Annex 4 - Property Investment and Disposal Strategy

Investment Strategy

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 £4.6m 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. Their findings are summarised below:

Current Portfolio

1. The existing portfolio appears to have evolved from longstanding ownerships and is biased towards retail and long leasehold asset classes.

2. Income from ground rents is 23% of the total portfolio income as a secure element of the portfolio this is sensible and to be expected.

3. Retail and office properties make up 26% and 21% respectively, these are historically subject to low rental growth (in the Swindon area) and higher obsolescence in the case of offices.

4. Industrial units only constitute 15% which shows an imbalance by sector and lack of exposure to an active sector of the local and South West occupational market and historically one of the best performing classes in Swindon and likely to show highest rental growth

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

6. The portfolio is nevertheless balanced and relatively well split across the other sectors it holds, and the current gross yield of circa 8.10% is a good overall return

Investment Strategy

1. The current portfolio is heavily weighted towards the Swindon borough boundaries with only Lysander House (Bristol) being held outside the borough boundary. Swindon would be considered a higher risk location by the commercial investor market due to historic oversupply in most sectors, and relatively low levels of rental growth. In order to diversify the exposure of the portfolio it would be sensible to spread investment beyond the local authority boundaries

2. The portfolio lacks modern industrial buildings, retail warehousing and has a low modern office content. Target asset classes for new acquisitions should prioritise industrial investments (particularly if investing in Swindon), the retail warehouse sector with a lower priority focus on recycling office investment to target quality office income in, for example, Bristol or Reading. The portfolio should remain balanced at all times.

3. 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)

4. 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

Investment Criteria – New Acquisitions

Aim –"*to provide a set of principals in the form of target investment criteria for the acquisition of properties for investment purposes to provide additional and sustainable sources of income over the medium to long term to support the delivery of council services"*

Location: candidate properties within Swindon Borough Council boundaries are preferred, but if a candidate property meets all the other Investment Criteria then consideration will be given to opportunities outside the Borough boundaries in an area along the M4 corridor from Bristol to Reading / Bracknell, and north east to the Oxford area.

Preferred Sectors: Industrial (single and multi-let), retail warehousing and offices

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 Creditsafe 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 Investment 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.