



Council Overview Board  
1 June 2016

**Investment Strategy: Property Portfolio**

**Purpose of the report:** Scrutiny of the Investment Strategy

To provide an update to Members on the Investment Strategy, noting the context of the Council's total portfolio of land & buildings. The report provides a note of the role of the Investment Advisory Board and its oversight of the strategy and an update on the progress made in pursuit of the strategy.

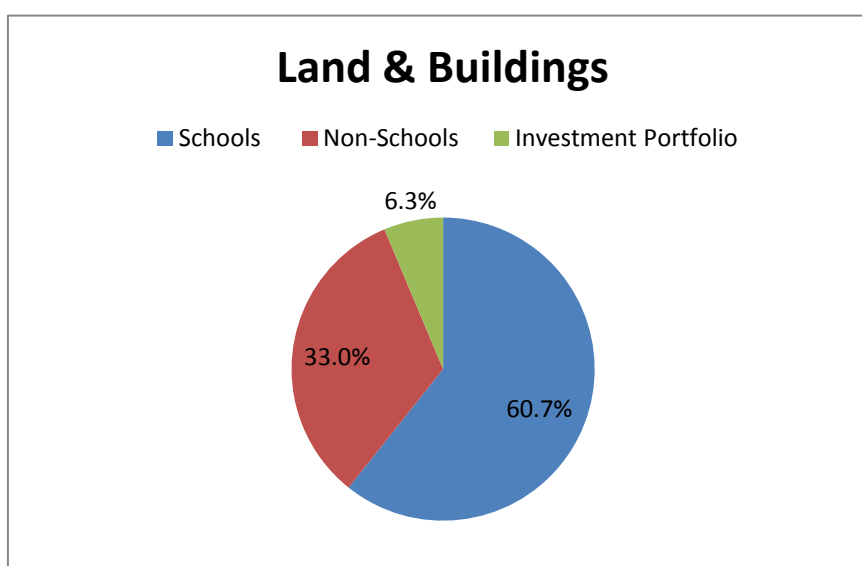
**Introduction: Investment Strategy**

1. The Investment Strategy was agreed by Cabinet in July 2013 as one of a series of responses to improve the financial resilience of the Council in the longer term. The Budget report in February 2013 created the Revolving Investment and Infrastructure Fund to meet the initial revenue costs of initiatives to deliver savings and income.
2. The main principles of the Investment Strategy as agreed by Cabinet are as follows;
  - a. Use of the established Revolving Investment and Infrastructure fund (the Investment Fund) to meet the initial revenue costs of funding initiatives that deliver savings and enhance income in the longer term,
  - b. The Investment Fund will be used to support investments that generate additional income to support the delivery of the Council's functions and services,
  - c. Creation of a diversified and balanced portfolio of investments to manage risk and secure an ongoing annual overall return to the Council,
  - d. Investing in schemes that have the potential to support economic growth in the county, and
  - e. Retaining assets where appropriate and undertaking effective property and asset management, and if necessary associated investment, to enhance income generation.

