Appendix A – SHDC Commercial Property Strategy & Criteria

Overall Objectives:
The Council's commercial property strategy has multiple objectives as stated below:

- To support regeneration and the economic activity of the District
- To enhance economic benefit/business rates growth
- To assist with the financial sustainability of the Council as an ancillary benefit.
- To help the Council continue to deliver and/or improve frontline services in line with the Council's adopted strategy & objectives

South Hams District Council is a business rates pilot area for 2018/19, which sets out the economic objectives of the pilot area.

Each acquisition or development opportunity will be assessed on its fit with meeting the objectives stated above, on a case by case basis.

This strategy will be achieved by the focussed acquisition of existing commercial property assets, or the development of new, using predominantly prudential borrowing or any other unallocated or available Council reserve or capital receipt.

The strategy criteria below are based on an overall spend profile. The level of spend (and therefore the size of the strategy) will be determined by the Council's borrowing limit.

This borrowing limit will be recommended to Members as part of the Medium Term Financial Strategy report in September to the Executive and will be further considered at Full Council for final approval.

Strategy

- To achieve the overall multiple objectives as set out above
- Achieve a spread of risk across a greater number of assets and by acquiring properties across a range of different property asset classes, namely retail, office, industrial or alternative (e.g. leisure, health, private rented sector, energy)
- Properties will be acquired to hold for the short to medium term rather than to dispose, although this strategy recognises that there may be exceptions to this.
- The Council will acquire properties where the ancillary yield benefit delivers sufficient income to fund the initiative. It is anticipated that the portfolio should aim for a gross yield in excess of 5%.
- Acquisition costs are forecast not to exceed 7% (Stamp Duty Land Tax (SDLT) / Legal / Agents / Due Diligence).
- Management of the acquired assets will be outsourced to property professionals where appropriate. The cost of this management is to be included within the target return
- The legal work required to complete transactions is most likely to be outsourced
- Specialists will be commissioned to act on behalf of the Council to source suitable properties and manage the acquisition due diligence process

Risk

- The risks of acquiring property may be mitigated through the acquisition of assets with secure, long income streams, although this risk will be weighed up against the social and economic benefits of acquisitions to support commerce and trade in the District.

- Acquisitions are to be made in a careful and controlled manner, with specific analysis of risk criteria carried out in the 'due diligence' stage prior to the completion of each purchase
- Should the portfolio yield drop below 5.0%, a review of the strategy will be triggered in terms of value for money
- The portfolio of properties being acquired should be diversified in order to spread risks via a balanced portfolio, such diversification principally being across geographical locations and the use type of properties
- The portfolio will be relatively risk-averse, when appropriate, limiting fresh acquisitions to properties with minimum unexpired lease terms of four years at the date of acquisition, and tenants of strong financial standing

  The final decision over the definition of "good", "strong", "spread", "balanced", "prime", "well-let" and "sound" will be agreed between the property acquisition advisers (including legal due diligence) and the individuals delegated with the responsibility to conclude the acquisition of the properties. This discretion will be based on both the risk to the capital value of the asset and its revenue returns.

Location:

- Wherever opportunities arise within the District, in order to acquire good properties which deliver the Council's multiple objectives stated above and are deemed an acceptable risk.

Sector:

- Neutral – Wherever opportunities arise in order to acquire good properties which deliver the Council's multiple objectives and are deemed an acceptable risk
- As the portfolio gets larger, a mix of sectors will be sought to create a balanced portfolio

Tenant mix:

- As the portfolio gets larger, a mix of tenants will be sought to create a balanced portfolio
- The final decision over the appropriateness of any tenant would be reviewed at the time of acquisition
- SHDC owns a significant number of commercial units already within the District, mainly smaller units and tenants with relatively low credit ratings. This reflects the historic policy of supporting small start-ups which has proved successful and continues to be. Newer acquisitions are likely to be for larger units which may have single tenant occupancy.

Lease length:

- Minimum 4 years unexpired (mean unexpired term for multi-let properties)
- For multi-let properties, a mix of lease expiry dates are preferred, thereby limiting void risk (unless the property is purchased with a view to re-development)
- Properties would preferably be let to sound tenants on leases with a preference for 'Full Repairing and Insuring' leases for single occupiers and through internal repair obligations and a service charge for multi-let properties. Albeit there may be overriding economic reasons to move away from this position.

