated or saved can be used to meet borrowing costs. It would be illegal for the council to spend this money on day-to-day council services.

Because commercial property is an attractive long term investment

Section 5 in this strategy shows that commercial property investments are attractive in terms of long term yields compared to other types of investment the council could make, despite the potential risks involved.

In addition, the council can borrow money cheaply, mainly from the Public Works Loans Board, which lends to public bodies at very preferential rates compared to commercial investors. This borrowed money can be used to buy standing investments - commercial properties with established tenants in place which generate a revenue stream for the council. The council collects the rents from these properties and then, once you take off the borrowing costs, what is left is the profit which can fund council services.

Because the council understands and has experience in managing a commercial property portfolio

We have owned and managed a commercial property portfolio for decades. Excluding car parks, the council owns some 200 investment properties and these have a capital value of £43.5m. These investments generate a gross annual income of £2.5m (net income of £1.9m). The portfolio is managed by the council's joint venture arrangement with NPS Norwich Ltd.

Because it contributes to the council's priority of promoting an inclusive economy

The council's aim, in partnership with others, is to continue to develop Norwich as a strong, vibrant and inclusive economy which is the key driver of growth and prosperity regionally, and one in which the benefits of economic activity are shared by all.

The council, as part of this strategy, will invest in commercial property in Norwich (although not exclusively) so as to generate a new net income stream but also in some circumstances to respond to local market failure and local opportunities, for example by ensuring sufficient commercial spaces are retained and not converted into housing.

Councillor Paul Kendrick
Portfolio holder for resources

2. The council’s objectives, investment principles and acquisition criteria

The council’s aims for investing in commercial property

2.1 To generate new sustainable income streams, with clear margins exceeding the cost of borrowing.

2.2 To build financial resilience through the creation of a diverse commercial property portfolio to mitigate the potential risk of owning these investments.

2.3 To contribute to the council’s priority of supporting an inclusive economy, where suitable opportunities arise.

Status of the investment principles and criteria

2.4 The investment principles set out in this strategy are to be taken as mandatory.

2.5 The criteria for identifying appropriate acquisitions are to be used as a guide in individual investment decisions. Reasonable departures from the criteria can be made as long as the rationale for doing this is articulated and recorded.

Commercial property investment principles

Scope

2.6 The council will, under this investment strategy, acquire established commercial properties generating an immediate secure income profile.

2.7 The investment strategy also includes the potential redevelopment of already-owned commercial property requiring capital expenditure and potential investment in pooled property funds.

2.8 This investment strategy does not include the purchase of housing for the private rental sector (PRS). Given the council has a Housing Revenue Account (HRA), such acquisitions by the council would automatically become social housing rather than PRS and therefore are unlikely to meet the income objective stated in 2.1 above. The investments would also be subject to the right-to-buy legislation.

Tenure

2.9 The acquisitions will be freehold or long leasehold purchases. The acquisition must be assessed by LGSS Finance to be an operating, rather than a finance, lease otherwise part of the rental income is a capital receipt (with restricted permissible uses) rather than an income stream for the council's revenue budget.

Diversification of the portfolio

2.10 The council will buy commercial property outside of the city boundaries in order to mitigate the potential risk of being over reliant on one economic location and in order to be better able to diversity the portfolio in terms of sector and tenancy mix. However, no more than 40%, by value, of the total commercial property portfolio will be located outside of the city's boundaries. This is because local investment ensures the council is best placed to know all the facts surrounding a property, its history, and potential developments in the area.

2.11 The council will acquire a good spread of properties across a variety of asset classes and tenancy sectors including the "alternatives" sector in order to reduce the risks of exposure to a single asset class, tenant or market failure. At this stage the portfolio is heavily weighted into certain sectors and classes. However it is expected that over the life of this strategy no more than 20% (by value of the portfolio) will be retail and of the remaining 80% there will be a mix of industrial, office, and alternatives in roughly equal proportions.

2.12 The council will invest within a range of lot sizes so that one (large) investment does not dominate the entire portfolio holding. Average lot sizes are likely to be in the range £5m to £15m, although this does not rule out smaller or larger lot sizes.

Size of the commercial property investment fund

2.13 The capital budget for commercial property acquisitions and investments will be agreed by the council annually (as part of the overall budget setting process) and total in-year expenditure will not exceed this approved budget figure (unless council is asked and agrees to increase the budget).

2.14 The amount of money the council will invest in commercial property, and the potential risks it takes on in doing so, will be proportionate to the size of the council. The council will publish appropriate indicators, required under DHCLG's (Department for Housing, Communities and Local Government) revised Investment Code, as part of the annual budget setting process. These indicators will show the size of the intended investments in relation to the size of the council's General Fund budget and balance sheet and the proportion of the council's budget that is funded from commercial property rental income.

Required rate of return from the investment

2.15 All investments considered under the delegated approval route must provide income equal to or above (or no more than 0.02 per cent below) the council's required initial net rate of return. This is defined as the return assumed and stated annually in the MTFS (Medium Term Financial Strategy) **<u>after</u>** taking into account the costs of borrowing for the investment (even if the investment is to be initially funded from internal borrowing (the temporary use of the council's cash holdings) rather than through external borrowing. At the time of writing this strategy the council's required initial rate of return is 2 per cent.

2.16 Council policy, in the case of commercial property investment, is to place the security of the investment first followed, in priority order by yield and liquidity when considering the investment decision (see paragraph 4.14).

2.17 20 per cent of the new net income will be credited to the commercial property earmarked reserve to help mitigate the long term financial and cyclical risks that are associated with these investments (see paragraph 4.18).

Financial evaluation

2.18 The financial analysis will be undertaken on a prudent rather than an optimistic basis and will include:

- the relevant capital and revenue costs and income resulting from the investment over the whole life of the asset including borrowing costs (being interest rate charges and MRP (Minimum Revenue Provision) costs)
- estimated costs of future voids, rent free periods, and landlord repairs
- as a "worse case" scenario, the estimated return to the council where there is no future rental growth
- a testing of the impact of increased interest rates on the financial return to the council.

Delegated decision-making process

2.19 Individual property acquisition decisions that fall within these principles will be taken following the delegated process set out in section 6 of this strategy. The key documents constituting the "business case" for the investment are:

- A scored criteria matrix for the potential acquisition (Appendix B).
- Statement of 'other good reason' if required (see paragraph 2.27).
- A purchase report from the council's agent.
- A RICS "Red Book" valuation.
- A financial appraisal from LGSS Finance.

2.20 Any acquisition that contributes to the promotion of an inclusive economy, or an investment in already-owned commercial property, that does not meet the council's required net rate of return will be considered on its merits by cabinet and council through the submission of a business case. Such investments will not be undertaken using the delegated process set out in section 6.

Ethical and reputational issues

2.21 The choice of investment will take into account ethical considerations relating to the vendors of the property in addition to the intended use of the property and its current or future tenants. The council will not engage with sellers or tenants who may present a significant reputational risk.

