

Investment Board Annual Report

Financial Year 2016/17

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The council has made investments in property to enhance its financial resilience and safeguard services



Our Corporate Strategy, Confident in Surrey's future



Listen



Responsibility



Trust



Respect

The council's strategic framework for innovation and investment is supporting the development of new ideas and approaches to enhance the financial resilience of the council. This increased emphasis on developing income streams has led to the creation of the Investment Board to approve acquisitions that contribute to the achievement of the agreed investment strategy, to monitor the performance of the portfolio and ensure satisfactory performance and effective risk management. The financial returns delivered from investment will help to ensure that we continue to deliver quality services for our residents.

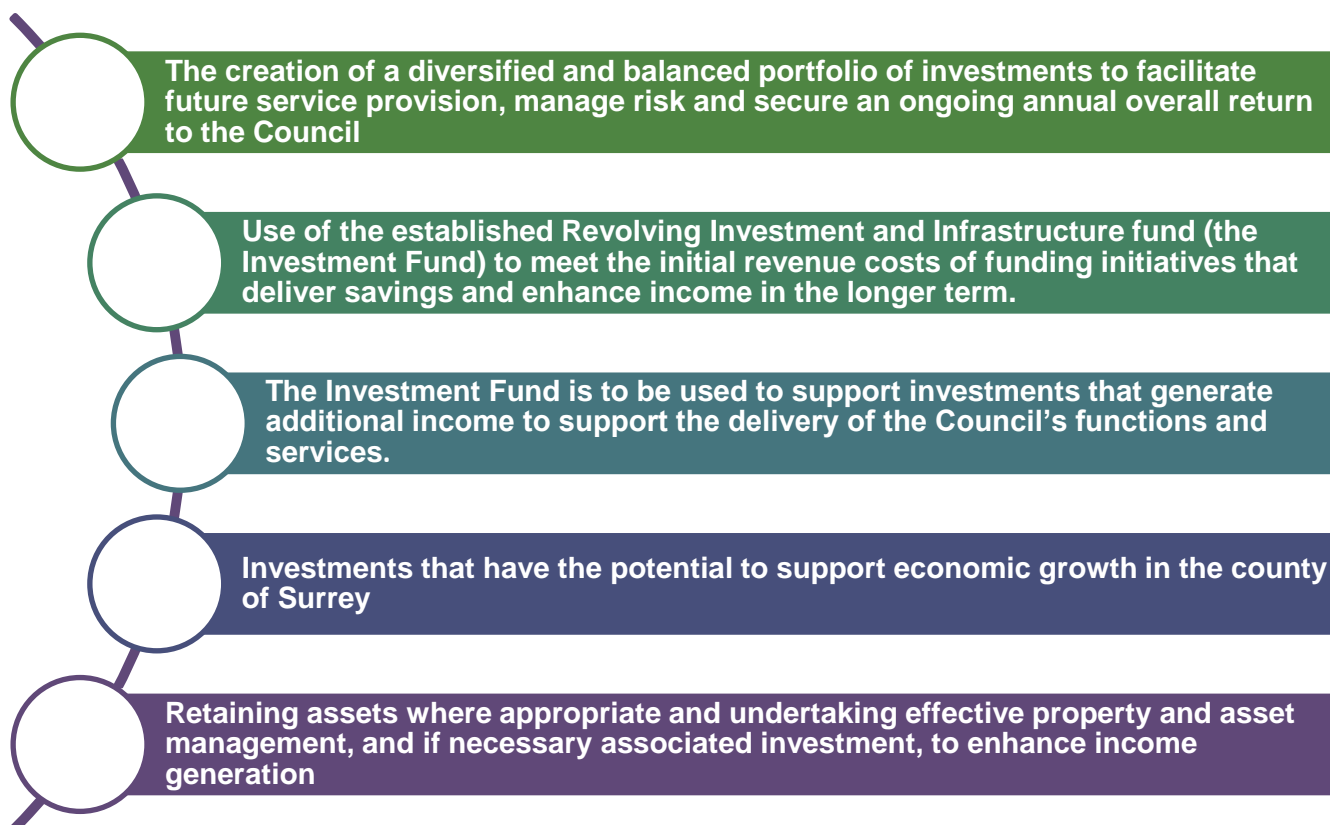
The Annual Report of the Investment Board provides an overview of the progress we have made in developing a property investment portfolio and enhancing the financial resilience of the council.



