Property Investment Strategy 2018/19

1. Introduction

The Local Government in Scotland Act 2003 included specific powers (Section 40) for local authorities to invest money in accordance with regulations approved by Scottish Ministers. Under these powers, the Local Government Investments (Scotland) Regulations 2010 were approved by Scottish Ministers on 1 April 2010, and came into effect from that date.

Each Council is granted the freedom to determine what types of investments they may make, and the level of risks acceptable to each Council in making investments must be explicitly stated. These must be approved by the Council in advance of each financial year.

The properties within the Council's commercial investment property estate which are held solely to earn rental income and/or capital appreciation fall within the scope of the regulations. The requirements outlined for financial investments therefore apply to these Council property investments. The Council is required to approve an Investment Strategy before the start of each financial year.

This paper is the Council's Property Investment Strategy for 2018/19, which forms part of the Council's requirement for an annual overall Investment Strategy.

2. Context

The Council does not normally acquire property solely for investment purposes.

New property acquisitions generally support one of the functions noted below and do not therefore fall within the scope of the Local Government Investments (Scotland) Regulations 2010;

- **direct service provision** e.g. new school sites and land for road junction improvements, or
- **Socio economic or economic development** e.g. land and buildings held on the Commercial Property Investment Programme (CPIP) to support a supply of land to businesses and industry.

The Regulations do, however, cover those parts of the commercial estate which are generally held to provide rental income. Predominantly these properties would have initially been acquired to meet a socio economic or economic development need, but having met that need at some time in the past, are now retained for the rental income they produce. The portfolio has therefore been developed over a long period and includes properties such as shops, offices, small workshop units, industrial and commercial ground and land purchased to facilitate development etc.

3. Strategic Vision for the Property Investment Portfolio

To move from the historic legacy of a portfolio of properties acquired or developed over many years to a more balanced sustainable portfolio to meet the future financial and corporate objectives of the Council.

4. Corporate Aims and Objectives

The overall aim of the Property Investment Strategy is to support the objectives of the 2013/18 Corporate Plan.

The Property Investment Strategy supports corporate objectives by seeking to:

- Maximise and enhance socio economic and economic development opportunities to the benefit of local communities and businesses.
- Encourage new business take up, retain and enhance existing businesses and opportunities.
- Maximise community benefit through the provision of land and premises.
- Clearly identify the primary purpose for holding individual assets (and groups of assets) and apply appropriate management, retention and disposal policies, and procedures relevant to the asset categories by completing a review of the commercial property portfolio.
- Optimise financial return and best value.

5. Current Portfolio

Perth and Kinross Council's commercial portfolio currently consists of approximately 215 properties together with land held for future investment, infrastructure or disposal;

The properties currently held for income generation are managed through the use of lease agreements and the number of leases per asset type is approximately;

32 Shops
9 Offices
39 Industrial premises
120 Ground leases
15 Miscellaneous properties

The budgeted gross income for the financial year 2018/19 is £1,707,000 and regular appropriate monitoring and reporting of the current position will be carried out.

The Council holds a number of town and village halls, leisure facilities etc which are "let" to management committees, community groups and Live Active. As these assets are effectively managed to provide functions which would otherwise be provided by the Council, they are not classified as investment properties and, therefore, lie outwith the remit of the regulations.

6. Categorisation

In developing a strategy for managing the commercial investment property portfolio it is necessary to define the reasons for retaining non-operational properties, to categorise the individual properties, and to apply criteria to ensure that the appropriate return (financial, economic or community benefit) is achieved from each property.

The portfolio can be split into the following categories, with each requiring a different approach when deciding future management and retention policies.

The categories adopted are:

- Socio economic
- Economic development
- Operational occupation
- Revenue generation (Investment)
- Housing Revenue Account (non-Housing - includes investment)

7. General Strategic Principles

There will be a presumption against the acquisition of new heritable properties solely for financial investment purposes.

- Heritable property will only be acquired to support the Council's strategic objectives, with the property's investment potential being secondary to securing Council objectives.

