

HG

Halsey Garton
Property Investments Ltd

Company Strategy
2023 - 2028

Background

This Report reviews the optimum strategic pathway for Halsey Garton Property Investments Ltd (the “Company”). It sets out the future strategic principles, which will be supported by an Annual Business Plan approved by the Company Board.

The current structure of the companies is as follows:



The Company began trading in June 2014 and currently holds 17 commercial property investments which range from parades of shops to large, single-let properties, all of which are outside the Surrey County boundaries.

Market Commentary

Economic Overview

The UK narrowly avoided falling into a recession in 2022. Although the economy is in a better position than forecasters expected, families and businesses continue to feel the pressure of rising bills. The Bank of England expects the UK economy to shrink throughout much of 2023 and the first half of 2024, as high energy prices and tighter financial conditions weigh on spending. The forecast would constitute the country's longest, albeit not deepest, recession since the 1920s when reliable records began.

Inflation continues to rise at the fastest rate for 40 years as food, energy and fuel costs continue to climb. CPI rose by 10.1% in the 12 months to January 2023, down from 10.5% in December 2022. The Bank of England expects inflation to begin to fall from the middle of this year and be around 4% by the end of next year.

The Bank increased interest rates in February 2023 for the 10th time since December 2021, with rates rising by 50 bps to 4.00%. Many economists now believe interest rates will peak at around 4.50% halfway through this year.

Property Market

The UK real estate market was already facing headwinds prior to the September 2023 mini-budget announcement, notably due to construction cost inflation and the rising cost of debt weighing heavily on the market. This has resulted in an increased level of uncertainty in the property market and some softening of pricing across all sectors, particularly those sectors of the market that are assessed in line with gilt markets such as long dated income.

There are clear signs of downward pressure on property values as on-going transactions falter in the face of market uncertainty and rapidly changing funding requirements.

Housing Sector

Annual house price growth slipped into negative territory for the first time since June 2020, with prices down 1.1% in February 2023 compared with the same month last year. Prices fell by 0.5% month-on-month in February 2023, the sixth fall in a row, and leaves prices 3.7% lower than their August 2022 peak.

The housing market looks set to slow in the coming quarters as pressures on household budgets intensify and labour market conditions start to soften, while mortgage rates remain well above the lows prevailing in 2021.

Commercial Sector

The commercial property market has witnessed mixed conditions throughout 2022, as the investment and leasing markets adjust to the changing macro-economic backdrop. Early signs suggest that investors and occupiers remain active, albeit the reality of the increasing cost of living and rising expenses for businesses mean that disposable incomes and margins will be negatively impacted. As a result, market activity is likely to be adversely affected as businesses look to contain costs, at least until inflationary pressures ease. This will almost certainly impact rental growth in the short term.

Retail

In February 2023, UK retail footfall was 11.0% higher than the same month in 2022. Compared to February 2019, footfall was down by 12.5%. High streets saw the biggest increase of 16.1% year-on-

year, while shopping centres also saw an increase of 9.7% and retail parks witnessed an increase of 1.4% compared to the same period 2022.

Retail investment volumes totalled £6.5 billion in the year to December 2022, compared to £7.3 billion in November 2022. Retail capital value growth has lost momentum in recent months with the MSCI Market Rental Growth Index showing a fall of 0.5% month-on-month in January 2023, compared to a fall of 2.7% in December 2022, and marking the seventh consecutive negative monthly figure.

Offices

Office rental growth decreased marginally in January 2023, with MSCI Market Rental Growth Index for offices contracting by 0.09%, compared to growth of 0.09% in December 2022.

Investment volumes in the year to December 2022 totalled approximately £15.4 billion across the UK office market. This is down on the £17.5 billion invested in the year to November 2022. Office sales volumes have been gradually falling since their May 2022 peak of £22.1 billion.

The MSCI Capital Growth Index for offices decreased by 0.8% month-on-month in January 2023, compared to the December 2022 figure of -3.3%. This marks the seventh consecutive negative monthly figure, although the rate of decline peaked in October and has slowed since.

Industrial

The MSCI Industrial Rental Growth Index grew by 0.51 month-on-month in January 2023, compared to 0.54% in December 2022. This was the strongest rental growth from the main sectors by marks a slowdown on last summer. Back in June 2022 industrial rental growth stood at 1.1%.

Take-up across the UK for Grade A space over 100,000 sq ft reached circa 37.6 million sq ft in 2022, which was down 18% on the record-breaking year of 2021. The vacancy rate increased to 4.8% in Q4 2022, up from 4.2% in Q3 2022.

Investment volumes in the industrial sector reached £14 billion in the year to December 2022. This was down from £15.7 billion in the year to November 2022.