David Hodge CBE
Leader of Surrey County Council

The Investment Strategy

The Investment Strategy was agreed by Cabinet in July 2013 and was developed in response to the requirement for the Council to enhance its financial resilience in the longer term. The main principles of the Investment Strategy are as follows;



The Investment Strategy provides the council with the ability to make investments 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 cost of capital in order to be affordable for the council. The council is also able to purchase properties that provide for long-term future service use, whilst delivering an investment return. These assets provide flexibility in the estate whilst delivering an investment return.

Cabinet approved the business case for the creation of the Property Company and its associated subsidiaries in May 2014 in order to enable it to invest in property outside the county and to invest for the commercial income return. The companies making up the Halsey Garton Property Group (HGP) were incorporated between June and July 2014.

The investment portfolio of the Council is therefore a combination of assets acquired or developed by the Council for future service need or economic development and those acquired or developed by HGP.

Governance

The Investment Board

- The Investment Board was created in March 2017 following the review of the Investment Strategy by Cabinet and in order to facilitate the further growth of the investment portfolio. Prior to this the Investment Advisory Board was in place to make recommendations for Cabinet approval.
- The Board and its role is noted in the constitution of the council. The Board works in accordance with its Terms of Reference (see Page 14) which are reviewed on an annual basis.

The members of the Investment Board are the Leader, the Deputy Leader, the Chief Executive and three Cabinet Members chosen by the Leader. The board is supported by officers of the council, including the Section 151 Officer (Director of Finance) and the Monitoring Officer (Director of Legal, Democratic & Cultural Services).

Members

- Leader
- Deputy Leader
- Cabinet Members x 3 [Tim Oliver, Mel Few & Colin Kemp]
- Chief Executive

Advisors

- Director of Finance (Section 151 Officer)
- Director of Legal, Democratic & Cultural Services (Monitoring Officer)
- Chief Property Officer
- Head of Strategic Finance (Board Secretary)
- Supported by external specialist professional advisors

The board is responsible for –

- Ensuring that investment opportunities are 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.
- Approving property investment acquisitions, property investment management expenditure, property investment disposals and the provision of finance to enable the council's property company to purchase assets.
- Monitoring the progress made in respect of achieving an appropriately balanced and diversified portfolio of assets and its performance.

Investment Portfolio

Property Investment

Other Investment

The Investment Board is also responsible for evaluating and recommending non-property investments for decision by Cabinet or Cabinet Member depending upon value. The council's non-property investment assets include debt & equity finance provided to FutureGov Ltd and equity investment in the Municipal Bonds Agency.

The Shareholder Board provides oversight for the council's shareholdings – it safeguards the council's interests and takes decisions in matters that require the approval of the council as owner or as a shareholder of a company. The Shareholder Board produces an annual report which provides information about each company and therefore to avoid duplication this report of the Investment Board focusses on the Property Investment Portfolio.

The Shareholder Board is responsible also for the oversight of the property company HGP in the same way that is responsible for the oversight of other trading companies created and owned by the council. The link between the two boards is summarised in the table below.

Property Investment & Halsey Garton Property Ltd

Investment Board

- Approves the business case for asset purchase or development by HGP
- Approves the provision of finance (equity & debt) to enable HGP to purchase asset
- Reviews and considers the performance of the total property investment portfolio- assets held by both SCC and HGP
- Considers the financial results of HGP from the point of view of the council - e.g. the interest received from providing loans (debt finance) to the company and the expected annual dividend.

Shareholder Board

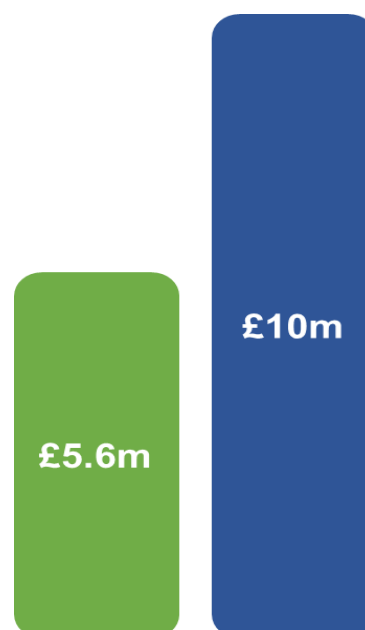
- Receives and considers the year-end financial accounts of HGP and approves the proposed dividend
- Approves the annual business plan
- Appoints and removes Directors
- Approves changes to the Articles of Association
- Reviews the financial results of HGP from the point of view of the company - e.g. rents received less expenses including interest payable to the council and administration costs.

