City of Cardiff Council

INVESTMENT ESTATE STRATEGY 2016 - 2021

CARDIFF
CAERDYDD

CONTENTS

1 EXECUTIVE SUMMARY

The Council holds a portfolio of property investments that generate an income of £3.48 million per annum. This estate is managed by the Strategic Estates Department.

In 2014/15 an independent review carried out by Jones Lang La Salle (JLL) advised that the estate should be streamlined with a focus on improving the quality of the assets to produce a better return with less management input.

Historically, the Council has managed the investment estate on a more reactive rather than proactive basis. The Strategic Estates Department now wish to implement a strategy which will involve a detailed review and challenge of the estate with a view to improving the performance of the portfolio and increasing income.

In November 2015 Cabinet approved some changes to the way the investment estate is managed. These key changes were:-

- All non-operational income producing property be held corporately, managed by Strategic Estates, with associated budgets realigned.
- The establishment of a new investment estate governed by a newly formed investment board.
- Capital receipts generated from the sale of investment estate assets be reinvested to improve existing properties within the estate or used to purchase better quality and better yielding assets.

This inaugural investment strategy has been prepared following a detailed review of the portfolio and is intended to set out the overarching strategy and plans that will be carried out over the next five years.

2 PURPOS
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The investment estate is a portfolio of non-operational property held by the Council for the primary purpose of generating income to support the Council's revenue budget. The estate has been acquired and built up over a number of years and currently includes a wide range of property types of variable commercial quality.

The estate comprises circa 200 assets producing a gross rental income of £3.48 million.

The value of the estate is £67 million and this represents a gross yield of 5%.

Asset Type	Num of Assets	Annual Rent	Asset Value (2016)	Gross Yield
Advertisements	2	6,000	60,000	10.00%
Agricultural Tenancy	2	12,250	401,300	3.05%
Car Parking	6	28,555	492,150	5.80%
Commercial	18	1,424,519	29,957,331	4.76%
Hostel	2	43,558	909,000	4.79%
Hotels	7	342,842	6,362,000	5.39%
Land	6	10	35,000	0.03%
Light Industry	86	899,687	17,878,420	5.03%
Pubs - Commercial	7	285,147	3,727,000	7.65%
Residential Accom	1	0	200,000	0.00%
Residential Land	15	161	91,791	0.18%
Retail Ground Rent	5	17,750	215,870	8.22%
Retail Rack Rent	16	280,839	3,222,630	8.71%
Sporting Activities	5	53,547	3,001,500	1.78%
University	7	60,026	815,577	7.36%
Utilities	13	30,362	162,048	18.74%
Total	**198**	**£3,485,251**	**£67,531,617**	**5.16%**

The public sector is under increasing pressure to identify new means of generating revenue and capital funding streams due to the prevailing financial climate of budget cuts and austerity.

The investment estate provides opportunity to increase revenue and it has been established that this can be done in different ways. The main method of increasing income is through the disposal of poor performing assets and reinvestment in better yielding properties.

A professional and proactive approach to the management of the estate will also be reinforced to ensure good and commercial asset management applies to obtain the best performance and value.

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3 DEFINITION OF INVESTMENT PRO

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The primary purpose for holding investment property is to generate income. However, secondary to that is the Council's commitment to stimulate and encourage economic growth by investing in key sites for regeneration purposes. There are numerous social, strategic and community reasons for the Council holding such an estate.

Property investment assets can provide a secure income and good return compared to other forms of investment.

The performance of the investment estate is analysed by considering the return or yield generated. A yield is the income return on an investment and is represented as a percentage. The gross yield is the rental income divided by the asset value and the net yield is the rental income less costs associated with holding the property divided by the asset value.

An investment portfolio should comprise a good mix of properties to spread risk and ensure you don't hold too many properties of the same type. For example, if your portfolio is predominantly offices and the market for that type of property falls, the portfolio will be exposed to too much risk. Therefore, it is recommended that consideration should be given to investing in a wide range of property types – offices, industrial, leisure, retail, all of which will have differing yields. This mix provides a good blended portfolio.

There is sometimes a distinction between properties held for investment and those which are held primarily for economic development purposes. The Council has a social role to play in holding or acquiring property for economic development and regeneration and in this regard, appropriate sites and properties will be considered as additions to the investment estate.

The table below shows the typical yields for commercial property investment in Cardiff and the Council would be an investor looking at properties within the 4% - 12% yield range.