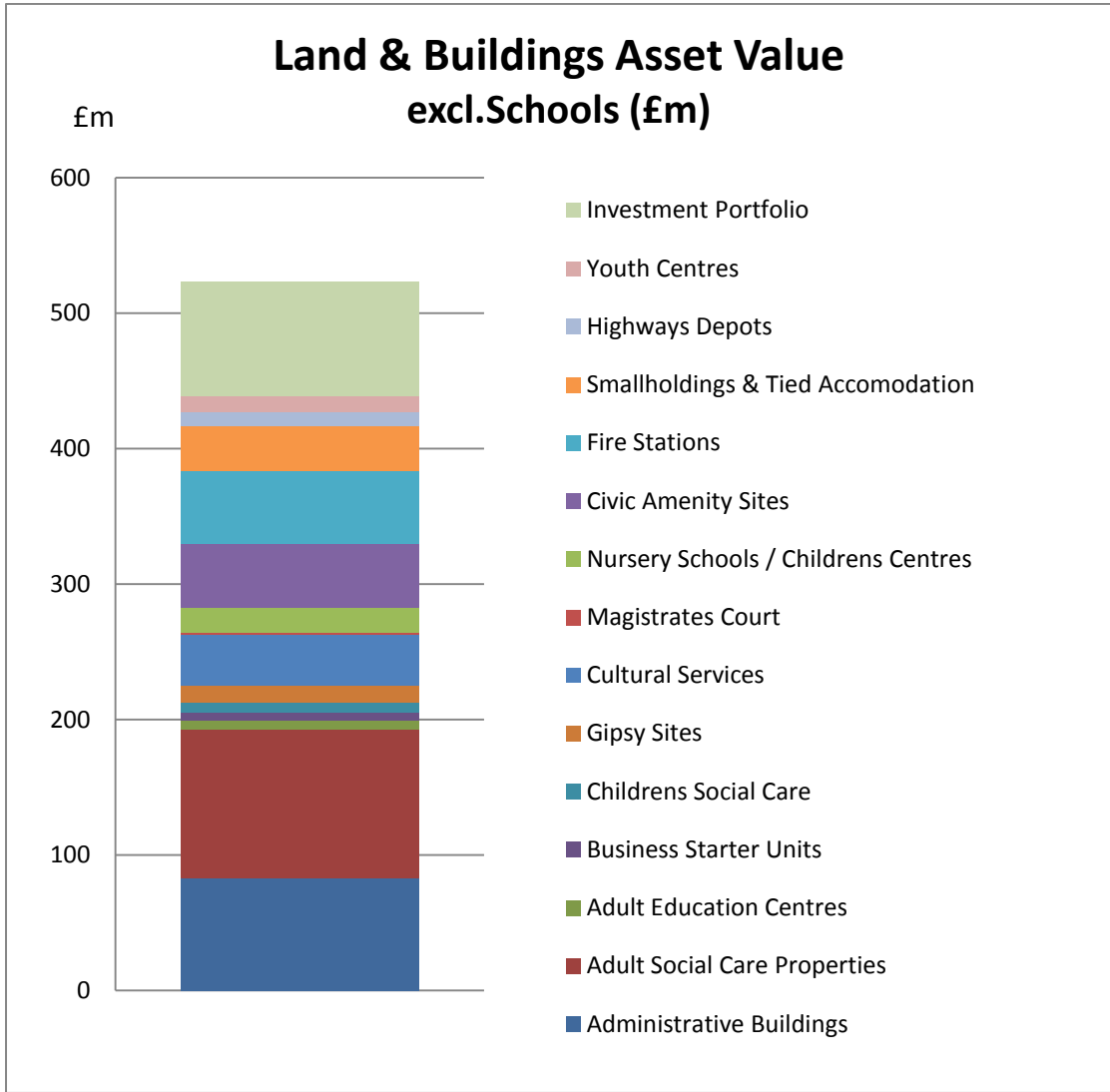
3. The governance for the Investment Strategy is provided by the Investment Advisory Board (IAB), established following the Cabinet report in July 2013 and comprising members of the Cabinet, supported by officers. The IAB is responsible for providing appropriate evaluation of opportunities (including business cases), prior to Cabinet approval and for the strategic management of the overall portfolio of investments consistent with the aims of the Investment Strategy. The IAB will also regularly review actual outcomes of each investment. The terms of reference of the IAB are attached in full as Annex 1.
4. Cabinet approved the creation of a Property Company (Halsey Garton Property Ltd) in May 2014 in order to strengthen the Council's ability to invest in a diversified and balanced portfolio of assets. The portfolio of investments therefore consists of both property and non-property assets and includes assets held by the council together with those owned by the Property Company.
5. All investments will be required to demonstrate a return in excess of the opportunity cost of capital, which will be calculated with reference to the Council's interest payable on equivalent borrowing and the statutory minimum revenue provision (MRP) that sets aside funds for the repayment of the borrowing. In accordance with the conditions set by the Prudential Code, the provision of finance to enable the Council's property company to invest in assets of a commercial nature will be funded by reserves and capital receipts. However the same test will apply to all acquisitions in order to reflect the opportunity cost of using these internal resources.

