

Asset Investment Strategy

Accounts and Audit Committee 28 September 2021

Coverage

- The Strategy and Objective
- Investment Criteria
- Prudential Code & Guidance
- Governance Arrangements/Role of Advisors and IMB
- Performance to Date
- Diversification
- Investment Monitoring
- Risks and Mitigations
- Prudential and Local Indicators

Background to the Strategy

- Originally approved in July 2017, with the objective of acquiring a balanced portfolio that would facilitate development and regeneration, support the Council's functions, and provide a sustainable income stream to support the Council's budget.
- In December 2020, the Executive approved an updated strategy. The changes brought more emphasis to the ability of new investments to bring about both regeneration and social, economic or environmental benefit to the area and wider region, and produce an income that gives a financial return to the Council.
- The updated strategy also allowed changes to regulations and market conditions to be factored in to the investment criteria.
- The total approved investment fund is £500m, supported by prudential borrowing. Current commitments total £336.87m, and are supporting some key regeneration projects.

The Strategy and Objectives

The Council's primary Investment Strategy Objective is:

To promote Trafford Council's Strategic Priorities while creating a suitable income stream to support local services.

Each investment will need to support one or more of the 5 Strategic Priorities of the Council identified as being relevant to real estate or infrastructure:

- Building Quality, Affordable & Social Housing
- Health and Well-being
- Successful and thriving communities
- Pride in the area
- Green and Connected

Investments should create a suitable income stream to support local services but have an appropriate level of risk and return.

Investment Criteria

Lending Investments:

- Transaction sized of £20m to £50m
- Return of 2.50% + the “Cost of Funds” to the Council
- Maximum of 80% of the total project cost and 70% of projected end value

Direct Investments:

- Criteria will depend on the specific objective for investment, e.g. capital return or strategic assembly

Prudential Code & Guidance

| Policy Document | Requirements |
|--|--|
| CIPFA Prudential Code for Capital Finance | <ul style="list-style-type: none">• Not to borrow purely to profit• All investment plans and borrowing are prudent and sustainable• Prudential Indicators |
| CIPFA Prudential Property Investments Guidance | <ul style="list-style-type: none">• Consider if the fair value could drop below Borrowing level• Ensure margin reflects risk• Ensure the investment is affordable / prudent |
| Public Works Loan Board: lending terms | <ul style="list-style-type: none">• PWLB will not lend to an LA that plans to buy investment assets primarily for yield• PWLB will lend for Regeneration, Housing, Environmental Sustainability and Education |

Governance

Role of Investment Management Board (IMB)

- Strategic direction and oversight of the Investment Strategy
- Approval of investment opportunities