Property Investment Performance

The council's property investment portfolio has a value of over £200m, which together with income from agreed acquisitions and developments, will deliver an **income of £5.6m** per annum by 2020/21 and enhance the asset base of the council. This portfolio has already delivered a net income in 2016/17 – which at £1.2m is a part year effect since the portfolio has grown significantly during the year.

These figures are net – after the deduction of all costs incurred including assumed borrowing costs,

The council has ambitions to grow the portfolio further as articulated in the report to Cabinet in March 2017 – to deliver an income of **£10m** per annum by 2020/21.



The current portfolio has been developed over a number of years with the rate of growth increasing more recently. The council has created a good reputation in the market by demonstrating our ability to complete acquisitions to agreed timescales and this means that the council and its property company are increasingly being invited to consider various potential acquisitions, including some that are off-market. Our ability to grow the portfolio further will be dependent upon the right opportunities coming to market. Actions are underway to ensure that we have in place sufficient capacity to deliver the ambition.

This report provides information about the results achieved so far and the expected results from investments and developments to which the council is committed – potential returns from future potential acquisitions are not included. . Due to the confidential nature of individual investments, this report provides high level summary information about the total portfolio. More detailed results, on an investment by investment basis, are provided by the Part Two confidential annex which accompanies this report.

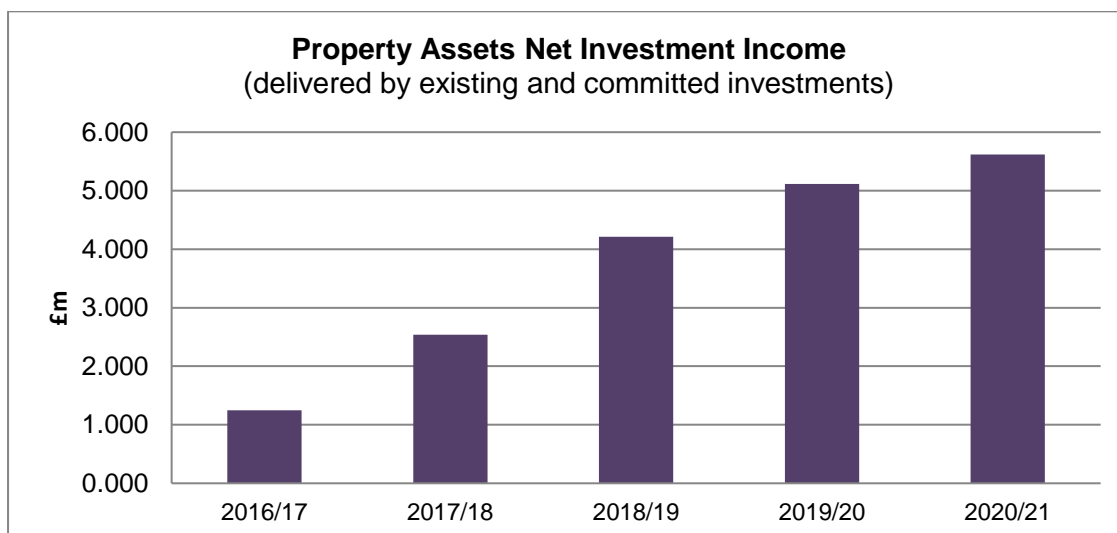
Investment Portfolio Results to March 2017	Capital Expenditure £m	Net (Income) / Expenditure					Total £m
		2013/14 £m	2014/15 £m	2015/16 £m	2016/17 £m		
		<i>Actual</i>	<i>Actual</i>	<i>Actual</i>	<i>Actual</i>		
Property Acquisitions	213.5	-0.5	-0.8	-0.9	-2.7	-4.9	
Property Development	37.2	0.1	0.8	0.9	1.5	3.3	
TOTAL / Net (income)/expenditure	250.7	-0.4	0.0	-0.1	-1.2	-1.6	

The figures in the table above includes the capital cost of providing finance to HGP and the net income achieved from investments from the point of view of the council. The income consists of the net interest margin receivable by the council on the loans provided to the company plus the estimated annual dividend.

Capital expenditure includes all costs associated with each investment acquisition including the costs of purchase – in particular stamp duty. The capital expenditure incurred will therefore be higher than the value of the asset purchased unless the value of the asset increases in time. The purpose of the investment strategy is to deliver an annual income stream in support of the council's services and in doing so the council is not assuming any gain from the value of the underlying assets. Instead a long term view is being taken since the value of the assets may decrease as well as increase over time. The assets are revalued each year for the year-end financial accounts and further information about this is provided in the part two report.