Existing Council owned properties which become surplus to operational requirements will be disposed of in line with the Disposal of Land and Buildings Policy.

- There will be a presumption against the retention of surplus property assets for financial investment purposes unless the retention supports Council strategic objectives. As with new acquisitions, the assets investment potential is secondary to securing Council objectives

There are a number of general principles that will be applied to the management of the retained investment portfolio;

- Day to day decisions on the management of the portfolio should support the efficient & effective delivery of the Council's strategic and operational objectives.

- The portfolio should reflect strategic and operational objectives by clearly differentiating between those held for the benefit of the community (economic development and socio economic) and those retained purely as investment opportunities.

- "Added value" principles should apply – investment and expected returns should be on the basis of what is "best for communities" rather than concentrating on purely financial return.

8. Specific Strategic Principles

The Council will use the portfolio to support corporate objectives by adopting the following principles in the future management of the various categories of commercial properties:

- **Socio Economic Portfolio** – Held primarily for promotion or enhancement of the Council's 5 strategic objectives for securing the future. Revenue generation for this category, although important and justifiable, is secondary to supporting Council objectives.

- **Economic Development Portfolio** - Held primarily to support strategic objectives but with an emphasis on supporting Objective (iii) - a prosperous, sustainable and inclusive economy. The portfolio will be used to safeguard, control and promote the use of land for economic development and regeneration through;

    - **Business Opportunity enhancement** – Land and buildings acquired or provided to facilitate and encourage business opportunities in local communities where the private sector has failed to provide infrastructure due to market conditions. There is a general presumption that this provision will be made available at sustainable market levels but with an acceptance that provision may have to be subsidised to generate development in certain areas. As part of this proposed approach the intention is to focus on strategic sites with development potential partnering with the private sector via Memorandums of Understanding intended to explore and exploit development and incoming-producing opportunities

    - **Start-up Workshop Units** – units should be held to encourage new and expanding businesses locate and flourish. Such units, where available, should be on short term lets with flexible terms to assist firms become established.

- **Commercial Investment Property** – Properties will generally only be held for rental income generation whilst generating an adequate and competitive return. There will be a presumption in favour of disposal of poorly performing properties. Units which are difficult to let, expensive to manage or present a company growth opportunity for a sitting tenant will generally be positively considered for disposal unless these form part of a larger grouping where disposal of part would be detrimental to the value of the whole e.g. part of a row of workshop units.

  In appropriate circumstances, consideration will be given to sales to sitting tenants if the disposal would not adversely affect the remaining portfolio; but only at full market value and at a price economically advantageous to the Council e.g. sales may be resisted at times of economic downturn when sale prices are unfavourable.

  Poorly performing multi occupancy investments; industrial estates, rows of shops etc will be considered for disposal to either existing occupiers or as investments.

  There is a presumption against properties held on the commercial estate being occupied by Council Services. Properties held for revenue generation may, however, be occupied by Council Services, with that service meeting the full cost of occupation, including payment of a market rent where appropriate.

Commercial Property Investment Programme

In September 2013 the Council approved a comprehensive 10 year programme of employment land acquisition, servicing and development to support the Council objectives of attracting investment and supporting businesses across Perth and Kinross. The programme (CPIP 2013-23) which is funded through sales receipts from sites and properties sold to developers and businesses has delivered 9.15ha of business land to support company growth since inception in 2013. The latest priorities and revised programme was approved by the SP&R Committee on 29 November 2017 (Report 17/390), which included a review of the approach to ensure effective delivery of corporate property development and investment activities. The CPIP is kept under regular review by the Estates & Commercial Investment Team and the Director (Environment) through the SP&R capital monitoring process and appropriate committee approval is sought regarding land and property disposals with an impact on the revenue budget.

Housing Revenue Account (non-housing) – There is no general presumption in favour of the disposal of investment properties held on the Housing Revenue Account (HRA) and the Interim Director (Housing & Community Safety) is consulted prior to the consideration of disposal of any HRA assets to allow consultation in accordance with current Housing Legislation to be carried out. The same principles as applied to the rental income-generating portfolio will generally be applied to the HRA portfolio.