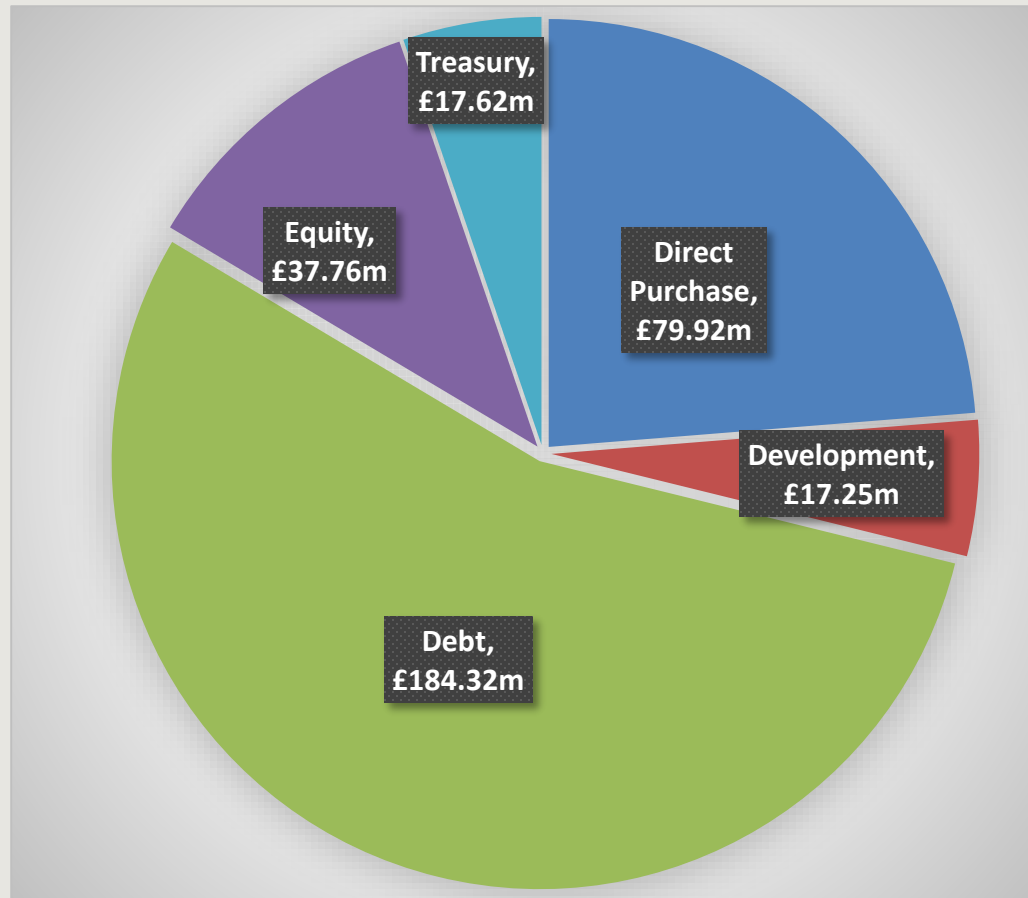
Role of Officers

- Review investment opportunities
- Make recommendations to IMB

Role of Investment Advisors (CBRE)

- Sourcing and recommending opportunities for consideration
- Due diligence, liaising with agents and legal advisors
- Evaluate performance of acquired assets and respective market conditions