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 the lease resulting in a potential letting void. 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 income, as is the case for development spend. This has not however been necessary since the net income delivered by acquisitions has offset development spend to date. The council is currently developing its site in Crawley to provide accommodation for South-East Coast Ambulance and other third-party occupiers. Phase 1 is on track for completion very soon and will be delivering rental income in 2017/18. The investment fund will continue to be required to smooth the impact of variations in the annual income due to potential lease expiries and to provide the ability to deliver further developments, including the full development of the Crawley site.

The chart below shows forecast net income returns from the current property investment portfolio and from committed schemes over a five year time horizon.



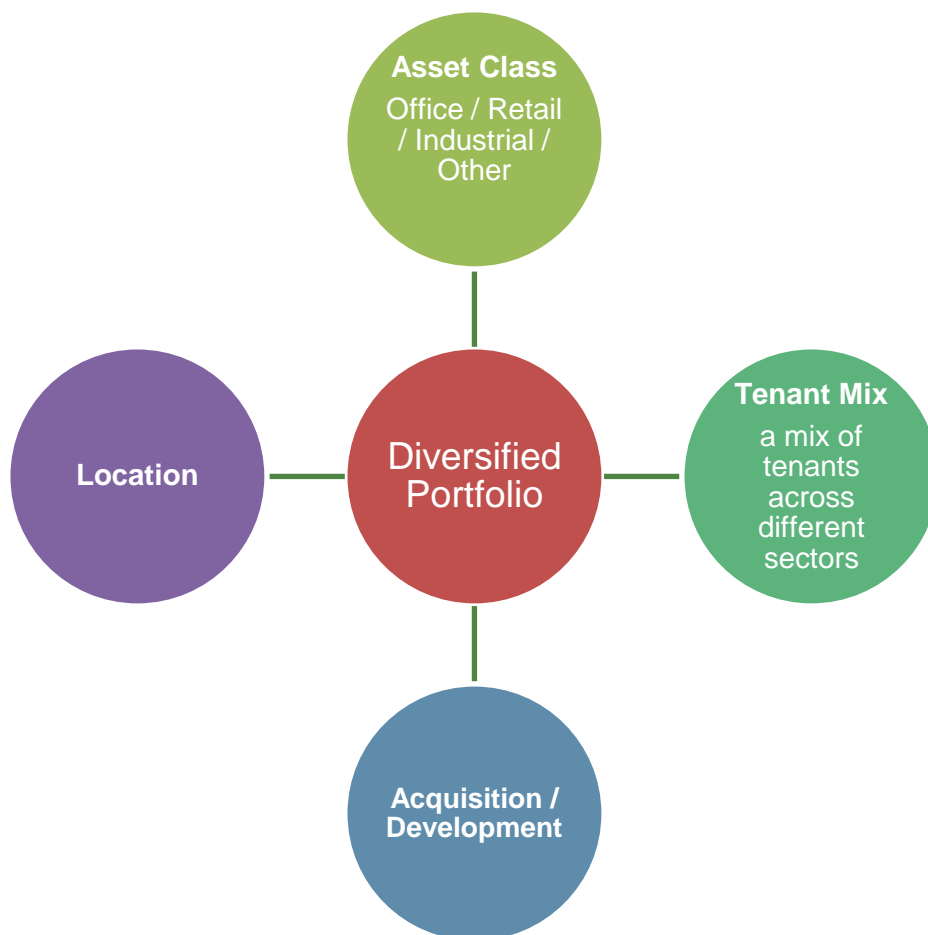
The net income is reported after deducting assumed funding costs and all other costs associated with the investment. The council may fund its capital expenditure through the use of reserves, capital receipts and prudential borrowing. As the council does not hypothecate (match) these funding sources against individual projects or acquisitions, we assume that all the Council's activities in progressing the Investment Strategy will increase the requirement to borrow. The council therefore requires all investments to demonstrate a return in excess of the assumed cost of capital which it calculates based on assumptions in the MTFP which are adjusted if required for market conditions. The council charges the assumed cost of capital to each individual investment (including the cost of finance provided to HGP) in a similar way to an inter-company charge.

As the council has made extensive use of cash resources during 2016/17 rather than borrowing, this results in an underspend on interest payable costs of **£3.9m** in the Central Income & Expenditure account.

Property Investment Portfolio

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 investments is being created. The Investment Strategy notes a preference toward 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 IB monitors the portfolio to ensure that an appropriately balanced and diversified portfolio is created over time, across the combination of directly Council-owned assets and those owned by HGP. Officers, supported by independent specialist professional advisors, support the IB. These specialist advisors periodically evaluate the recommended portfolio of property investment, taking into account market conditions and achievable returns. The IB also manage the portfolio in order to avoid over-reliance upon single tenants or types of tenants in terms of their impact as a percentage of the portfolio.