9. Portfolio Management Principles

Socio Economic Portfolio:

- Clearly identify any “subsidy” level in leases to future socio economic and community lets.
- Only consider future lets on socio economic grounds where supported by a business case clearly identifying the community benefits and financial viability of the proposed let and having identified a sponsoring Service within the Council to provide support.

Economic Development Portfolio:

- The sale or lease of land and premises held for economic development purposes will be considered against the economic benefit to the local community and business needs.

Revenue generating portfolio:

- Always seek to maximise the return from the investment by applying market rents to all properties held in this category.
- Wherever practical, identify and allocate all running costs associated with the portfolio including “hidden” costs e.g. management costs.
- Monitor return on investment.
- Regularly review portfolio performance.
- Assess requests to sell from sitting tenants against the return on investment and the impact of sale on any remaining holdings in the immediate area.
- Manage the portfolio to maximise returns, balancing maintenance expenditure requirements against capital and rental growth potential.
- Support capital receipt generation (disposal of poorly performing assets) whilst seeking to achieve a balance between revenue and capital. Investigate options for investment to maximise and maintain revenue streams.

HRA (non-housing) Portfolio:

- Unless identified by the Interim Director (Housing & Community Safety) as a property held for socio economic or economic development purposes, manage the portfolio on terms consistent with the management of the general fund revenue generating portfolio.
- Consult with the Interim Director (Housing & Community Safety) prior to agreeing to the disposal of investment properties, providing advice on whether disposal represents a good return on the investment.

10. Risk Management

Risk of falling rental income
A substantial unforeseen decrease in projected rental income could present a risk to the Council's revenue planning. Rental forecasts are regularly reviewed and managed in consultation with the Head of Finance.

The major risks affecting income potential are;

- Changing market conditions and
- Reducing rental income through disposal of investment properties.

Changing market Conditions – Low to Medium Risk
The risk of a substantial unanticipated decrease in income resulting from changes in market conditions was previously considered to be "Low" as leases tend to terminate on set dates, with a relatively small proportion terminating within a single year. The risk element in the retail sector of the portfolio rose to "Low to Medium" for 2013/14 due to challenging economic conditions and currently sits at medium due to permanent changes in shopping habits i.e. internet shopping. Any likely reduction in income can however, generally be anticipated. As leases terminate, even if unanticipated, the Council retains the capital asset which can be made available for re-letting or disposal. The current economic climate however, continues to make re-letting challenging.

Disposal of investment properties – Low Risk
Disposal of investment properties will result in a capital receipt, but the consequence of this will be the loss of rental income from the asset. Decisions to dispose of major assets will therefore affect income. Disposal will be discussed with the Head of Finance and a programme agreed as appropriate to support the Council's revenue budget and capital programme needs.

Risk associated with new investment acquisitions
Procedures are in place to assess and manage the risk attached to any new investment proposal as the acquisition will be subject to a full business case analysis and risk assessment by the appropriate corporate group and will require subsequent Committee approval.