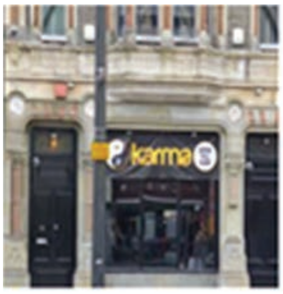
Asset Type	Typical Yield
Prime Retail / Ground rents	2-4%
Retail / office let to blue chip / high covenant strength tenants on with over 10 years unexpired	4-7%
Prime offices (city centres) or retail within estab-lished town centres	7-8%
Prime industrial and offices in established locations	8-12%
Secondary/ tertiary industrial	12-20%

4 STRATE

i. Detailed Review of Each Asset

This is a 5 year strategy and in conjunction with external property advisors, the Strategic Estates Department has carried out a high level assessment of every property in the portfolio which has been allocated an initial status of **Release**, **Remodel** or **Retain** (see definition below).

The allocated status will be used as a guide to determine future action but all properties will be kept under constant review.



Release (RED)

- **The asset does not deliver an appropriate return on investment.**
- **The property has redevelopment potential.**
- **The asset is considered a liability.**

Remodel (AMBER)

- **Consider how existing investments can be improved, i.e. re-gear existing leases on better terms or invest in the asset.**

Retain (GREEN)

- **Good investments, hold as they provide a good return.**

The estate will be continually reviewed and approaches from tenants or developers to purchase a freehold property will be considered where the value is in excess of the Council's current asset value or where it is strategic to do so.

- The high level assessment of each property will provide opportunity to review in greater detail each asset and devise a plan for the next 5 years. In turn this will present opportunities to generate capital receipts through disposals and premiums from lease re-gears which can then be reinvested.
- The reinvestment can be in the form of purchasing other investment properties or carrying out work to improve existing properties.
- It will also provide opportunity to increase rental income through lease re-gears.

GY TO DELIVER 2016 – 2021

ii. Review of Operational Estate

The Council also owns a vast operational property estate which comprises assets used to deliver or support Council services.

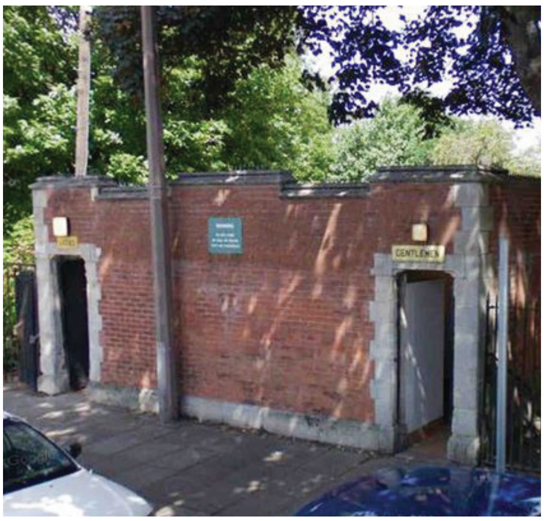
There are in excess of 400 operational properties including assets such as offices, libraries, schools, depots and community buildings together with a vast acreage of land.

As part of this strategy, a review will be carried out of all operational assets to identify any opportunities to generate rental income from properties that may be underutilised, surplus to requirements or sites where there is potential to let out the whole or split the site for commercial benefit.

In line with projects such as office and depot rationalisation, properties and sites should be challenged to ascertain whether they are still required for operational purposes or whether the service can be accommodated elsewhere. During this process an assessment should be made to assess whether it would be more beneficial to retain the property with a view to securing a letting at a commercial rent or whether the property should be disposed of to generate a capital receipt. An example of this is if a property has been identified for disposal, the letting potential should be considered which could generate a rental income. A financial appraisal can then be carried out to assess the benefits and risks associated with revenue potential against capital receipt potential.

Development sites should also be considered where there is opportunity to generate rental income through an obligation being put on the developer to construct and provide a lettable asset back to the Council. An example of this is where a site is sold for housing development and as a condition of the disposal the developer is required to construct retail units to be transferred back to the Council at no cost to the Council so that it can be let at a market rent.

The Strategic Estates Department will work with service areas to identify these opportunities. This will be done in line with the Council's Corporate Asset Management Plan which is produced annually and continually reviews the Councils estate.



5 TYPES OF ACQUISITIONS

What type of Investment property should the Council be looking

In order to improve the portfolio the Council will consider the acquisition of new investments. Opportunities to acquire new assets will depend on where the Council is willing to invest and how much it is willing to spend. There is an increasing trend toward local authorities with a remit to acquire investment property on a national basis, seeking the best opportunities wherever they can be found, often in competition with private sector investors.

There are many properties that will be suitable for the Council to acquire and important factors to take into consideration are Location, Covenant Strength, Lease Length, Investment Yield and Lease Repairing Terms.

Location - Acquiring property outside the boundary of Cardiff should not be discounted but opportunities within Cardiff should be explored first or wherever possible.