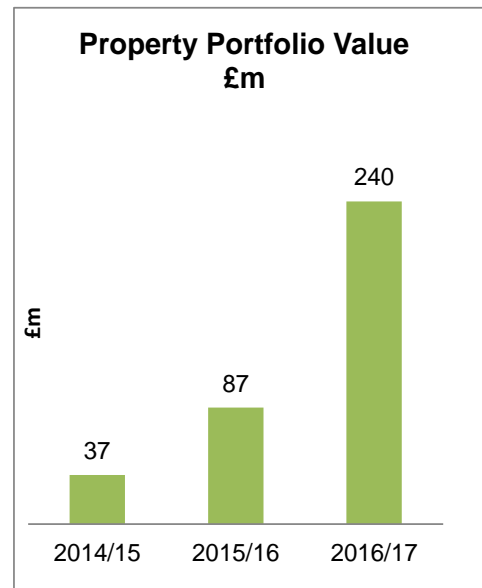
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The total asset value of the current property portfolio, based upon the valuation exercise undertaken on 31st March 2017 and incorporating assets under construction is £240m. The portfolio incorporates assets held by the council and by HGP.



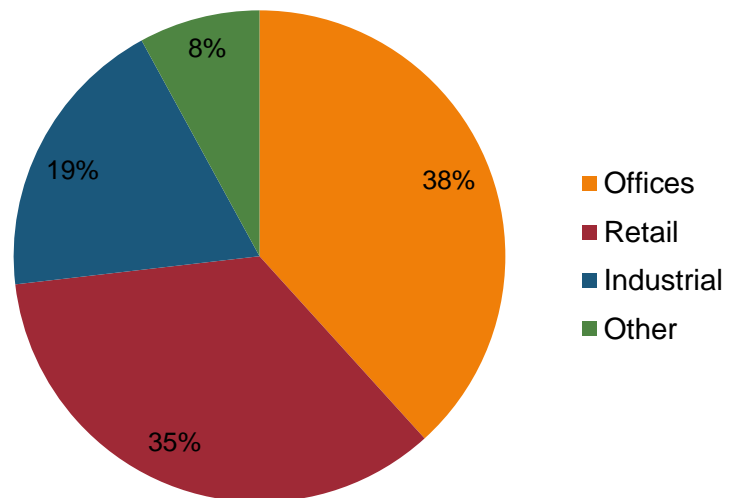
The tables and charts in this section of the report provide further information about the current portfolio - the aspects of the portfolio and its diversification – the asset class, the geography and the tenant mix. The charts do not include acquisitions or developments not yet completed since the information is based upon year-end balance sheet values and current gross rents but where appropriate a commentary is provided about the impact of commitments.

Achieving a fully diversified portfolio will take time and will be dependent upon the opportunities in the market. The growth achieved in the portfolio in the financial year 2016/17 has however significantly improved the diversification – particularly in terms of asset class.



Asset Class

Property Portfolio as at 31.03.2017	Asset Value £m
Offices	92
Retail	84
Industrial	45
Other	19
Total	240