Criteria for identifying appropriate acquisitions

2.22 When a commercial property investment opportunity presents itself, the council will undertake an initial screening to assess whether the following activities are involved:

- armaments and nuclear weapons production or sale
- escort services
- environmentally damaging practices and
- the manufacture of tobacco products.

2.23 These will be taken account in the decision as to whether to bid for the property but will not necessarily preclude the council investing in a property that has a connection to these activities.

2.24 A criteria matrix will then be used to score the potential property acquisition, and this score will also inform the decision as to whether to bid for the property. This matrix can be found in Appendix B.

2.25 The matrix gives different weightings to the various factors to be considered. A score of below 120 (out of a possible total of 195) will be deemed to be a below-average investment and will be ignored.

2.26 The factors considered in identifying an appropriate investment are as follows:

- The strength of tenant covenant - which will be assessed through CreditSafe and/or Dunn and Bradshaw credit assessments.

- Prospects of re-letting at expiry either with the existing tenant or with others given the location, size and nature of the property, and the demand in the locality for properties to rent.

- An assessment of the exit opportunities – such as disposal or redevelopment.

- Lease length will be determined by market sector forces but the premise will be to maiximise.

- Net Initial yield should be at or above five per cent. (This is not the same as the council's required net rate of return discussed in 2.15 above. The latter is the real initial return to the council's budget whereas net initial yield is simply the rental income from the property at acquisition expressed as a percentage of the acquisition cost (including taxes and fees).

- Macro and micro locations with rental growth, good letting prospects, and with good transport links will be actively sought.

- Specification - properties with a fully usable and flexible space will be preferred.

- Properties with a practical configuration of buildings and land will be preferred to enable easy servicing and access.

- Obsolescence – properties that are in good condition, are high quality and have prospects of lasting over many years with minimal investment will be actively sought.

- To minimise management and risk, preference will be for single occupancy investments although multi-let or multi-unit schemes may be considered.

- Investments should be on full repairing and insuring (FRI) terms, meaning that all costs relating to occupation and repairs are borne by the occupier(s) during the lease term.

- The lease should allow for rent reviews increases linked to the retail price index or open market value. Leases with downward rent review terms should be avoided.

- Ideally the market rent should be equal to or higher than the passing (current) rent (indicating prospects for rental growth). To be generally avoided is the opposite, i.e. an over-rented property

- Sustainability – properties with a high energy performance certificate (EPC) (BREAM outstanding or excellent - Building Research Establishment Environmental Assessment Method) are preferred

Other good reasons for acquisition

2.27 As referred to in paragraph 2.3 there may be occasions where the council acquires property to contribute to the council's priority of supporting an inclusive economy. In such circumstances it may be acceptable to acquire a property which has a matrix assessment below the threshold score normally considered acceptable (but still meets the council's required net rate of return).

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2.28 These other circumstances may include:

1) Where the council is a special purchaser as it will obtain marriage value;
2) Strategic Importance of the land/building
3) Strong links to tenant / vendor
4) Represents model example of socially responsible investing
5) Exemplary green or sustainable factors
6) Synergies with other properties
7) Alternative Use value at reversion
8) Development potential

2.29 In such circumstances the council will record the reasons for departing from the matrix threshold with fully set out reasons so that informed decision making can be made.

3 Commercial property as an investment – a short guide

Definition of commercial property

3.1 The commercial property market is primarily made up of three sectors (retail, office and industrial) and these have traditionally dominated investors' portfolios. Other sectors are starting to emerge and these are termed "alternatives".

- **Retail**: Shop units and similar (e.g. restaurants & coffee shops, bank branches, estate agents, etc.), in-town & out-of-town shopping centres, retail warehouses & retail parks (typically occupied by DIY stores, carpet & electronics retailers).

- **Office**: Office blocks, out-of-town business parks, and data centres.

- **Industrial:** Warehouses, light industrial use (e.g. workshops), distribution and logistics, and most types of factory other than structures such as steel works, chemical plants etc.

- **Other commercial property ("alternatives")**: A wide range of miscellaneous building and property types used by profit making businesses including: leisure premises, hotels, petrol stations, car parks, student accommodation, agricultural /horticultural holdings, GP surgeries, and renewable energy. These can often have very unusual characteristics in terms of risks and income flows.

3.2 Investment returns from commercial property arise from both an increase (or decrease) in the asset value on sale (capital receipt return) and the annual cash flow generated from leasing the property to a tenant (rental income).

Rental income

3.3 The most reliable source of return from commercial property investment is the rent paid by the tenant/s, which they are legally obliged to pay under the terms of the lease until lease expiry.

3.4 Rent is a first charge on the assets of a company and therefore takes priority over many other forms of debt in a bankruptcy situation.

Demand and supply

3.5 The rent at which a property will let, or the price at which a property will sell, is determined by market forces and the imbalance between supply and demand. Strong demand from prospective tenants for particular buildings will usually lead to an increase in the rental value of that space, particularly if there is a limited supply, e.g. a shop in Bond Street in London's West End.

3.6 A strong tenant demand also means that landlords do not have to offer tenants so much in the way of incentives to take the lease. This is illustrated by looking at rent-free periods at the start of the lease, a common incentive. When market rents are rising rapidly, the length of the rent-free periods being offered falls and the reverse is true when rental values are static or falling. In 2017, the unweighted average rent-free period for all offices was 9.1 months (source: “Understanding UK Commercial Property Investments”, Investment Property Forum, 2017) well below the high of 11.4 months recorded in 2010.

3.7 In addition, the amount of time needed to find a replacement tenant and income stream tends to be shorter in a stronger market.

3.8 Capital values increase where there is greater investor demand (as well as greater tenant demand). For example, the capital value of trophy assets in London has grown rapidly in value because of the high level of international investor demand.

3.9 It is important to note that movements in capital and rental values are not perfectly positively correlated, and it is possible (and often the case) for the investment value of an asset to rise faster or slower than its rental value. The occupier and investor markets for commercial property are distinct and have different drivers. The occupier market is connected more closely to the “real” economy and comprise of businesses seeking to expand and contract. Capital investors however are competing for the best fixed income returns that are obtainable from a wide range of investments types including commercial property.

Rent reviews

3.10 UK commercial property leases generally provide for rents to be reviewed every five years and set to the market level where this is above or equal to the rent being paid at the time of the review. If the market rent is below the current rent, the rent would remain unchanged for the next five years. Although a ‘five-year, upward-only rent review’ is the most common review type in the UK, there are other mainstream provisions:

- **Fixed uplift rents:** these are rents that are uplifted after a pre-established period (e.g. every three or five years) by a set value or percentage as stated in the original terms of the lease.

- **Index-linked rents:** these are rents that are linked to an index such as the Retail Price Index (RPI). They have been increasingly adopted by the UK investment market as they provide inflation hedging.

