Annexe 2 - Property Acquisition and Disposal Strategy

Investment Strategy

On 25th November 2020 the Government ended access to the PWLB for Local Authorities that wish to buy commercial assets primarily for yield. Part of the assurance process introduced is for Local Authorities to submit their spending plans for the next 3 years, including their expected use of PWLB and the S151 officer must certify that the authority is not borrowing in advance of need and does not intend to buy investment assets primarily for yield. (as assessed against guidance)

Authorities that wish to buy commercial assets primarily for yield remain free to do so but are unable to take out new loans from the PWLB for any purpose in that financial year, either for new investments or for re-financing existing debt.

Swindon Borough Council holds a substantial portfolio of property held for non-operational purposes. Within this portfolio is a large estate of income-producing property that would traditionally form the basis of an investment portfolio, comprising the retail, office and industrial premises together with ground rents. This produces an annual revenue income of about £5.6m used to support the delivery of Council services.

In September 2017 Hartnell Taylor Cook were appointed to advise on the performance of the existing portfolio and devise a strategy and criteria for future investment acquisitions. They reviewed the performance of the portfolio in March 2020 and the portfolio will be reviewed again once the impact of the pandemic on commercial property values is clearer recognising the ongoing impact lockdown is having on the economy. The findings of Hartnell Taylor Cook's review of March 2020 are summarised below. :

Current Portfolio

1. Reflecting some new acquisitions, the portfolio increased in value from January 2019, from £68.8million to £86.8million in March 2020.

2. New acquisitions have rebalanced the sector weightings; these are now well balanced between the primary sectors of retail, which has reduced from 26% to 19%, industrial (which historically is one of the best performing classes in Swindon and likely to show the highest rental growth), which has increased from 15 to 26%, and office, which has changed from 21% to 23%.

3. Total portfolio rental income has increased from £4.6million (Jan 2019) to £5.6million (March 2020). Income from ground rents is 18% of the total portfolio income, this is a sensible weighting for this secure income. The proportion of income from retail assets has reduced from 26% to 23% of the total income whilst the industrial income has increased from 15% to 24%. The income from the portfolio is well balanced with relatively equal weighting across the sectors

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4. There is no direct exposure to some established or emerging use classes such as retail warehousing or hotels

5. The portfolio is nevertheless balanced and relatively well split across the other sectors it holds, and the current gross yield of circa 6.4% which is a good overall return.

6. Funding of Kimmerfields will provide a further £1,851,328 a year of rental income secured on the Zurich Assurance Ltd covenant, when the new Zurich headquarters is completed which is expected in summer 2022. Zurich are taking a 20 year lease on the majority of the new building.

Acquisition Strategy

1. The portfolio lacks modern industrial buildings, retail warehousing and has a low modern office content but this will be improved with the acquisition of the Zurich headquarters. Target asset classes for new acquisitions should prioritise industrial investments), the retail warehouse sector with a lower priority focus on recycling office investment to target quality office income. The portfolio should remain balanced at all times.

2. The current portfolio is quite dated, with obsolescence an ongoing issue and many smaller properties with high levels of management. Preference should be for assets with minimal associated management costs and those with low obsolescence costs, typically modern single let properties or those with 2-3 tenants and unexpired lease terms of 5-10 years reducing the requirement for active management. A regular review of potential disposals and the recycling of sale proceeds into opportunities to achieve a better or more sustainable return should be carried out to identify higher risk properties in the portfolio (see **Disposal Strategy** and **Disposal Criteria** below)

3. In addition to reviewing potential disposals, asset management opportunities to increase the commercial return / investment value from existing portfolio should be pursued. These may include buying in existing long leasehold interests for increased revenue, pursuing early lease renewal negotiations to add certainty to income streams, extending / restructuring shortening leasehold and long leasehold interests, and pursuing site assembly and joint venture opportunities with adjoining owners, leaseholders and developers to release and maximise values

Purchase Criteria – New Acquisitions

Aim –"*to provide a set of principals in the form of target purchase criteria for the acquisition of properties to support service requirements in particular regeneration and growth and provide additional and sustainable sources of income over the medium to long term.*

Location: candidate properties within Swindon Borough Council boundaries are preferred but other properties may be considered if they meet the overall aims set out above..

Preferred Sectors: Industrial (single and multi-let), retail warehousing but with a preference of maximising rental income and minimising management costs

Target lot size: £2,000,000 to £10,000,000

Lease length: 5 years minimum, or Weighted Average Unexpired Lease Term (WAULT) of at least 5 years.

Repairing covenants: Full Repairing and Insuring (FRI) or FRI via service charge

Tenant Covenant: Tenants with a Credit safe credit rating in excess of 50B

Rental income profile: Estimated Rental Value (ERV). Treat over-rented buildings with care.

Target yield: To meet the criteria outlined the likely yield range will be 6.00% -7.00%. Yields above this will be subject to careful risk scrutiny and likely to be within the Swindon boundaries. Yields below this will be considered on their merits but will be dependent on candidate properties exceeding the minimum lease length and tenant covenant strength criteria

Capital expenditure: Candidate properties requiring capital expenditure within the first 5 years of ownership are generally to be avoided

Disposal Strategy

1. As highlighted in the Purchase Strategy, the current portfolio is quite dated, with obsolescence an ongoing issue and many smaller properties with high levels of management. The preference should be for assets with minimal associated management costs and those with low obsolescence costs, typically modern single let properties or those with 2-3 tenants and unexpired lease terms of 5-10 years reducing the requirement for active management. A regular review of potential disposals and the recycling of sale proceeds into opportunities to achieve a better or more sustainable return should be carried out, aiming to maintain a balanced portfolio at all times.

2. The Council undertook a programme in recent years of rebuilding several of its older suburban shopping parades but other properties remain that are close to being functionally obsolete, or require significant expenditure to bring them up to date. In addition, MEES (Minimum Energy Efficiency Standards) have come into force meaning that properties that fall below a certain threshold will no longer be able to be lawfully let.

3. Properties that are likely to need significant capital expenditure to maintain the current income stream should be considered for disposal where that expenditure will not guarantee a return on the expenditure that cannot be achieved or bettered

elsewhere

4. In addition to the sale of properties where obsolescence is a major factor or capital expenditure is required, opportunities will arise for a sale of a property at above market value. Typically (but not exclusively) such circumstances will be:

- Where an occupying lessee wishes to invest significant sums in on improvements to the building or business expansion, and requires the freehold to raise the necessary finance or justify the expense
- Where a lessee holds the property on a long ground lease from the Council, paying a ground rent and wishes to acquire the freehold to merge the interests and release latent marriage value, shared with the Council as freeholder
- Where a purchaser owns nearby or adjacent properties and has a special interest in acquiring the Council's property

Disposal Criteria – Existing Stock

Aim –"*to provide a set of principals against which to identify properties within the portfolio for sale and the re-investment of the proceeds of the sale into opportunities to achieve a better or more sustainable source of income over the medium to long term to support the delivery of council services"*

Sale Price: properties will be considered for disposal where opportunities arise for a sale at above market value.

Capital Expenditure Exposure: properties will be considered for sale where substantial capital expenditure is likely to need to be incurred within the next five years and where incurring such expenditure cannot be justified

Balanced Portfolio: properties will be considered for sale where the portfolio shows an unacceptable imbalance in any sector which requires correction, or where opportunities arise for reducing the need for active management.