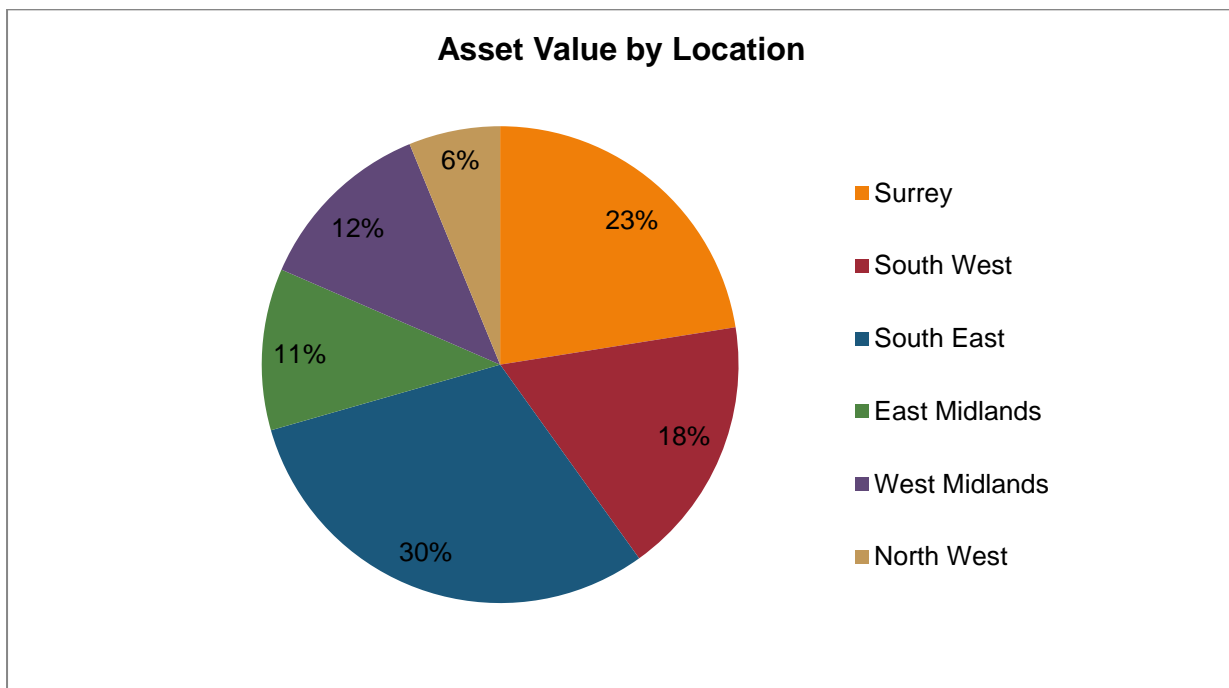
The portfolio is under-weight in the Industrial sector however this will alter with the completion of Phase 2 of Nexus, Crawley and the agreed purchase of a distribution warehouse by HGP. Further industrial purchases are being evaluated by HGP and it is expected that further acquisitions in this sector will be achieved during 2017/18.

Investment decisions that have been made but not yet completed would alter the portfolio. The Farnham Brightwells acquisition would increase the retail holding once the development is completed in 2019. Assuming no further investments in the interim the impact of the Farnham acquisition, the completion of both phases of the planned development of Crawley and the completion of the committed warehouse acquisition will increase the portfolio to an asset value of c.£330m.

Property Portfolio including commitments	Asset Value %
Offices	29%
Retail	38%
Industrial	26%
Other	7%

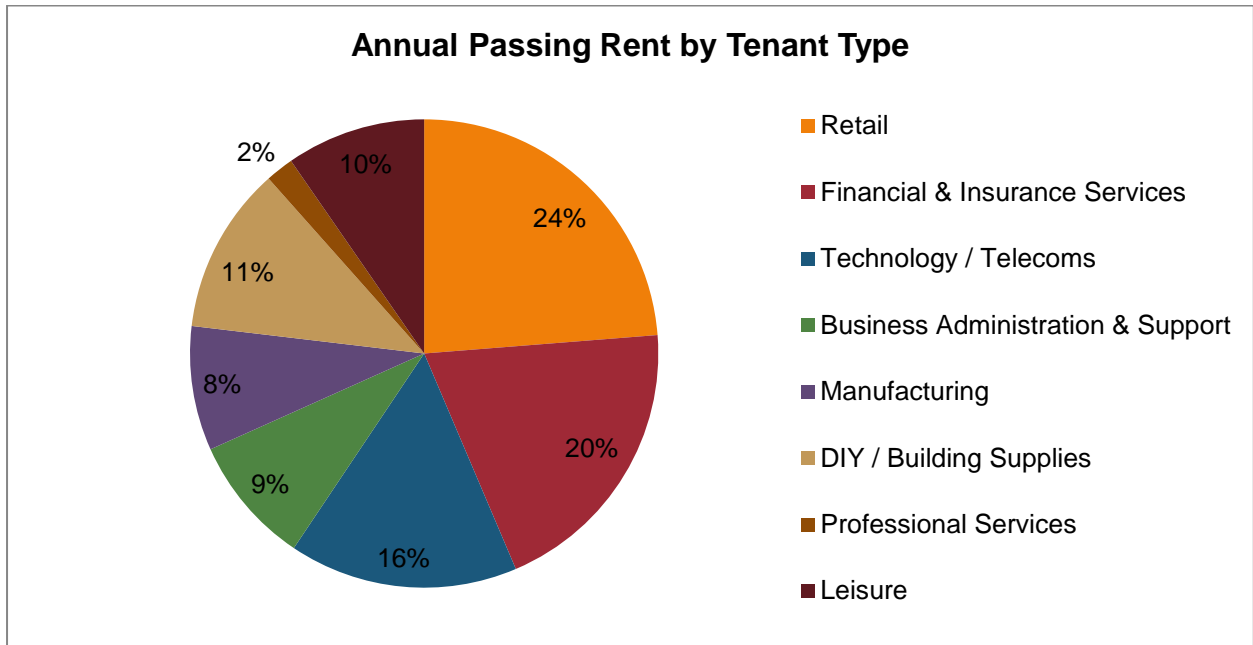
Geographic Mix

The Investment Strategy notes a preference towards assets within Surrey however a mix of geographic locations is required in order to achieve a diversified portfolio. The total asset value of property held for investment purposes within Surrey is £55m / 23% of the portfolio.