The sector has witnessed a slowdown in capital value growth in recent months. The MSCI Index also fell by 0.8% month-on-month in January 2023, compared to a fall of 5.0% in December 2022, and comprises the seventh consecutive negative reading. During the current market correction industrial has seen values fall the most of the three main commercial property sectors.

Conclusion

Whilst inflation, interest rates and geopolitical risks will continue to dominate investor concerns, research from Knight Frank (The Wealth Report January 2023) identifies Real Estate (46%), Tech (33%) and Equity Markets (28%) as the leading investment opportunities in 2023, noting that property investment attributes are considered as an inflation hedge and portfolio diversify. Furthermore, that where property values have been under pressure for several months as investors recalibrate their views on pricing in light of higher interest rates, there remains limited evidence of the levels of distress required to significantly push values down.

This strategy has been developed to facilitate ongoing commercial returns to the Company and considers all the factors above.

Company Background

HGPI Company Profile & Business Case

The Company was incorporated in June 2014, to fully implement the recommendations of the Investment Strategy approved by Cabinet in July 2013. The Company enables the Council to invest in a diversified and balanced portfolio of assets to deliver an alternative revenue stream and enhance the Council's financial resilience over the longer term.

Local authority investing for commercial return is not a new concept, albeit the scale of it has seen an increase over recent years as many councils have used this to respond to reduced Central Government funding. Investment has been connected to both regeneration and income generation. The practice of commercial investment peaked during the period 2016-2019 when approximately £6.6bn was invested across the UK. This precipitated greater scrutiny and new guidance, which culminated in HM Treasury stepping in and restricting access to the Public Works Loan Board (PWLB) for all councils that intended to invest 'primarily for yield'.

The investment portfolio is governed by a strategy that was last reviewed in January 2022. Since this time, the Company has:

- Appointed a Non-Executive Director and a Managing Director.
- Re-procured the External Property Management Supply Chain; and
- Confirmed the PWLB funding position.

Consequently, it is now timely to implement a medium to long-term strategy for the strategic realignment of the investment portfolio, including consideration of introducing alternative asset classes.

Governance

The governance process for the Company is set out in Appendix 1.

Original Purpose and Strategy of the Company set by the Shareholder and Returns

The purpose of the Company when it was incorporated in 2014, was to generate commercial returns from investment in commercial property for the Shareholder. The Shareholder required commercial returns from alternative sources, for the purpose of offsetting income pressures created by a reduction in central Government funding. The financial returns delivered by trading and investment helps to ensure that the Shareholder continues to deliver quality services to its residents.

Revised Company Strategy (December 2019)

The agreed strategy was for properties owned by the Company *'to be held for the long-term'*, with any further investment made to maximise their value and protect the returns to the Shareholder.

Revised Company Strategy (January 2022)

The agreed strategy was to *'continue with the current strategy to hold the investments, delivering revenue benefits to the Shareholder'*, thus enabling the Company to work the current portfolio to maximise returns.

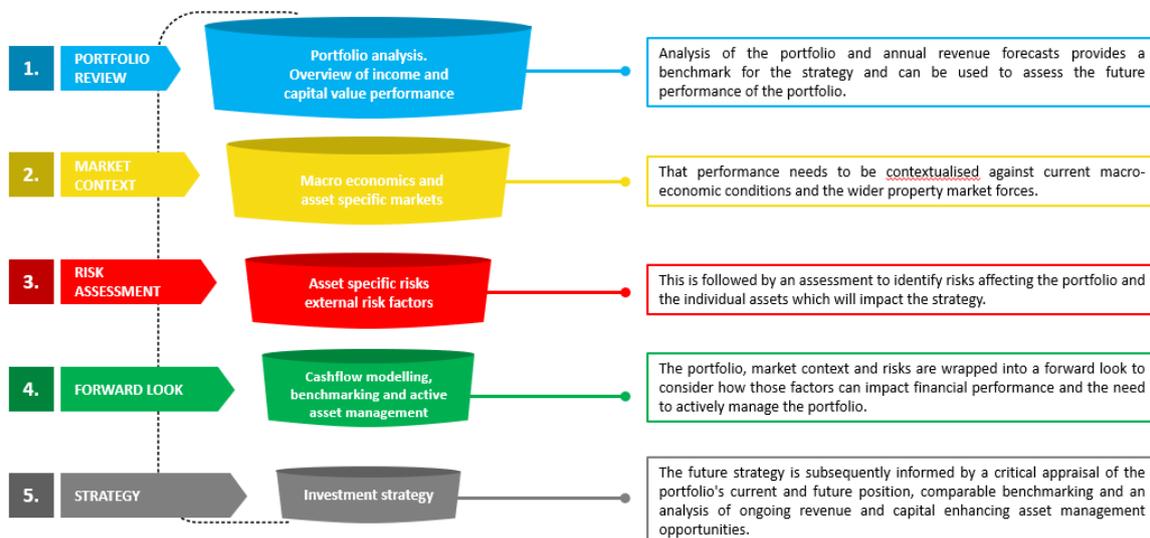
Further that over the Medium to Long-term period (12 – 48 months), while continuing to maximise the returns from the current portfolio in the short-term, the future risk of the Company's ability to deliver long-term financial contributions should be reviewed. The ability to manage the portfolio, divest individual assets at the right time, and potentially re-invest proceeds into more stable, less risky, investments supporting wider Council agendas was seen as key.