Current Commitments - £336.87m



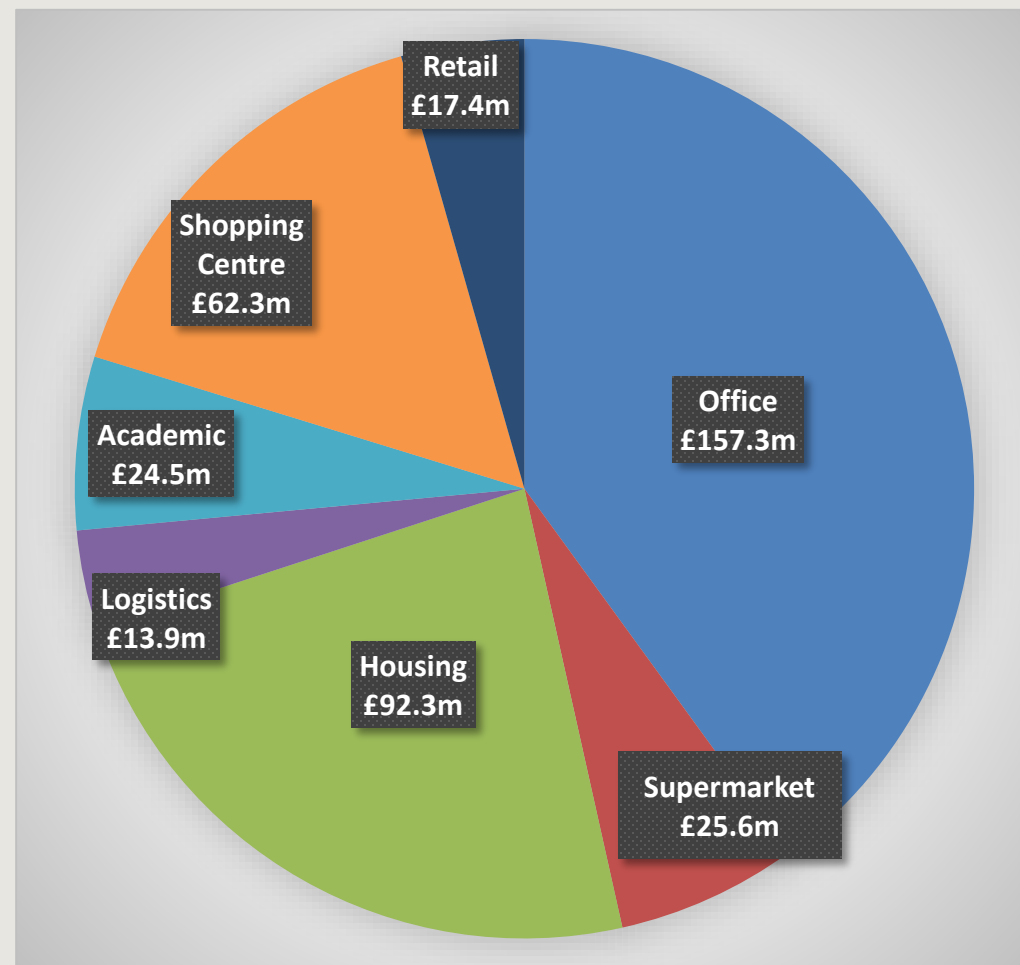
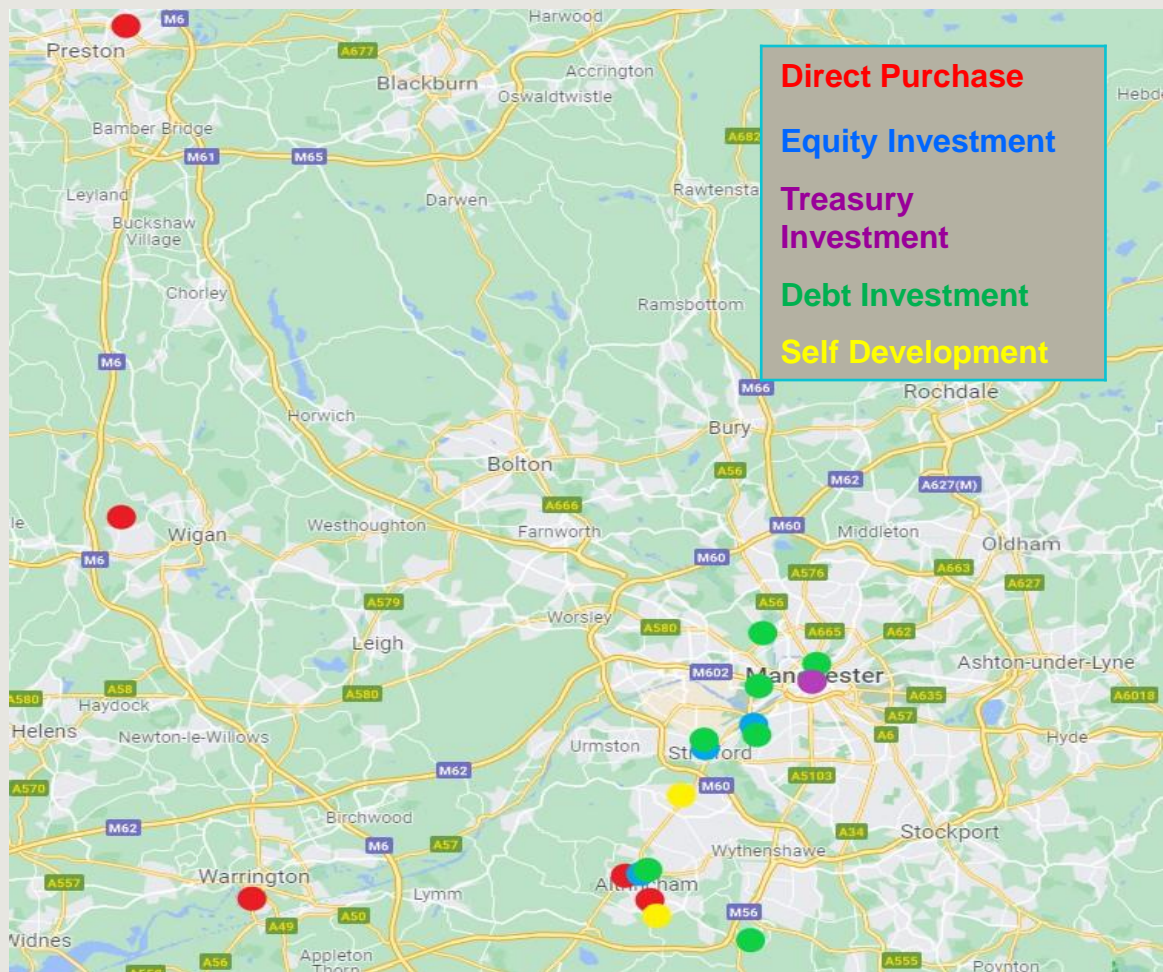
| Investment Type | 2018/19 Income | | 2019/20 Income | | 2020/21 Income | |
|---------------------|----------------|--------------|----------------|--------------|----------------|--------------|
| | Gross £k | Net £k | Gross £k | Net £k | Gross £k | Net £k |
| Direct Purchase | 2,840 | 455 | 4,938 | 345 | 4,948 | 30 |
| Development | 0 | (172) | 0 | (19) | 0 | (66) |
| Debt | 2,389 | 1,386 | 7,887 | 2,623 | 11,216 | 6,864 |
| Equity | 0 | 0 | 570 | (4) | 718 | (821) |
| Treasury | 0 | 0 | 645 | 178 | 661 | 363 |
| Total Income | 5,228 | 1,669 | 14,041 | 3,123 | 17,543 | 6,371 |