- **Turnover-related rents:** these are relatively rare these days and comprise of rents that are set as a percentage of the tenant’s business activity turnover from occupying the space. These leases are most commonly found in retail shopping centres and in the student accommodation sector.

.Lease length

3.11 Commercial property leases in the UK can range between 5 and 15 years in length, but usually 5 to 10 years, with the market average currently being around seven years, compared with 23 years in 1990. Average lease lengths differ across sectors, (e.g. retail warehouse tenants generally want long leases), location and the size of the space (tenants with more floor space are more likely to want a longer lease because of the level of upheaval associated with relocation and the higher capital expenditure on fit out).

3.12 Some leases include a ‘break clause’ that gives the landlord and/or tenant the option to terminate the lease prior to its expiry date. This can impact on the value of a property because the income stream is no longer certain for the full term of the lease. The number of leases with a tenant break clause has been increasing over recent years and currently some 40 per cent of leases contain such a clause.

Impact of movements in the capital value of the investment

3.13 Local government has a unique financial regulatory framework and, unlike the private sector, any fall in the capital value of the property due to market changes is not a cost to the council’s General Fund revenue budget. The principle risk to the revenue budget is lost rental income and potential liability for business rates due to void properties.

3.14 Net gains or losses on property disposals are reversed out of the General Fund balance through capital accounting impairment entries in the Movement in Reserves Statement and posted to the Capital Adjustment Account, Capital Receipts Reserve and Revaluation Reserve (if all appropriate) so not to impact council tax.

3.15 However, if there is still an outstanding debt liability arising from the borrowing undertaken to finance the acquisition of the property, and the capital receipt obtained from the sale is not sufficient to pay off the loan debt, this would have an adverse impact on the council’s General Fund budget. In this scenario the council would still have interest and Minimum Revenue Provision (MRP) costs to fund but without the benefit of the rental income stream to cover these costs.

4. Unique features of commercial property as an investment

A tangible asset that requires management

4.1 Property is a tangible asset, usually comprising two elements: land and buildings. While buildings can become obsolete or be destroyed, land remains an asset that generally retains some value because in the UK it is in limited supply and is subject to the restrictions of the land-use planning system.

4.2 Property may also offer the opportunity to increase its value, and hence investment returns, through ‘active’ management. This can entail such actions as refurbishment or redevelopment, the renegotiation and extension of leases, the ‘right-sizing’ of tenants (providing them with the optimum sized unit), or acquiring property with rental reversions (i.e. where the rents received for space are less than the rental value of that space).

4.3 The downside of owning a tangible asset like property is management and costs of ownership. The amount of time and cost will depend on the terms of the lease, the state of the market, and the balance of power between the parties to limit their obligations. Although it is common for leases of commercial properties in the UK to make the tenant take responsibility for some or most of the costs of repair, maintenance and insurance of the building, the landlord must still collect rent, settle dilapidations, serve notices, and undertake rent reviews and relets.

4.4 Effective management is essential to maintain income flow and to ensure that a building remains attractive to occupiers. It should be noted that the costs of managing multi-let assets are often considerably more than for single let assets, since the landlord will often retain responsibility for common parts paid for via a service charge recovery. If the lease repair obligations on tenants are internal only then the landlord must arrange, oversee and pay for any external works required. In the case of large buildings, dedicated resources (facility managers, security teams and receptionists) may be needed and not all costs may be recoverable from tenants. In the case of having a unit void in a multi-let property the council would pay the service charge and business rates until a new tenant is found.

4.5 The council intends to implement an improved process for monitoring the total and individual property performance of the portfolio along with a formal annual portfolio review.

4.6 The annual portfolio review will include:

- A market update on activity and forecasts and review of the current commercial property investment strategy.
- An external market valuation of the portfolio to monitor and benchmark performance (undertaken already for the Annual Statement of Accounts preparation).
- An updated five year cash flow and capital expenditure forecast.

- A review of retain, sale, re-purpose or re-gear of each asset.
- Review of previous year's performance including rent collection rates, arrears and service charge reconciliations.
- Review of the underlying lifecycle of the asset, holding period, refurbishment expectations, dilapidations, health and safety, statutory compliance and insurance claims.
- Tenant covenant strength monitoring report and tenant compliance with lease terms and any default/issues.

Diversity and valuation

4.7 The heterogeneous nature of property as an investment is one of its most significant features and is both an advantage and a drawback. On the plus side, it means that an almost infinite range of opportunities exists, each providing distinctive investment characteristics. This offers the prospect for diversification, even within a portfolio of a relatively small number of properties.

4.8 However, the diversity can make asset pricing and an assessment of whether the council is achieving value for money in its acquisitions difficult. For example, unlike equity investments, property does not trade on an exchange with openly quoted prices.

4.9 The Royal Institution of Chartered Surveyors (RICS) Appraisal and Valuation Standards (known as 'The Red Book') are the most recognised professional standards used by valuers in the UK. They are used by RICS members (chartered surveyors), who value most of the investment property in the UK. Properties are valued principally for transaction purposes (buy/sell decisions), financing for borrowing or capital raising purposes, performance benchmarking, and for the preparation of the annual Statement of Accounts.

4.10 The Council employs an external expert agent to advise on the pricing strategy for a potential commercial property acquisition. In addition, an independent valuer also undertakes a "Red Book" valuation of the property before a bid is made.

Liquidity

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4.11 The process of selling and buying property takes a lot longer than buying financial investments such as equities or government bonds. This is because of the unique nature of every property, its complexity (both physically and from a legal perspective), the large unit size, and the nature of the market in which transactions occur. Even in a buoyant market selling takes a long time and involves lengthy marketing periods that can easily take up to a year to conclude for limited market or complex assets. Investing directly in property therefore involves more liquidity/transaction risk than financial assets such as equities, bonds, and deposits in banks and building societies.

4.12 When investing in commercial property local authorities are obliged "to have regard to" DHCLG's (Department for Housing, Communities and Local

Government) Investment Code and the complementary Treasury Management Code produced by CIPFA (Chartered Institute of Public Finance and Accountancy). These codes stress the importance and long-held good practice of placing security and liquidity above yield (in that priority order) when making any investment decision. A council can choose to disregard the codes but must articulate its rationale for doing so and what the council's relevant policy will be.

4.13 The council has noted and has had regard to the guidance in the codes. It has decided after careful consideration to depart from the guidance in this instance for the purpose of generating new income streams in order to help maintain a robust and sustainable financial position. The council has set out within this strategy its approach to commercial property investment including risk mitigation, the approach taken to financial modelling of the returns, the due diligence undertaken, and the use of external advisers.