Future Strategy of the Company

The primary purposes of the Company is to deliver longterm revenue benefits whilst protecting as far as possible the capital investment. With the portfolio now maturing, it is timely for the Company to reflect on its resilience, future performance and risk profile to ensure that the required revenue returns will enable the Shareholder to continue to provide quality services to its residents.

The Company has historically taken a passive approach to asset management. If the Company is to avoid revenue returns falling over time, in part due to challenging macro-economic conditions, a pro-active approach must be taken to ensure that all assets perform to their maximum. Furthermore, to ensure the required financial returns to the Shareholder, there is a need for a strategic re-alignment of some individual assets, with capital proceeds recycled to ensure a diversified portfolio which delivers optimum revenue benefits.

The Company takes a sequential approach to analysing economic conditions, the portfolio, the risk, opportunity, forward strategy, and governance.



Future Strategic Principles:

The Future Strategy of the Company has been set against the principles below. On this basis the Company will:

- Retain a clear and dedicated focus on long term revenue return.
- Adopt a portfolio approach by developing an Annual Company Business Plan.
- Retain existing assets forecast to deliver long term, secure income with minimum volatility.
- If necessary, divest underperforming assets to maximise optimum portfolio performance and recycle capital proceeds to ensure a diversified portfolio which delivers revenue benefits .
- Ensure that a primary consideration when assessing acquisitions is commercial revenue.
- Protect the capital investment as far as possible.
- Identify the availability of short-term loan facilities to leverage opportunities.
- Build up cash reserves to enable delivery of revenue enhancing initiatives of existing assets through capital investment and support, to the extent possible, the Shareholder's wider agenda of Net Zero emissions by 2030.
- All decisions to be made via an Options Appraisal supported by pros and cons of the investment opportunity alongside a robust Business Case setting out the financial implications.

Next Steps

The Company will:

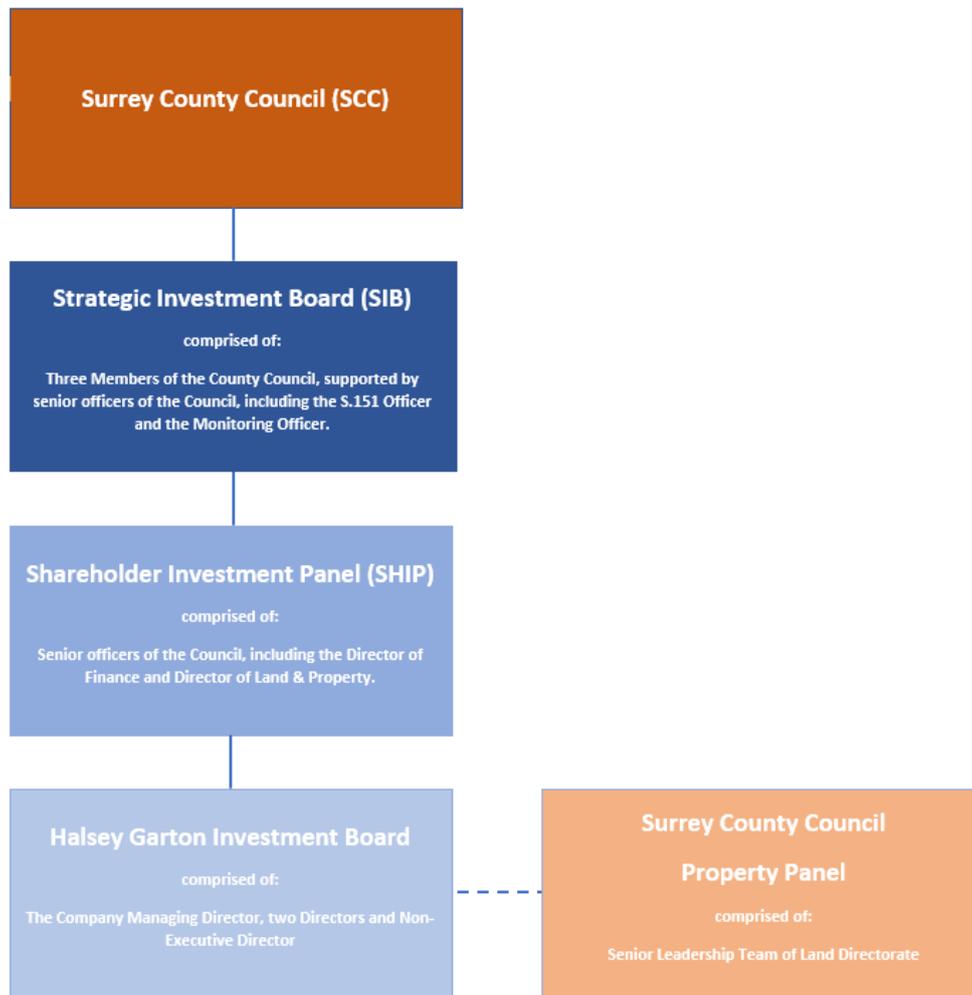
1. Adopt the agreed Future Strategic Principles as outlined above.
2. Prepare an initial Company Business Plan by April 2023 to deliver the Strategy, which will be reviewed by SHIP (Shareholder Investment Panel) and agreed by SIB (Strategic Investment Board), and includes:
 - Expected individual asset and total portfolio returns.
 - Analysis of compatibility with the wider Surrey County Council Treasury Management approach, which considers total borrowing requirements and balanced risk approach across all SCC's current and projected investments.