### Background: Council Land & Buildings

6. The council currently owns operational land and buildings to the value of £1,332m<sup>1</sup>. Land & buildings are primarily held and managed for the purposes of current service delivery; for example to provide education or library services. The Council also holds assets, purchased under the Investment Strategy, for potential long-term future service requirements or to aid the economic development of an area. Property Assets held and managed as the Investment Portfolio make up 6.3% of the total land and buildings value as at the last balance sheet valuation date of 31.03.2016.



<sup>1</sup> Balance Sheet Value as at 31.03.2016



7. Property Services work in support of the service strategies of the Council and it is these strategies that determine the Council's portfolio of land & buildings. The Strategic Asset Management Plan provides a guide to future property decisions and the link between the strategic consideration of assets and their role in the delivery of the council's services. The plan covers the range of activities undertaken by the Property team, from investment and acquisition to the day-to-day management of the built estate. The service is currently looking to refresh the document and develop a joint strategic approach across the Orbis partnership. This will articulate, for example, the journey to adopting a common approach to the management of the rural estate in order to deliver efficiencies over the longer term.

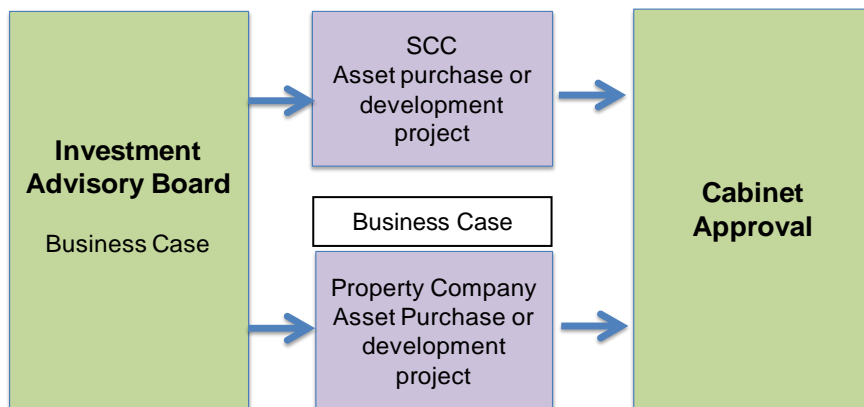
## Governance: Investment Advisory Board

8. The Investment Advisory Board was established following the Cabinet report in July 2013 and is comprised of members of the Cabinet, supported by officers. Officers receive support from independent specialist professional advisors where appropriate. The Board are responsible for the strategic management of the investment portfolio consistent with the aims of the Investment Strategy. This includes the consideration of all business case proposals that contribute to the delivery of the Investment Strategy and meet the investment criteria.



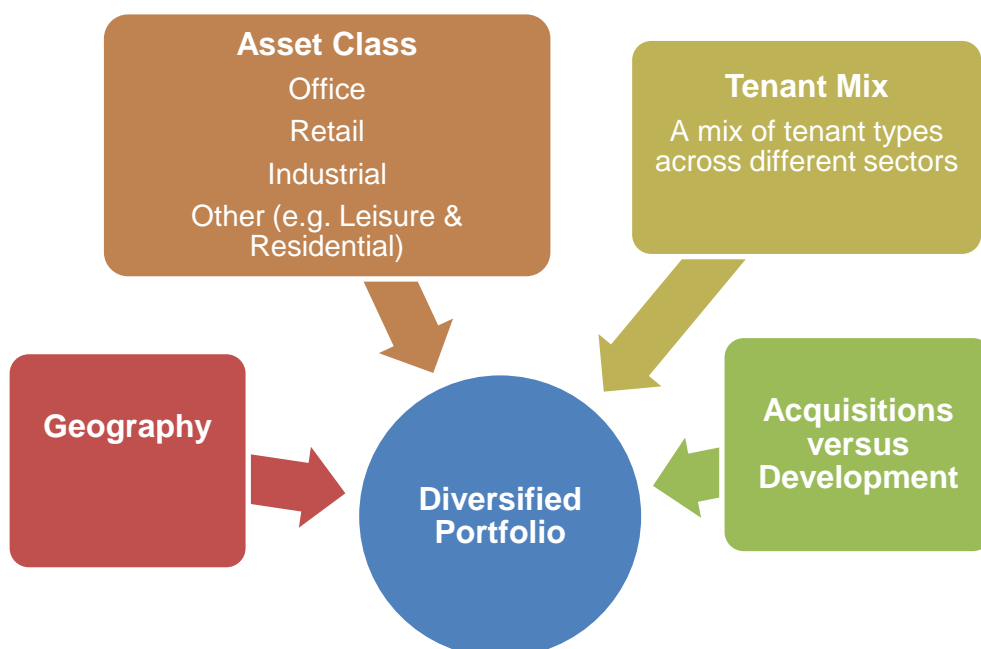
9. The Investment Advisory Board is responsible for
- Ensuring that opportunities recommended to Cabinet for approval have been thoroughly evaluated, ensuring that there is an appropriate balance between risk and reward and that the acquisition contributes to the achievement of the aims of the strategy.
  - Reviewing proposals to enable the Council's Property Company to purchase assets, recommending to Cabinet that the Council provide equity and / or loan finance to facilitate the purchase.
  - Monitoring the progress made in respect of achieving an appropriately balanced and diversified portfolio over the longer term across the combination of council owned assets and those owned by the Property Company.