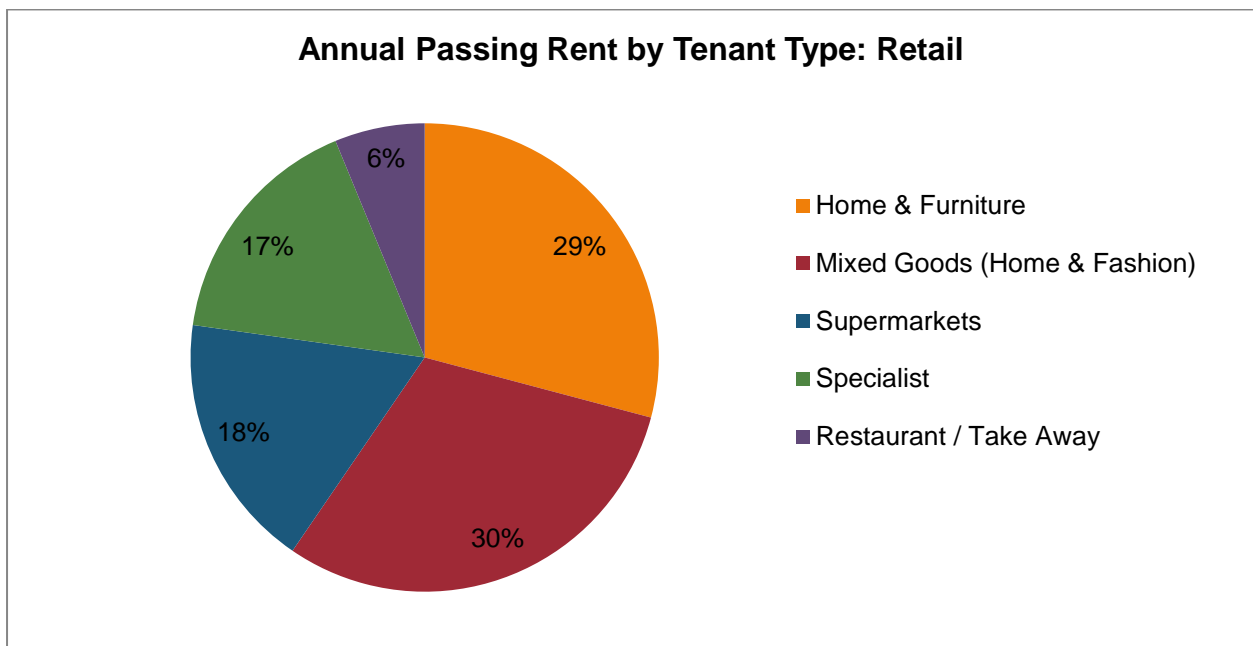


Tenant Analysis

The following chart provides an analysis of the annual passing rent by type of tenant. The most significant exposure is to retail tenants, followed by tenants in the financial and insurance services industries. The second pie chart provides a further breakdown of the retail tenants.



Retail tenants are 24% of the portfolio when analysed by the annual passing rent – of this, the biggest type of tenant is in the mixed goods sector as this includes Debenhams and B&M. The Home / Furniture sector includes tenants such as Bensons for Beds, Dreams and The Range. Specialist retailers include Halfords and Pets at Home.



SURREY COUNTY COUNCIL

INVESTMENT BOARD



TERMS OF REFERENCE

Overview

The Investment Board will oversee the development and management of the portfolio of investments created in accordance with the Investment Strategy of the council. The board has delegated authority from the Leader to;

- approve property investment acquisitions
- approve property investment development and management expenditure
- approve the provision of finance to the council's wholly owned property company, Halsey Garton Property Ltd, for the purposes of the Investment Strategy
- approve property investment disposals (including those held by Halsey Garton Property Ltd)

The board will recommend non-property investments to Cabinet for approval.

Membership

The Investment Board membership will be the Leader of the Council (Chairman), the Deputy Leader, the Chief Executive plus three Cabinet Members appointed by the Leader.