11. Strategy Action Plan

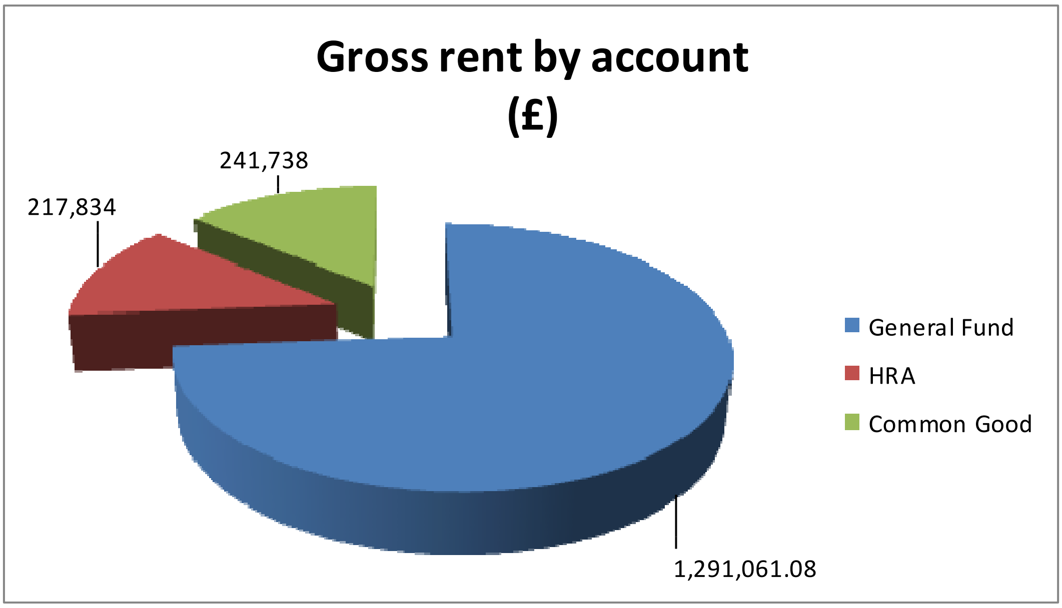
The portfolio is being transformed from the historic legacy to a more balanced sustainable portfolio to meet the Council's current strategic objectives and the future financial viability of the commercial portfolio will be maintained through;

- the assessment and classification of each property as either socio-economic, economic development, investment or HRA (investment),
- regular review of the commercial estate to determine each property's investment potential and viability, and

- by disposal of poorly performing investment properties and redevelopment/conversion of properties (e.g. conversion from retail to social housing).

Commercial Investment Property Review 2016/17

The valuation, classification and review of the portfolio is periodically carried out by the Council's Estates and Commercial Investment Team and the 2016/17 review is shown in the following diagrams. It can clearly be seen that the vast majority of the rental income is received from ground leases which by their nature provide a low risk, low management, secure net rental income to the Council. The findings will inform the emerging framework for development and investment in the Perth and Kinross area and in Perth as part of the work being undertaken nationally to develop a consistent approach to investment in the Scottish cities and City Investment plans.



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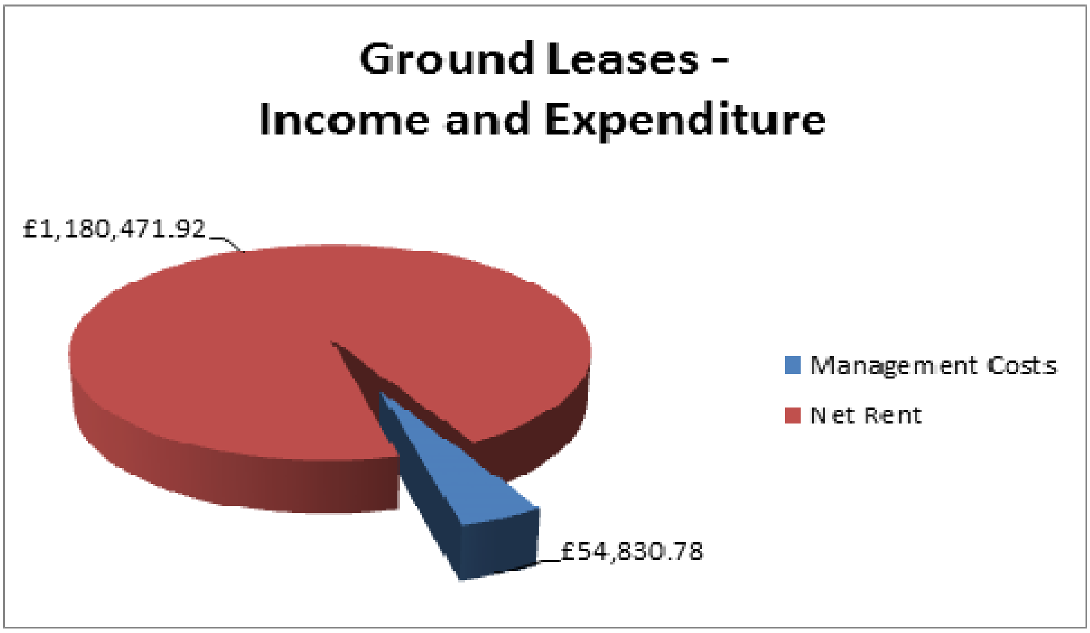