Covenant Strength - in the case of a let property, the quality of the tenant and, more importantly, their ability to pay the rent on time and in full is of high importance.

Lease length - in the case of a let property, the length of the unexpired lease term is also of high importance. To ensure that the revenue stream is maintained, the risks associated with a tenant defaulting must be taken into consideration together with the potential to attract a good quality replacement on appropriate terms if necessary.

Investment Yield - The rental return on the capital investment should be at an appropriate level to ensure an increase in rent is secured on the portfolio. This needs to be weighed against risk as the higher the level of return that is required from an investment, the higher the level of risk it will carry. For example a property let at a very attractive rent may produce an attractive return on paper but the investment could carry high risk if the tenant has poor covenant strength exposing potential default or the lease term is low exposing potential void periods.

Repairing Terms – This is an important consideration as the Council does not want to be exposed to costs incurred in repairing a property. Therefore, the only properties suitable will be leases on full repairing and insuring terms or leases on internal repairing and insuring terms with a service charge in place to recover 100% of costs incurred.

The table on the right shows how these factors can be applied to a scoring matrix to determine whether initial interest in a property is considered in more financial detail.

Acquisitions should not be limited to freehold properties. The council currently owns a high number of properties that are let on long ground leases and if these leasehold interests come to the market, the merits of purchasing this interest should be explored.

to acquire?

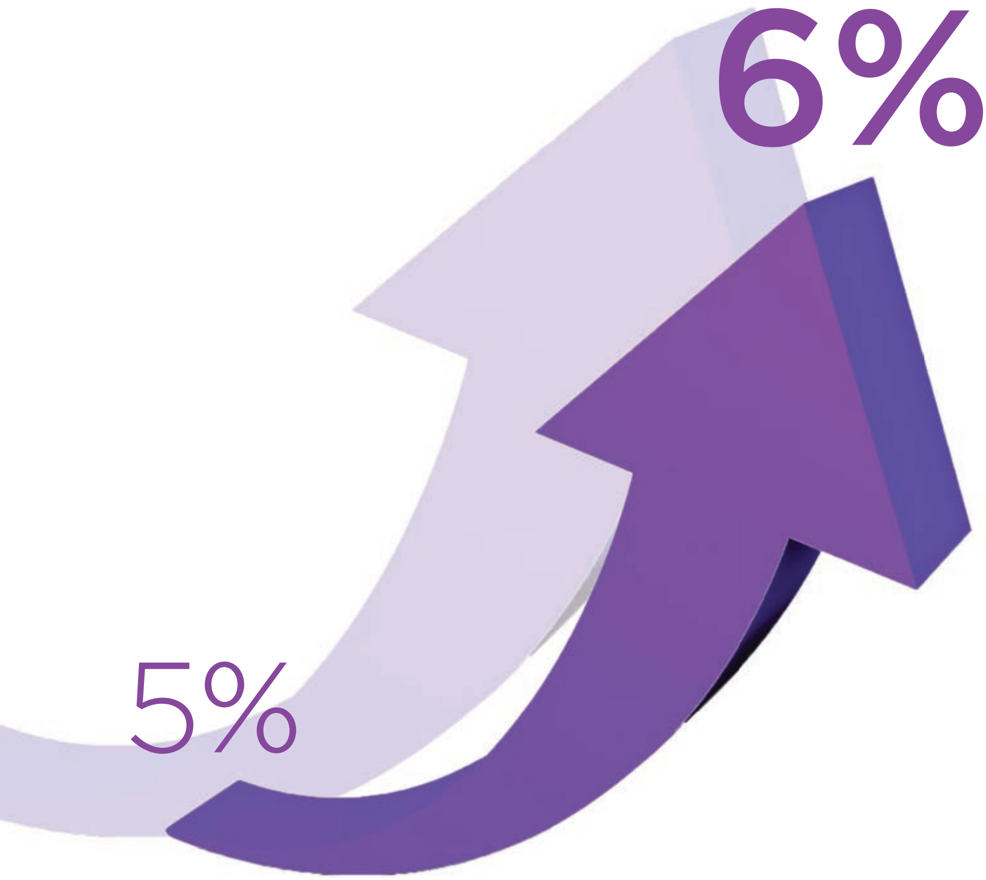
Scoring Criteria	Score	4	3	2	1	0
	Weighting Factor	**Excellent / Very Good**	**Good**	**Acceptable**	**Marginal**	**Unacceptable**
Covenant Strength	**12**	Single tenant with strong financial covenant	Single tenant with good financial covenant	Multiple tenants with strong financial covenant	Multiple tenants with good financial covenant	Tenants with poor financial covenant strength
Investment Yield	**10**	2 -4 %	4 - 7 %	7 - 8 %	8 - 12 %	12 - 20 %
Lease Length	**8**	10 years or greater	Between 6 and 10 years	Between 3 and 6 years	Between 2 and 3 years	Less than 2 years or vacant
Repairing Terms	**6**	Full repairing and insuring	Internal repairing - costs 100% recoverable through service charge	Internal repairing - costs 100% recoverable through service charge	Internal repairing - costs partially recoverable	Internal repairing - costs non recoverable or landlord fully responsible
Location	**4**	City Centre	Prime for Use, i.e. prime industrial area or prime office area	Good Secondary	Reasonable Secondary	Tertiary