Yield:

- Per lot, a minimum gross yield of 4.5% is envisaged, before management, maintenance and funding costs
- A maximum gross yield in excess of 10% will not normally be sought
- As the portfolio gets larger, a mix of yields will create a balanced portfolio
- It is envisaged that the gross yield (an ancillary benefit) will average or exceed 5.0%

Cost:

- Larger lot sizes are favoured - smaller size properties have disproportionately higher management costs and expose the Council to greater property void risks, but the economic and trade benefits of buying smaller units may outweigh this.
- All acquisitions will normally be subject to a minimum lot size of £1m

For all of the above, flexibility of +/- 15% (relative to the measure) is allowable in order to conclude a deal without recourse to reviewing the terms of this strategy. The overall budget for acquisitions is not subject to this flexibility.

Funding:

- This is to be secured on a case by case basis on the most favourable terms available predominantly through prudential borrowing or any other unallocated or available Council reserve or capital receipt
- The term will not exceed the expected remaining life of the property, but as a rule, the Council wishes to secure borrowing over a maximum 50 year term
- The Council will opt to borrow monies on the most commercially advantageous terms, seeking advice from its retained Treasury Management Advisors

Exit Strategy:

- The Council is acquiring to hold for the short to medium term. It is not looking to actively trade commercial property in this timeframe
- If capital values determine that the most prudent action is to sell an individual asset, this will be considered on a case by case basis and will be acted upon in consultation with the 'Investment Group' Chair, Leader, S151 officer and Head of Paid Service
- It is proposed that all properties will be held as Council Assets. This may change if the Council were to set-up an arms-length management organisation (ALMO) or trading company and it was found to be commercially advantageous for such a vehicle to hold the asset
- It is important to note that there would be early repayment charges if the loan used to acquire the commercial property were to be repaid before the end of the loan term. However, Public Works Loan Board (PWLB) lending is not secured against property, so this would not inhibit the asset being traded during the loan period. An alternative asset could be purchased (& held) with any sale proceeds

Tax Implications:

- Due to the Council holding the asset, it is not anticipated that there will be any corporation tax or income tax implications from this strategy
- Some properties may be VAT elected, meaning VAT must be charged to tenants. This will be dealt with on a case by case basis and will be covered by the due diligence connected with that acquisition. The Council is able to charge and recover VAT

- Capital Gains Tax would not apply to assets sold from Council ownership. This position may change if a company were to be used to hold the acquired asset

Governance Arrangements:

Purchase
Purchases must conform to the adopted commercial property acquisition strategy. Any deviation from the agreed strategy (beyond the flexibility parameters) will require Council approval.

Delegated authority to be given to the Head of Paid Service, in consultation with the S151 officer and Leader and Chair of the 'Investment Group' (or their deputy). Each receive one vote to proceed with purchase. In the event of a split decision, the S151 officer has the casting vote. Only purchases which are in line with the agreed strategy will be considered by this group.

The Council will consider proportionality on a case by case basis for each acquisition as part of the decision making process, with information provided to the Investment Group Members, the s151 officer, the Head of Paid Service and the Leader of the Council.

The 'Investment Group' will determine its chair and will receive details of potential purchases from the Assets CoP. They will vote on whether to bring a potential purchase decision to the Head of Paid Service.

In the context of development, the same governance arrangements will be used to approve capital spend and the granting of leases in excess of 15 years as recommended by the Assets CoP Lead, on a project by project basis.

Running / Review
The Investment Group to receive regular reporting to confirm portfolio composition and performance. Regular reporting to Audit Committee.

Disposal
Once acquired, decisions relating to the ownership of any acquired properties will be dealt with in-line with the Council's constituted scheme of delegation.

Disposal will be considered if the portfolio breaches the approved strategy. Decisions to be made in consultation with the 'Investment Group' Chair, Leader, S151 officer and Head of Paid Service.

Resources:

The work to filter, appraise and recommend investment and development opportunities will be undertaken within the Assets CoP. This will be supplemented by specific consultant advice as required and associated costs built into the business case for each project. The Assets CoP has strong relationships with a number of local and national consultants who will be required to support the projects. Examples of this include: Arcadis (building technical due diligence), Womble Bond Dickinson (legal due diligence) and Savills (commercial property investment advice).

As part of this strategy it is proposed to make 2.2 FTE (1 x L6 Specialist + 1.2 X L7 Case Manager) currently working on a temporary basis supporting the Assets CoP permanent. This is a fully funded proposal.