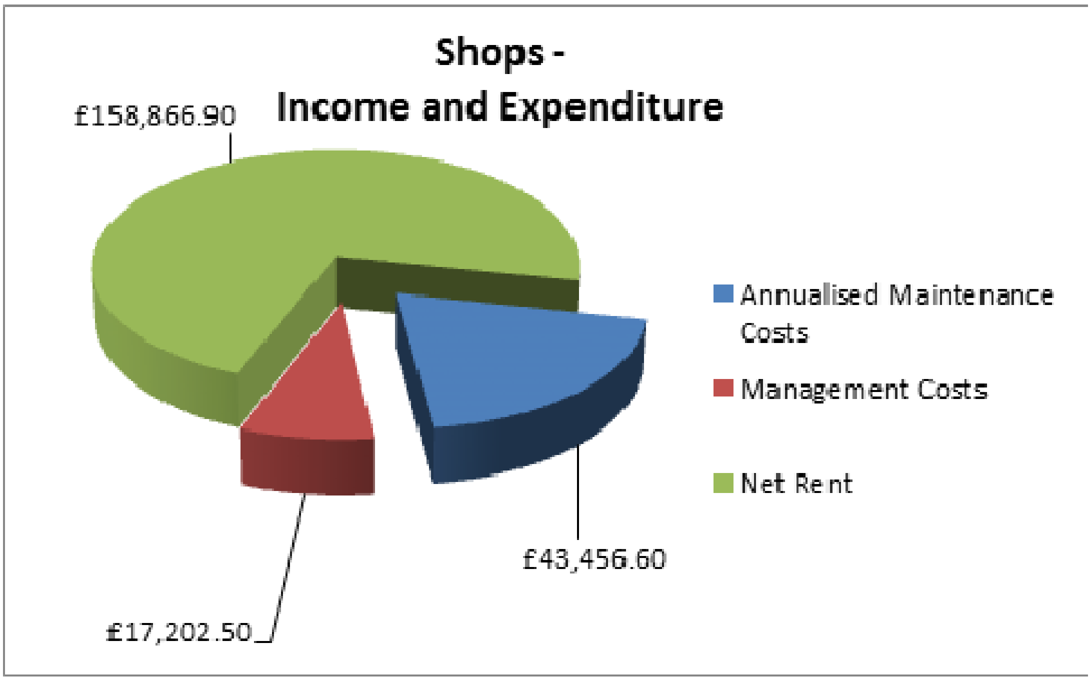

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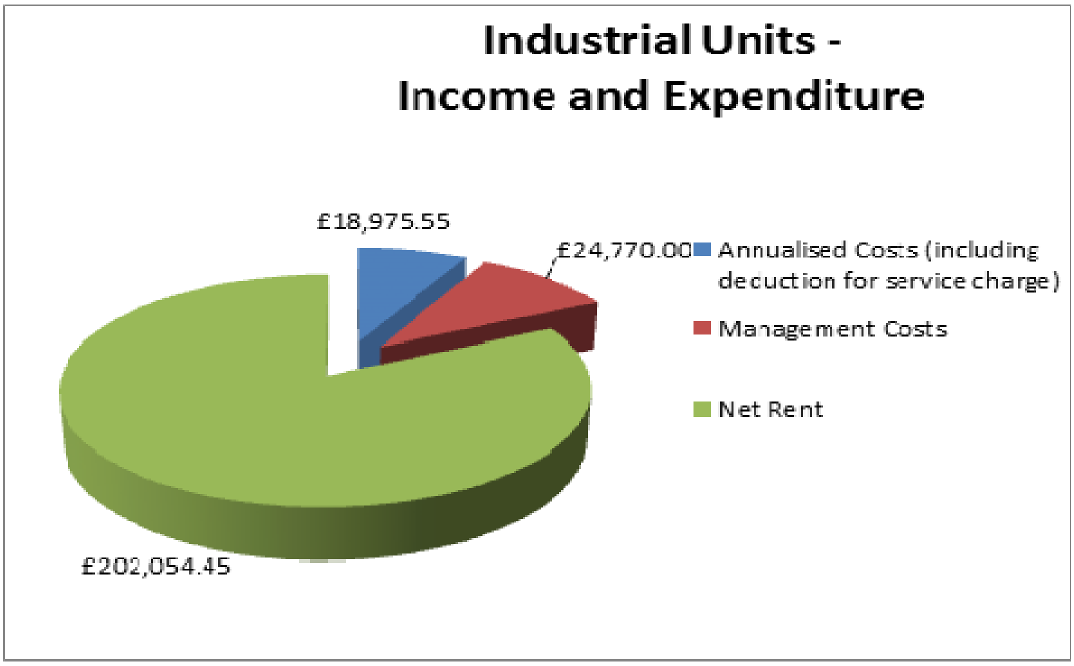
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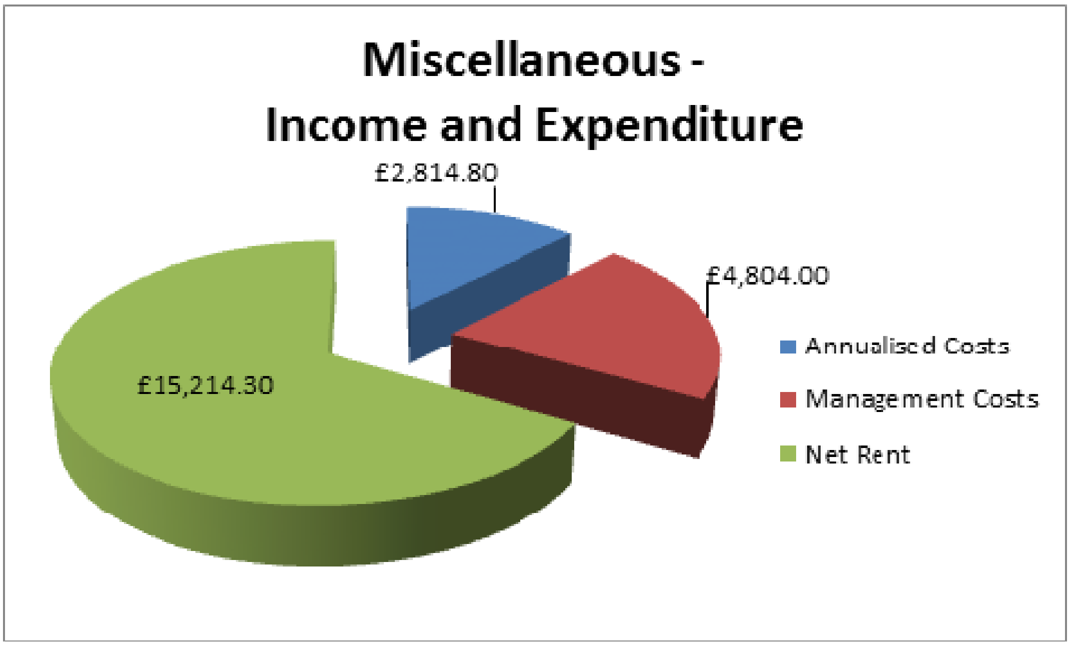
£202,054.45
Annualised Costs (including deduction for service charge)
Management Costs
Net Rent


Miscellaneous -
Income and Expenditure
£2,814.80
£4,804.00
£15,214.30
Annualised Costs
Management Costs
Net Rent