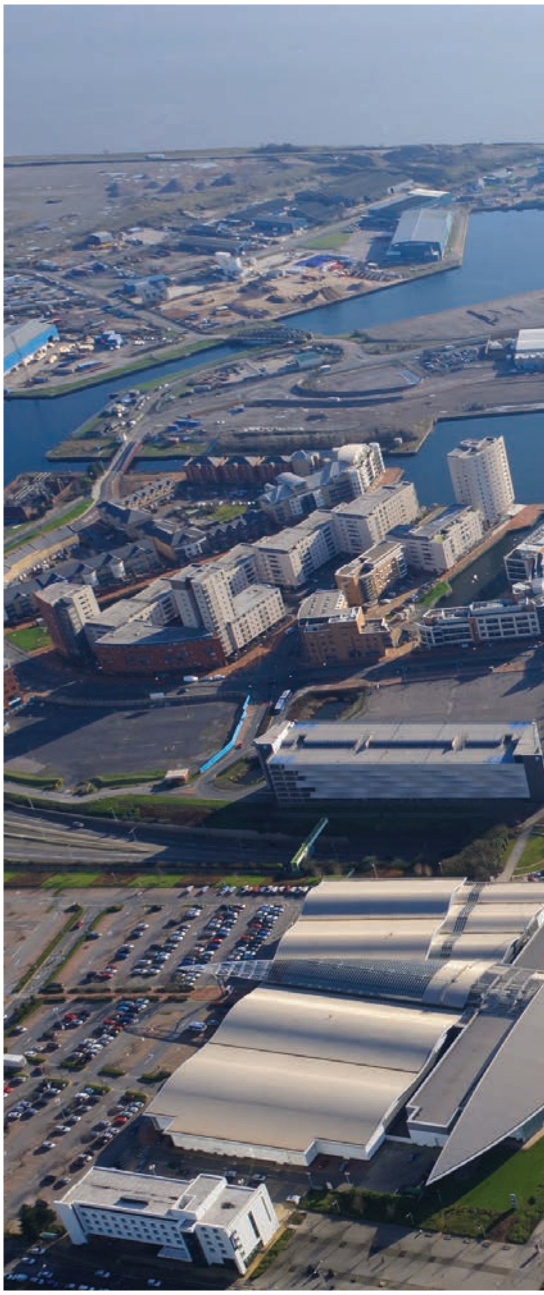
6 PERFOR

The current estate comprises circa 200 assets, generates £3.48 million per annum, is valued at £67 million (2016 valuation date) and this represents a gross yield of 5%.

The target performance measure for the five year strategy is to increase the gross yield from 5% to 6% which represents a 20% improvement in performance.

As part of the review the Strategic Estates Department also want to analyse the net yield. The net yield is calculated from the true income receivable after costs are deducted. The standard costs to be deducted are running costs and staffing costs.





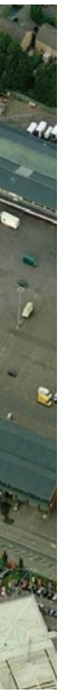
MANCE TARGETS

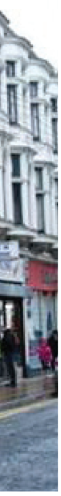
7 GOVERNANCE

The investment estate is managed on a commercial basis with the objective of increasing the value of the estate, the annual net income and contributing to economic regeneration initiatives.

The Council retains the services of external property consultants to advise and assist in this objective and a governance framework is in place to oversee all decisions and ensure accountability.

All valuations pertinent to these activities will be carried out, or verified, by a fully qualified member of the Royal Institution of Chartered Surveyors with relevant valuation competency.





The investment Board will deliberate all activity in connection with the investment estate including disposals, new acquisitions, lease re-gears etc… These will be reported in accordance with the Council's constitution depending on value and whether Officer Decision Reports or Cabinet Reports are required.

An annual report will be produced by the Strategic Estates Department which will set out activity and the financial position of the previous year, and will also set out a plan for the year ahead.

This will be reported to Asset Management Board, Cabinet and Scrutiny.

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