- d. Monitoring the financial outcomes, including a review of the annual valuation exercise and consideration of market intelligence to inform acquisitions and disposals.

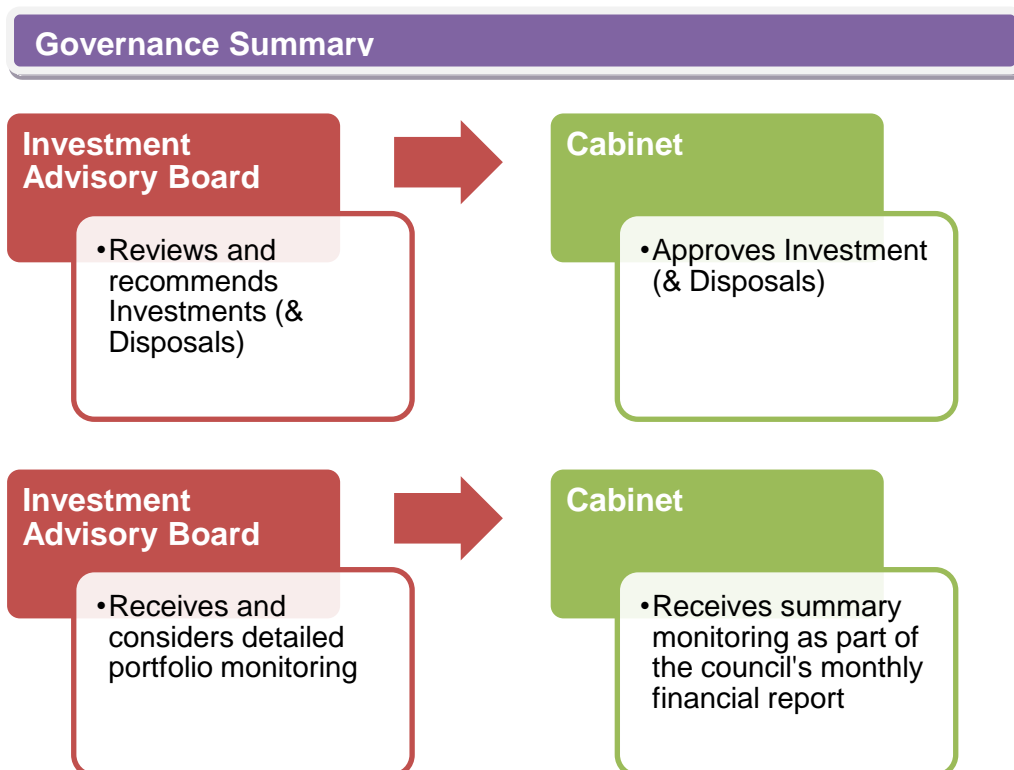


### Risk Management

- 10. The Investment Strategy means that the Council is managing different financial risks. Investments will be subject to inherent economic and market risks, and therefore a balanced portfolio of investment is recommended. However a balanced portfolio will take some time to create and will be dependent upon appropriate opportunities coming to the market.
- 11. The performance of the portfolio across the Council and the Property Company will be monitored by the IAB. The Investment Strategy notes a preference towards assets within Surrey that are of good quality, in good or growth locations however in order to create a diversified portfolio a mix of geographical locations will be required. The portfolio will be managed in order to avoid the over-reliance upon single tenants or types of tenants in terms of their impact as a percentage of the total portfolio.