4.14 Council policy, in the case of commercial property investment, is to prioritise the security of the investment followed, in priority order by yield and liquidity when considering the investment decision. The scoring matrix weightings for potential property acquisitions (Appendix B) shows that 45% of the total score relates to the security of the future rental income stream(s) associated with the investment. In terms of commercial property investment these terms mean the following:

- **Security** – security of the investment (primarily term certain i.e. length of lease term remaining, exit strategy, prospects of reletting at expiry or if it were to fall vacant) and strength of tenant covenant
- **Yield** – the net return to the council that is appropriate for the level of risk being assumed, and
- **Liquidity** – to ensure that the property is attractive and marketable for the future.

4.15 The council will implement the recommended practices contained in the Investment Property Forum's "*Readiness for Sale: A guide for streamlining commercial property transactions"*, May 2012) in order to help speed up the sale and purchase process and thereby increase the liquidity of this investment category.

Transaction costs

4.16 The cost of buying and selling commercial property is significantly higher than for a comparable volume of equities and gilts. This is due to much higher levels of stamp duty (stamp duty land tax (SDLT), together with the costs of lawyers, chartered surveyor agents, environmental and condition surveys, Land Registry and other fees, all of which typically add an additional five to seven per cent to direct property acquisition costs (although this is closer to two per cent on a disposal).

4.17 In practice, the high transaction costs associated with buying and selling property mean that investors need to hold property as a long-term investment, with limited opportunities for short-term gains.

The potential risks of commercial property investment

4.18 The key risks associated with commercial are shown below.

Figure 1: **Principal risks associated with commercial property investment**

Potential risks at asset level	Potential risks at market level
Stock specific – there is more risk in owning a property portfolio where there is limited diversification in terms of geographic location and tenancy/type of property owned	**Economic outlook** – property financial performance is closely correlated to national GDP (Gross Domestic Product) growth
Liquidity – commercial property is relatively illiquid which is a risk if the Council ever needs to sell investments quickly in order to raise cash	**Sector and geographic concentration** – an individual property may perform better or worse than other property due to its location and/or tenancy type (for example – retail property is currently under-performing in some areas of the UK)
Valuation – property values are determined by the market. RICS registered valuers provide estimates of market value at any given date but their values do not represent guaranteed transaction prices and this makes it difficult to demonstrate value for money Also the risk that the future value of the property will be less than the amount of loan repayment required upon disposal.	**Investor confidence** – not a constant and shifts in sentiment can have a positive or negative impact on values
Void rental periods – from vacancies (end of lease terms or tenant bankruptcy) and from rent free incentives given to new, and sometimes existing, tenants at lease renewal	**Changes in taxation** – can impact value and property's relative attraction as an asset class e.g. increases in stamp duty land tax or VAT
Condition and Environmental – the property itself may not comply with current market standards so requires expenditure to upgrade building fabrics etc Also locational issues, such as risk of flooding	**Availability of debt finance** – the government could stop (or increase the cost of) borrowing from PWLB (Public Works Loan Board) for all (or for out-of-boundary) commercial property acquisitions **Interest rate changes** – affect cost of property borrowing

Potential risks at asset level	Potential risks at market level
Litigation – related to acquisition, ownership, management and disposal of property	**Changes in legislation / regulation** – risk that central government could legislate to stop or limit local government buying commercial property Upgrades to older building types can be very costly particularly when the penalty for not complying with statutory legislation is that the property cannot be let as, for example, under MEES (minimum energy efficiency standards).

4.19 The council agreed in February 2018, as part of the budget setting report, to the establishment of a commercial property earmarked reserve. The reserve is held to help mitigate the financial risks of holding commercial property and can be used to fund any future void periods, the granting of rent free periods to new tenants, and any landlord repairs.

4.20 The amount of money in the reserve will be reviewed annually as part of the budget setting process and will take into account the outputs of the annual portfolio review (see paragraph 4.6).

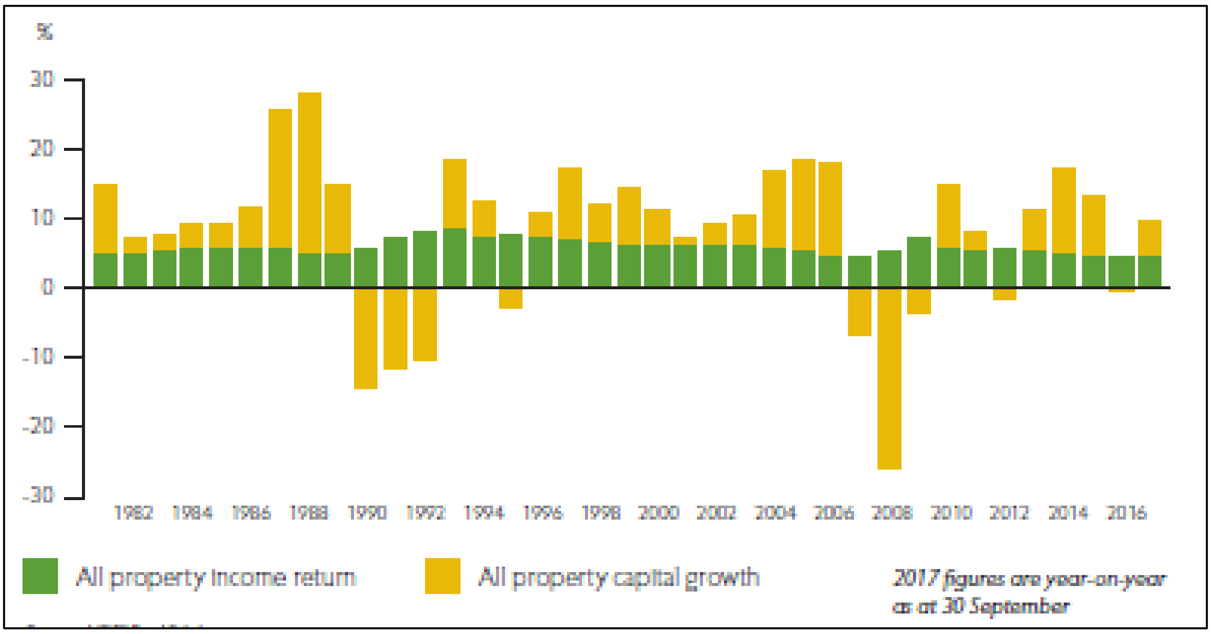
5. Investment returns from commercial property

Income and capital returns

5.1 As previously stated, investment returns (both gains and losses) from commercial property can arise from both an increase (or loss) in the asset value on sale (capital receipt return) and the annual cash flow generated from leasing the property to a tenant (rental income).

5.2 Property rental returns are relatively consistent when compared with capital returns which can rise and fall quite dramatically on a cyclical basis depending on the supply and demand for investment stock at any given time (underlying the importance of timing when deciding to buy or sell property). This is shown in figure 2 below.