Appendix 1

Company Governance

Company Governance

The governance process for the Company is as follows:



The HGPI Board has the delegated authority to make formal decisions which support the ongoing strategy and day to day operations of the Company. Decisions relating but not limited to, a change in company strategy, capital investment, and acquisition and disposal of Assets are restricted by the Shareholder within the reserved matter of the Company's Articles of Association.

The decision-making Board on reserved matters is the Strategic Investment Board (SIB), with some matters in turn referred to Cabinet. The SIB monitors the Council's trading activity and its investments in companies to ensure satisfactory performance and effective risk management.

The Shareholder Investment Panel (SHIP), an Officer led panel, chaired by the Director of Finance – Corporate and Commercial (Deputy s151), works within delegated authority limits set by the SIB. The Panel's remit is to review and challenge the Company's performance in year and assist with the approvals and operational workings of the Company.

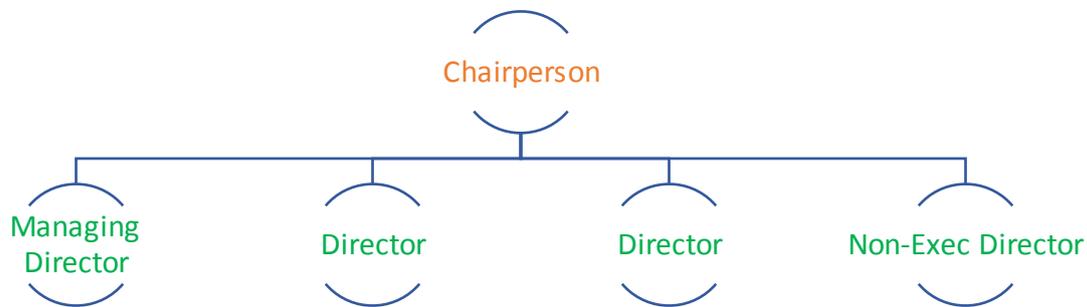
SHIP has delegated authority by SIB to approve:

- Addition and removal of Directors
- Capital Investment between £0.1m - £1.0m (the Company has authority to approve up to £0.1m in a single accounting period)
- Approval and ongoing review of annual business plans aligned to the SIB approved strategy of the Company

Prior to consideration at SHIP, any property related proposals relating to HGPI will be considered at SCC Property Panel for endorsement. This is to ensure proposals are compatible with other activities within the property estate of the Shareholder.

Company Board

The Company Board currently consists of three Directors who are also employees of the Shareholder, and one Non-Executive Director.



All Board Members are required to ensure that the decisions are made in the best financial and commercial interests of the Company and Shareholder. In addition, the skills and experience expected from each position is summarised below:

Non-Exec Director:

- Provides expert knowledge and insight from a career within Investment Property.

Director(s):

- Provides expert knowledge from associated fields to the one that the Company operates.

Managing Director:

- Provides expert property investment and asset management knowledge.

The role of Chairperson is undertaken alternately by the current Directors of the Company.

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