12. Development opportunities will have a higher risk than investing in existing assets but will also provide the opportunity for a greater rate of return. Priority will be given to development opportunities within Surrey where the wider benefits to the county will be taken into consideration, such as provision of affordable housing, new business premises or town centre regeneration.
13. Assets that are being developed will not produce an immediate income stream and there will be occasions when a tenant triggers their break clause or vacates at the end of their lease resulting in a potential letting void. In these circumstances there will be a revenue loss position on these particular assets however this will be offset by the net revenue income produced by other assets in the property portfolio. The Council's Revolving Investment and Infrastructure fund is available to meet the initial revenue costs of opportunities that produce an income in the longer term.
14. The governance process put in place is designed to mitigate these risks. All investment opportunities will be based upon a robust business case, developed using appropriate technical advisors and which take into account due and proper consideration of the balance between risk and reward and an assessment of the underlying security of the investment to ensure compliance with the fiduciary duty the council holds.



## Financial Implications

15. The Council may fund its capital expenditure through the use of its reserves, capital receipts and prudential borrowing. Any borrowing that is undertaken by the Council is made in accordance with the conditions of the Prudential Code, which requires the borrowing to be affordable, sustainable and provide value for money. As the Council does not hypothecate borrowing, the use of receipts or the utilisation of cash resources against individual projects or acquisitions, we assume that all the Council's activities in progressing the Investment Strategy will increase the Council's requirement to borrow. All investments are therefore required to demonstrate a return in excess of the opportunity cost of capital which is calculated with reference to the Council's interest payable on equivalent borrowing and the statutory minimum revenue provision (MRP) that sets aside funds for the repayment of the borrowing.
16. The Investment Strategy provides an ability for the Council to invest in schemes that have the potential to support economic growth or deliver economic regeneration within the county. This may mean that schemes with lower returns are considered however all investments need to demonstrate a return in excess of the opportunity cost of capital in order to be affordable for the Council.
17. The Investment Portfolio will provide an income to the Council over the longer term, contributing to, and strengthening financial resilience. The Council approved the creation of the Revolving Investment and Infrastructure Fund in the budget report approved by the council in February 2013 to meet the initial revenue costs of initiatives. In creating this reserve, the Council recognised that it will take some time to build a portfolio that delivers a net income. The reserve is not used to provide for the initial capital expenditure but to provide for the cost of any additional borrowing that is not being offset by additional income, as is the case for development spend.
18. The Portfolio consists primarily of property investments which have been made in order to deliver economic regeneration or to provide for long-term future service use, whilst delivering an investment return. These assets provide flexibility in the estate whilst producing a net revenue. The Council has also provided its subsidiary company, Halsey Garton Property Ltd, with equity and debt financing to facilitate the purchase of assets for their investment return. This finance is provided in order to enable the council to create a diversified portfolio of assets in order to manage risks. The Council has invested £75.3m to the year ending 31 March 2016 on income generating property assets which have delivered a net income of £2.1m. Further information about the financial returns from the property investment portfolio is provided in the PART TWO annex to this report.

<b>Recommendation</b>
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That the Scrutiny Board continues to support the Council's approach to investment which is carried out in order to improve the council's financial resilience over the longer-term and notes the role of the Investment Advisory Board and associated governance arrangements.

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Annex 1: Investment Advisory Board Terms of Reference  
Annex 2: PART TWO Investment Portfolio Details

**Sources/background papers:**

1. Investment Strategy (Cabinet July 2013)
2. Establishment of a Property Company (Cabinet May 2014)