Figure 2: **Property: income and capital returns**



Source: "Global Real Estate Performance in 2017" MSCI's IPD® Global Annual Property Index

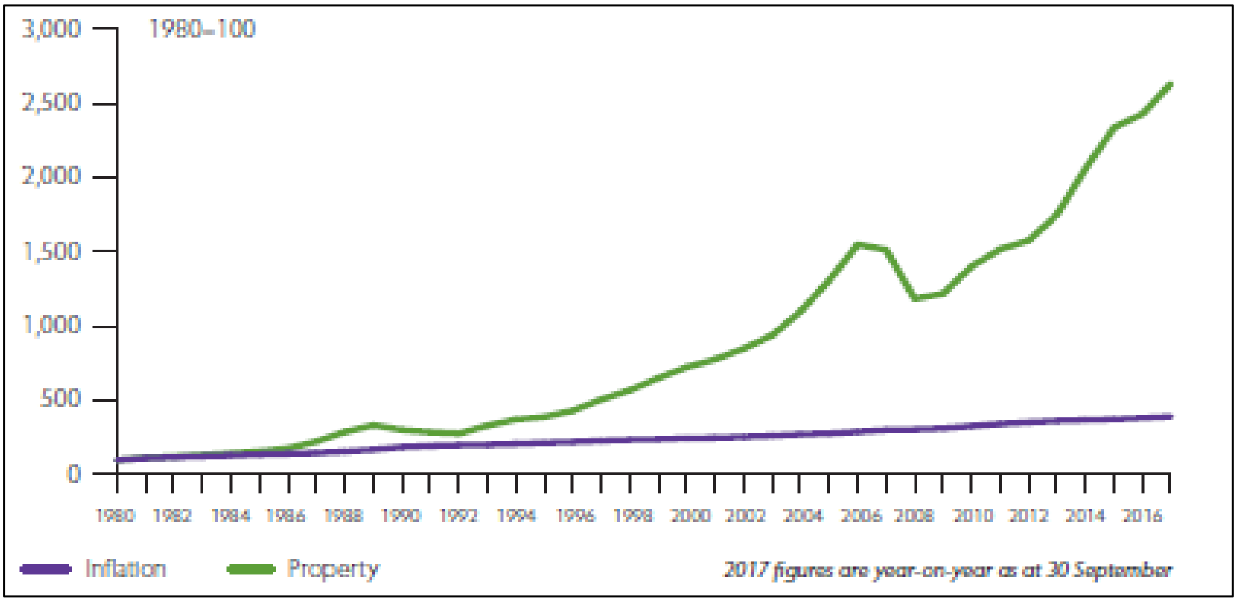
Inflation

5.3 The Investment Property Forum (IPF) looked at property values and inflation over the long term and found that whilst property is not a hedge against inflation (a 'hedge' is defined strictly as moving at the same time as inflation or reacting to it) property does deliver long-run real returns, as shown in figure 3. The figures show the "total returns" from property which comprise both the annual rental income and the capital value of the asset.

Returns compared to other investment classes

5.4 The investment returns from property are usually compared with those from equities and bonds, both of which are permitted investment choices for local government (see figure 4). In comparison with income from equities, property rent is generally much more predictable and certain. While conventional bonds (except for those that are index-linked) also provide an assured return, they do not offer the prospect of income growth.

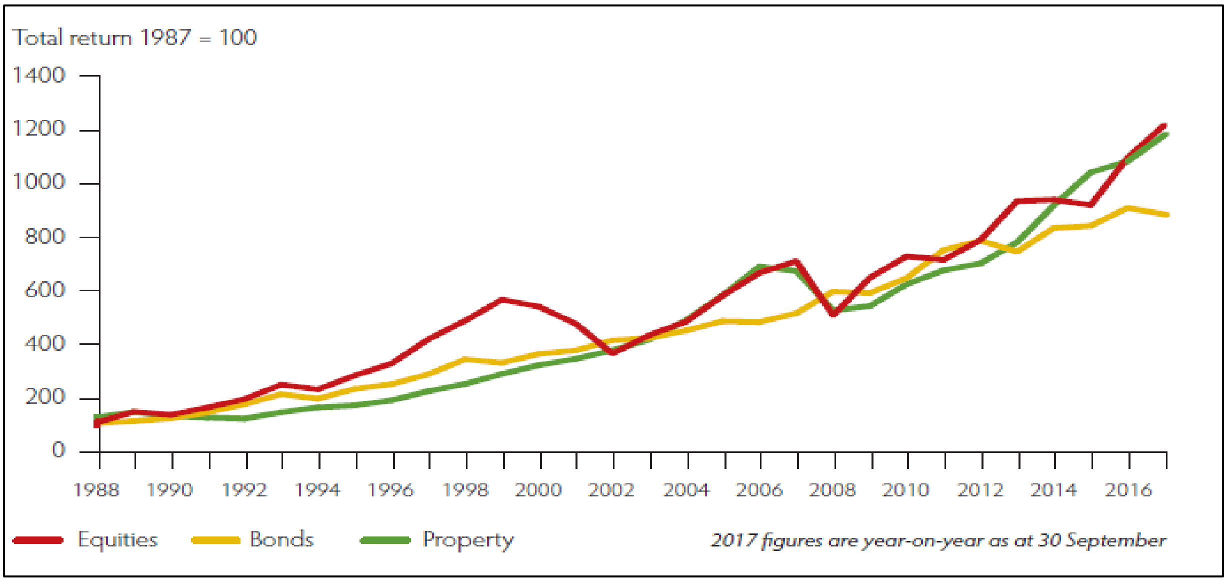
Figure 3: **Property total returns vs. inflation**



Source: Understanding UK Commercial Property Investments, Investment Property Forum (2017)

5.5 In terms of risk profile, property is usually regarded as being between bonds (lower risk) and equities (higher risk) but with the benefit of potential income growth from rental uplifts. However, the liquidity risk of holding property, as mentioned in the previous section, should not be understated, especially in an economic downturn where there can be very few buyers except for the most prime assets.

Figure 4: **Performance of commercial property compared with equities & bonds**



Source: "Global Real Estate Performance in 2017" MSCI's IPD® Global Annual Property Index

6. Acquisition process

Delegated authority for decision making

6.1 Delegated decision making is required so that decisions on whether to bid for and acquire a particular property can be made in a timely and decisive way which is essential in this market. It also allows the council to respond to opportunities as they arise.

6.2 Cabinet agreed at its meeting on 12 April 2017 to delegate authority to invest in commercial property acquisitions to the director of regeneration and growth in consultation with the chief finance officer, the portfolio holder for resources, and a quorum of three other cabinet members.

6.3 The maximum lot size (purchase price or capital investment in an existing commercial property) under the delegation is £20 million. This was agreed by cabinet on 12 December 2018.

Acquisition process

6.4 Appendix A gives a process workflow diagram for the acquisition process showing the six phases of the process (initial screening, detailed investigation and financial modelling, pre-contract due diligence, exchange of contracts, completion and post-completion). The diagram shows when decisions are made, what activities are involved, and who undertakes these activities.