The Investment Board will be supported and advised by the following officers of the council;

- Director of Finance
- Director of Legal, Democratic & Cultural Services
- Chief Property Officer
- Secretary to the Board

The Investment Board will additionally be supported as required by appropriate professional external advisors which will be commissioned by the Investment Board when deemed necessary in relation to specific investment or types of investments.

Purpose

1. The Investment Board will consider all proposals that contribute to the delivery of the investment strategy and meet the investment criteria. Officers will provide advice on each proposal for consideration. This advice will include how each investment proposal could be taken forward, including a consideration of the risks, structuring and financing required.
2. Each investment considered by the Investment Board will be supported by a business case. In approving a business case, the Board will satisfy itself that the investment is within the council's legal powers, it has properly considered the advice provided and its structure provides value for money taking into account all financial considerations, including taxation. Full due and proper consideration will be given to the balance achieved between risk and reward and the underlying security of the investment proposed to ensure compliance with the fiduciary duty of the council.
3. The Investment Board will be responsible for approving all property investment acquisitions and for approving the provision of finance to the council's wholly owned property company, Halsey Garton Property Ltd, for the purposes of the Investment Strategy.
4. The Board will be responsible for approving all property development expenditure where this results in an asset that will be managed as part of the investment portfolio and will be responsible for approving property management expenditure for the portfolio including projects that deliver additional value to an existing asset. The Board will be responsible for the approval of the provision of finance to Halsey Garton Property Ltd for the same purpose
5. Appropriate non-property investments will be recommended to Cabinet for approval.
6. The Investment Board will be responsible for approving the strategic management of the overall portfolio of investments, ensuring that an appropriately balanced portfolio is maintained over an agreed period and that all risks, including those that are emerging are given due consideration.
7. Unless approval of Full Council is required by law the Board will be responsible for approving the disposal of property investment assets including those held by Halsey Garton Property Ltd.
8. The Investment Board will consider and recommend the use of the Revolving Investment and Infrastructure Fund (the Investment Fund) to meet the initial revenue costs of appropriate initiatives that deliver income in the longer term. The Board will receive reports twice a year regarding the status of the Investment Fund for consideration.
9. The Investment Board will approve the use of the Revolving Investment and Infrastructure Fund to procure external advice, for example property investment advisors, legal and financial specialists, including taxation advice.

Scrutiny

10. The Investment Board will provide a report on the investment portfolio and its performance to Cabinet annually and provide summary information to each Cabinet meeting as part of the update of decisions taken and the financial monitoring report.
11. The Overview & Budget Scrutiny Committee will be able to call the Investment Board to account for progress in relation to achieving the stated aims of the Investment Strategy.

Scope

12. The Investment Board will consider all significant investment activity including, but not limited to, the acquisition of property, share capital and provision of financial assistance, for example loan financing.
13. The Investment Board will consider investment in council owned trading companies (LATC) where the proposal includes significant financial investment in excess of £1.0m. Once established, trading companies will be overseen by the Shareholder Board.

Evaluation Criteria

14. The Investment Board will apply the criteria described in the Investment Strategy approved by Cabinet in July 2013 in evaluating proposed investments. These are;

a) The acquisition or investment is within the powers of the Council and can be undertaken with appropriate regard to tests of reasonableness, fiduciary duty and value for money.

If this is the case, then the following criteria will be evaluated;

b) The amount of investment required is greater than the threshold for investment which has been set for the Investment Strategy (initially more than £10m except for trading opportunities where this threshold will not apply). In establishing the portfolio it may be the case that smaller sized investments will be considered.

c) The period over which a return will be made, ensuring that this is achieving a balance between the short, medium and longer term.

d) Whether the investment aids the achievement of a balanced portfolio in the longer term.

e) That the rate of return is consistent with the level of risk involved (within tolerances) as defined by the Investment Strategy.

Meetings

15. The Investment Board will have scheduled meetings on a monthly basis with further meetings arranged if necessary in order to respond promptly to opportunities. Meetings will be cancelled if there are no agenda items to be discussed.
16. The quorum for the Board is a minimum of 3 members, with one being the Leader or Deputy Leader.
17. The Chairman approves the agenda for each meeting. The agenda and papers for consideration are circulated at least two working days before the meeting. After each meeting, the Chairman approves the meeting notes and actions agreed. Susan Smyth, (Head of Strategic Finance: Business Development & Investment), will act as secretary to the Board.
18. The Investment Board will review the Terms of Reference annually.

Date of Last Review: 28.03.2017

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