Governance and due diligence

6.5 A formal business case document is not written for every commercial property acquisition as there is often not the time to undertake this. However all the key elements that would go into such a business case are produced and documented in a variety of reports/lists or models.

6.6 The key reports/lists or models are the following:

- A scored criteria matrix for the potential acquisition (Appendix B).
- Statement of ‘other good reason’ if required (see section 2.27).
- An initial purchase report from the council’s agent.
- A RICS “Red Book” valuation.
- A financial appraisal from LGSS Finance.

6.7 Any decision made to bid for a property is published as a key decision notice and the property details and financial model are also circulated to all elected members on a confidential basis because of commercial sensitivities.

6.9 All key decisions can be called in by elected members for further consideration. Scrutiny committee will consider key decisions that have been called in and can refer the decision back to cabinet.

6.10 A decision to exchange contracts (when the transaction becomes legally binding for both parties) is taken on the basis of:

- A report from NPLaw on the due diligence they have undertaken on title, leases and searches.
- A final purchase report including advice arising from the building and environmental surveys undertaken.
- A revised financial analysis from LGSS Finance (if this is required).
- A recommendation from NPLaw about the draft contract terms.

6.11 Appendix C sets out in more detail the due diligence undertaken.

Assurance

6.12 As part of the 2017/18 audit of the council's statement of accounts, the external auditors, Ernst & Young LLP, undertook a value for money review on the council's commercial property investments. The audit results report (July 2018) states:

"Management have provided evidence that an appropriate methodology for appraising and analysing the investment opportunities was in place to make a decision to purchase…The investment strategy sets out a number of criteria and key recommendations from the Council's advisors that the council should have regard to in purchasing property. The methodology reviewed follows these areas in helping to formulate a decision…We have compared the data used in the models to market trends and have comfort in the assumptions included…We have concluded proper arrangements were in place during 2017/18 for informed decision making."

Capacity, skills and the use of external advisers

6.13 DHCLG's Investment Code requires that elected members and officers involved in the investment decision making process have appropriate capacity, skills and information to enable them to take informed decisions as to whether to enter into a specific investment.

6.14 The chief finance officer, as project sponsor for the commercial property investment programme, will set out for Asset and Investment Board agreement, a suitable annual training plan for both officers and relevant members.

6.15 The council recognises that investing in commercial property is a specialist and potentially complex area. It will therefore engage the services of professional property, legal, financial and tax advisors where appropriate in order to access specialist skills and resources to inform the decision making process associated with this strategy.

APPENDIX A **Buying investment properties** – process workflow

OPPORTUNITY
On market or off market investigation

1. Initial screening phase

Stage 1
Agent sends information through to HCD and PM (via email) with scored matrix

Stage 2
HCD reviews matrix score and statement of good reason if required;
PM (with HCD/CFO)**:** Reviews for potential ethical issues

NO
(Agent informed by PM)

Outputs:
- Scored matrix
- Statement of good reason if required

Decision 1 (via email). Investigate further
Within 3 days DRD and CFO in consultation with HCD, agent and NPSN confirm property is consistent with CIPS principles and agree further investigation

YES

2. Detailed investigation and financial modelling phase

Stage 3
PM: Instruct agent to undertake further investigation and inform NPlaw of potential aquisition; **NPSN/HCD:** Visit site. Undertake red book valuation; **LGSS Finance:** Detailed financial modelling and risk analysis.

Outputs:
- Red Book valuation
- Initial purchase report
- Financial model

Decision 2 (via meeting or email) 'Do we bid and how much?'
PM: distributes information to decision makers. Decision of DRD in consultation with the CFO, Portfolio Holder for Resources and 3 other cabinet members. A second bid amount should also be agreed at this meeting, in case second bids are invited.

NO
Relevant parties informed by PM. Back to Stage 1

YES

Stage 4
PM: Collate responses from quoram of cabinet members, DRD and CFO. Record responses for audit trail. Publishes key decision and sends confidential information to all members. Inform AGT to place bid. Inform NPLaw. Asks LGSS finance to notify HMRC of decision to opt to tax;
AGT: Sends offer letter to vendor.

Decision 3 (whether the vendor agrees or not)

NO
Relevant parties informed by AGT and PM

YES

3. Pre contract and due diligence phase

Outputs:
- agreed heads of terms

Stage 5
PM: Circulates Heads of Terms to CFO, NPSN, HCD and collates comments back to Agent;
HCD: Agrees Heads of terms in consultation with agent, CFO and NPlaw.

Stage 6
AGT: Undertakes building and environmental surveys. Final purchase report written; **NPLaw:** Undertake due diligence on title, leases, searches and reviews draft contract; **LGSS Finance:** Amends financial model if required and arranges far deposit monies to be ready; **PM:** Informs LGSS insurance of progress and organises meeting, if required, to clarify/confirm any issues associated with purchase of the property.

Outputs:
- report from NPlaw on titles, leases and searches
- final purchase report
- revised financial analysis if required
- draft agreed contract

4. Exchange of contract phase

Decision 4 To exchange contracts
If the purchase is still within the parameters of decision 2 then DRD in conjunction with the CFO agrees to continue with the purchase. If any variations raised then quorum of members consulted.

NO
Relevant parties informed by PM. Back to Step 1

YES

Outputs:
- contract signed and sealed
- deposit paid

Stage 7
PM: Arranges signing and sealing of contracts; **NPLaw:** Sends documents to council procurement team with sealing authority; **LGSS finance:** Pay deposit.

5. Completion phase

Stage 8
LGSS finance: Pays purchase price; **NPlaw:** Approve agreed completion statement;
LGSS insurance: Arranges appropriate insurance cover; **HCD/PM:** If required, service contract is entered into.

Outputs:
- purchase price paid in full
- insurance cover
- service contract if required

6. Post completion phase

Stage 9
LGSS finance: Pays SDLT to HMRC; **PM:** Transfer property to NPSN management;
NPlaw: Register property at land registery.

Outputs:
- SDLT return
- transfer to NPSN
- land registry notified

COMPLETION

APPENDIX B

Scoring matrix

Parameter (score)	Excellent (4)	Good (3)	Acceptable (2)	Marginal (1)	Not acceptable (0)	Weighting	Max score	% of total score	Comments
Covenant strength	Very low risk	Safe low risk	Moderate risk	High risk	Very high risk	6	24	10%	Based on risk of tenant default or bankruptcy as recorded by Creditsafe™ or equivalent ratings agency
Prospects of re-letting	Within 3 months	3 to 6 months	6 to 12 months	12 to 15 months	More than 15 months	6	24	7.5%	Anticipated timescale to re-let property (in current market conditions)
Possibility of alternative use **'Exit strategy'**	In demand use; Value of use greater than existing; Planning a near certainty; Minimal or no capital expenditure required	In demand use; Value of use within 90% of existing; Planning consent likely; Modest	Likely to be in demand use; Value of use within 80% of the existing; Planning consent reasonably likely; Average capital expenditure required	Likely to be in demand use; Value of use less than 80% of the existing; Planning consent uncertain; High	Little or no alternative use likely due to demand and/or planning considerations; Prohibitively high capital expenditure required	6	24	7.5%	Prospect that property could be occupied by an alternative use if it was no longer possible to let it in its existing use.
Unexpired lease term	Over 10 years	8 to 10 years	6 to 8 years	3 to 6 years	Less than 3 years	6	24	10%	Lease term defined by expiry date or tenant break if latter exists. Weighted average calculated on multi-let properties
Net running yield	More than 8%	7% to 8%	6% to 7%	5% to 6%	Less than 5%	6	24	10%	Takes account of net initial yield at purchase and yield once rent has reached its estimated rental value

Parameter **(score)**	**Excellent** **(4)**	**Good** **(3)**	**Acceptable** **(2)**	**Marginal** **(1)**	**Not acceptable (0)**	**Weighting**	**Max score**	**% of total score**	**Comments**
Location - macro	Major location with excellent access	Strong location with good access	Recognised location with good access	Weak location with poor access	Isolated location	3	12	5%	Use PMA Services Ltd or similar datasets to help inform Needs to take into account future prospects.
Location - micro	Central business district or prime sub-market	Better secondary location	Average secondary location with good transport or footfall	Location with high vacancy levels and/or regeneration required	Location difficult to access and isolated	3	12	5%	Location within the city or town, etc. and whether
Specification	Top specification (equivalent to grade A)	Better than average or recently refurbished (equivalent to Grade B+)	Average (equivalent to Grade B)	Below average but with clear refurbishment potential	Below average major investment required or too large for market	3	12	5%	Grading based on quality of buildings
Configuration	Very well organised with good access, circulation, productive space and parking (as relevant) and capacity to scale up operations	Organised with sufficient access, circulation, productive space and parking (as relevant)	Satisfactory access, circulation, productive space and parking (as relevant) but with potential challenges over flexibility or growth	Some access, circulation, productive space and/or parking (as relevant) challenges which might limit attractiveness to occupiers	Overcrowded and/or poor access and/or hazardous configuration	3	12	5%	Takes into account negative features of the property’s configuration that for example limits a tenants operations or trading functions

Parameter (score)	Excellent (4)	Good (3)	Acceptable (2)	Marginal (1)	Not acceptable (0)	Weighting	Max score	% of total score	Comments
Obsolescence	Building is up to 5 years old	Building is in first quartile of useful economic life (assuming normal levels of repair)	Building within second quartile of useful economic life (assuming normal levels of repair)	Building is within 3rd quartile of useful economic life (assuming normal levels of repair)	Building is in last quartile of useful economic life or has not been adequately maintained	3	12	5%	Age of property
Levels of active management	Minimal active management required Within 20 miles of Norwich	Some active management required Within 50 miles of Norwich	Requires regular but not excessive active management Within 100 miles of Norwich	Requires regular active management	Requires considerable active management potentially requiring dedicated on-sites staff	3	12	10%	Single let properties will generally require less active management. Properties further from Norwich will be more difficult to manage unless say single let and full repairing and insuring (see also below)
Tenant's repairing terms	Tenant effectively responsible for internal and external repairs and insurance	0-5% of costs not recoverable from tenant	5-10% of costs not recoverable from tenant	10-15% of costs not recoverable from tenant	More than 15% of costs not recoverable	3	12	5%	To what extent are repair and insuring costs covered by the tenant
Rent Review provisions	Fixed to greater of upward only market rent or RPI increases	Open market reviews, clauses beneficial to the landlord	Open market review with some restrictive assumptions limiting potential for uplift	Inappropriate, complicated or dated rent review assumptions e.g. gearing	Upwards and downwards or reviews based on turnover	3	12	5%	Terms under which rents can be reviewed as defined in the lease

Parameter (score)	Excellent (4)	Good (3)	Acceptable (2)	Marginal (1)	Not acceptable (0)	Weighting	Max score	% of total score	Comments
Rental value compared with rent paid (for parts let)	Rent paid is >10% less than the rental value	Rent paid is 0-10% less than the rental value	Rent paid = the rental value	Rent paid is 0-10% more than the rental value	Rent paid is >10 more than the rental value	3	12	5%	A very strong covenant and a long unexpired lease may compensate for a property being over-rented
Sustainability - EPC rating	EPC score of A or B	EPC score of C	EPC score of D	EPC score of E but good prospects for upgrade to D	If EPC score is E, F or G	3	12	5%	Government policy moving towards more stringent Energy Performance Certificate (EPC) standards
Total						**60**	**240**	**100%**	

If any parameter scores zero then the property would be rejected and not considered further except if there is an ‘other good reason’

APPENDIX C

Commercial Property Investments - due diligence checklist for internal use

Date bid accepted:
Estimated date of exchange:

Phase	Documented evidence (to be shared on Huddle)	Date complete	Responsibility	Any comments	Status
INITIAL SCREENING	Marketing brochure / details including site plan, floor plan and tenancy schedule		AGT		
	Completed Scoring Matrix		AGT		
	Initial screening for any ethical / reputational issues		PM		
	Review of Scoring Matrix		HCD & NPSN		
	Statement of "other good reason" as per the council's Commercial Property Investment Strategy (if required)		HCD & NPSN		
	Statement that purchase complies with the diversification principles set out in the Council's Commercial Property Investment Strategy		DRD & CFO		
	DECISION WHETHER TO INVESTIGATE FURTHER		**DRD & CFO**	*PRM to file email correspondence on the decision*	
DETAILED INVESTIGATION AND FINANCIAL MODELIING	**Location and physical condition of the property**				
	Property description: schedule of floor areas, construction method		AGT	*Included in the Agent's Initial Purchase Report*	
	Strength of macro and micro location		AGT	*Included in the Agent's Initial Purchase Report*	
	Physical condition of the building - initial views		AGT	*Included in the Agent's Initial Purchase Report*	
	Market analysis - demand levels in the locality		AGT	*Included in the Agent's Initial Purchase Report*	
	Initial planning issues		AGT	*Included in the Agent's Initial Purchase Report*	
	Alternative uses		AGT	*Included in the Agent's Initial Purchase Report*	
	Council site visit		HCD & NPSN		
	Council sign off agent's Investment Report		HCD & NPSN		
	Tenant covenant strength				
	Tenant credit analysis		AGT	*Included in the Agent's Initial Purchase Report*	
	Details of rating agency		AGT	*Included in the Agent's Initial Purchase Report*	
	Details of any tenancy arrears (rental or service charges)		AGT	*Included in the Agent's Initial Purchase Report*	
	Details of competitors in immediate area and strength of industry sector		AGT	*Included in the Agent's Initial Purchase Report*	
	Details of tenant's intentions to renew lease (if known)		AGT	*Included in the Agent's Initial Purchase Report*	
	Financial modelling, risk analysis, VFM, and financing				
	Asking price and proposed bid strategy		AGT	*Included in the Agent's Initial Purchase Report*	
	Independent RICS red book valuation		HCD		
	Full details of current rent passing		AGT	*Included in the Agent's Initial Purchase Report*	
	Advice on whether passing rent is over rented or reversionary. Details of rentals achieved in nearby similar property		AGT	*Included in the Agent's Initial Purchase Report*	
	Lease terms regarding rent reviews (e.g. upwards only?)		AGT	*Included in the Agent's Initial Purchase Report*	
	Schedule of dates for rent reviews, end of leases, any break clauses		AGT	*Included in the Agent's Initial Purchase Report*	
	Forecast of future rental uplifts		AGT	*Included in the Agent's Initial Purchase Report*	
	Advice on future void lengths and rent free periods upon lease renewal		AGT	*Included in the Agent's Initial Purchase Report*	
	Details of service charges (if multi-tenanted property)		AGT	*Included in the Agent's Initial Purchase Report*	

	Details of Business Rates payable (if multi-tenanted property)		AGT	*Included in the Agent's Initial Purchase Report*	
	Standard finance questions list completed (used to ascertain whether transaction is an operating lease)		AGT	*Included in the Agent's Initial Purchase Report*	
	Confirmation that the transaction is an operational lease		LGSS Finance	*Senior Technical Accountant*	
	Advice on any current /future landlord repairing liabilities including timing and cost estimates e.g. MEES compliance, structural works, fit out		AGT and NPSN	*Included in the Agent's Initial Purchase Report*	
	Estimate of future exit / redevelopment values (if required)		AGT and NPSN	*Included in the Agent's Initial Purchase Report*	
	Details as to whether the transfer of the property is intended to be treated as a TOGC (Transfer of Going Concern) for VAT purposes		AGT	*Included in the Agent's Initial Purchase Report*	
	Advice from PSTax (if required)		LGSS Finance	*Commercial Finance Business Partner*	
	Calculation of SDLT (Stamp Duty Land Tax)		LGSS Finance	*Commercial Finance Business Partner*	
	Current PWLB (Public Works Loan Board) lending interest rate		LGSS Finance	*Commercial Finance Business Partner*	
	Financial appraisal (undertaken in line with principles agreed in Council's Commercial Property Investment Strategy) and financial risks identified		LGSS Finance	*Commercial Finance Business Partner*	
	Financial appraisal sign-off and confirmation that the investment meets the council's required initial rate of return and is within the councils' approved capital budget		CFO		
	Decision whether to fund the acquisition by internal borrowing (using council's cash holdings) or by external borrowing (PWLB)		CFO		
	DECISION WHETHER TO MAKE A BID (AND BID OFFER/S)		**DRD**	**In consultation with CFO, Portfolio Holder for Resources and 3 other Cabinet Members** *PRM to file email correspondence on the decision*	
	Key decision notice published		**PM**		
	Property information & financial analysis circulated to all Elected Members		**PM**		
	Copy of bid letter		**AGT**		
PRE CONTRACT DUE DILIGENCE	**Heads of Terms**				
	Heads of Terms agreed by council and vendor		HCD	*In consultation with agent, NPLaw, and CFO*	
	Title and leases				
	Official copy of the registered title and title plans from Land Registry		NPLaw		
	Copies of any other registered / unregistered title documents including covenants, agreements, easements, restrictions etc		NPLaw		
	Copy of head lease (if required) and all tenancy documents including leases, any other documents conferring occupational interests, rent review memoranda & notices, and any licences (relating to assignment, underletting, alterations, change of use)		NPLaw		
	Copy of any agreements made with respect to boundaries, party walls, third party access to property		NPLaw		
	Review of Commercial Property Standard Enquiries (CPSEs)		NPLaw		

	Management information for multi-tenanted property				
	Managing agent's details and copies of most recent rent and service charge demands		AGT		
	Tenant arrears schedule, payment history, and status of all arrears		AGT		
	Details about service charge - current year's budget and expenditure to date, apportionment and service charge collected to date, last 3 years service charge accounts, and reserves fund statement		AGT		
	Details of any disputes		AGT		
	Copies of all management & maintenance contracts		AGT		
	Details of any repair, refurbishment or capital improvement work being undertaken or proposed		AGT		
	Searches				
	Chancel liability, water and drainage, and environmental searches		NPLaw		
	Copies of planning applications, planning permissions, approval of reserved matters/conditions, evidence of satisfying planning conditions, any planning agreements (section 106, highways / infrastructure)		NPLaw		
	Building/site/mechanical and electrical surveys				
	Asbestos survey / assessment		AGT		
	Measured/structural/mechanical and electrical surveys		AGT		
	Environmental / ground survey and report		AGT		
	Regulatory compliance status of the building and surrounding sites		AGT		
	Building condition survey		AGT		
	Energy Performance certificate		AGT		
	Advice on whether any other documentation needed on design and construction (e.g. warranties, guarantees, snagging outstanding, retention etc)		AGT		
	Taxation				
	A copy of the notice given to HMRC to opt to tax under TOGC (needs to be sent before any deposit is paid)		LGSS Finance	*Financial Support Officer*	
	A copy of any option to tax and the notice given to HMRC (from vendor)		NPLaw		
	Confirmation of anticipated TOGC treatment		LGSS Finance	*Financial Support Officer*	
	Copies of stamp duty land tax certificates		NPLaw		
	Capital allowances report and calculations (if required)		LGSS Finance	*Commercial Finance Business Partner*	
	Insurance				
	Insurance valuation		AGT		

	Documents / reports needed to take decision to exchange contracts				
	Reports on title, leases, and searches identifying any potential issues from a property law perspective		NPLaw		
	Final purchase report including advice arising from the building & environmental surveys undertaken		AGT		
	Revised financial analysis (if required)		LGSS Finance	*Commercial Finance Business Partner*	
	Draft contract (including apportionment of rental income, basis of dealing with any arrears, continuation or termination of any contracts, etc)		NPLaw		
	DECISION WHETHER TO EXCHANGE CONTRACTS		**DRD & CFO**	*PRM to file email correspondence on the decision*	
EXCHANGE CONTRACTS	**Exchange contracts**				
	Contract signed and sealed by City Council then transferred to vendor for signature		PM		
	Pay deposit		NPLaw & LGSS Finance		
	Date of exchange		PM		
COMPLETION	**Completion**				
	Approved completion statement		NPLaw and PM		
	Arrange insurance cover		LGSS insurance		
	Contract for service management agreed (if multi-let property)		HCD & RM		
	Purchase price (less deposit) paid to vendor		NPLaw & LGSS Finance		
	Date of completion		PM		
POST COMPLETION	**Post completion**				
	Stamp Duty Land tax paid to HMRC		NPLaw & LGSS Finance		
	Register transfer at the Land Registry		NPLaw		
	Transfer property to NPSN management		PM		

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