Commitments to date

| Asset Investment Fund (1/2) | Expenditure to date £m | Commitment £m | Total £m |
|---|---------------------------|------------------|--------------|
| Total Investment Fund | | | 500 |
| Property Purchase: | | | |
| Sonova House, Warrington | 12.17 | - | 12.17 |
| DSG, Preston | 17.39 | - | 17.39 |
| Grafton Centre incl. Travelodge Hotel, Altrincham | 10.84 | - | 10.84 |
| The Fort, Wigan | 13.93 | - | 13.93 |
| Sainsbury's, Altrincham | 25.59 | - | 25.59 |
| Sub Total | 79.92 | - | 79.92 |
| Property Development: | | | |
| Sale Magistrates Court | 4.8 | - | 4.8 |
| Brown Street, Hale | 6.79 | 2.04 | 8.82 |
| Former sorting office, Lacy Street, Stretford | 0.87 | 0.09 | 0.96 |
| Care Home Purchase | 2.23 | - | 2.23 |
| Various Development Sites | 0.43 | - | 0.43 |
| Sub Total | 15.12 | 2.13 | 17.25 |

| Asset Investment Fund (2/2) | Expenditure to date £m | Repayments £m | Commitment £m | Total £m |
|---------------------------------|---------------------------|------------------|------------------|---------------|
| Equity: | | | | |
| Stretford Mall, Equity | 8.82 | - | - | 8.82 |
| K Site, Stretford Equity | 11.00 | - | 1.25 | 12.25 |
| Stamford Quarter, Equity | 16.69 | - | - | 16.69 |
| Sub Total | 36.51 | - | 1.25 | 37.76 |
| Development Debt: | | | | |
| Bruntwood; K site | 10.9 | - | 1.35 | 12.25 |
| The Crescent, Salford | 44.32 | (44.32) | - | 0 |
| Bruntwood Shopping Centre | 25.57 | - | - | 25.57 |
| CIS Building, Manchester | 60 | - | - | 60 |
| The Hut Group | 62.45 | (62.45) | 67.5 | 67.5 |
| Castle Irwell, Salford | 11.28 | - | 7.72 | 19 |
| Sub Total | 200.16 | (106.77) | 76.57 | 184.32 |
| Total Capital Investment | 331.71 | (106.77) | 79.95 | 319.25 |
| Albert Estate Investment | 17.62 | - | - | 17.62 |
| Total Investment | 349.33 | (106.77) | 79.95 | 336.87 |
| Balance available | | | | 163.13 |

Diversification



Prior Years Performance and Forecast

| | Actuals 2018/19 £'000 | Actuals 2019/20 £'000 | Actuals 2020/21 £'000 | Budget 2021/22 £'000 | Budget 2022/23 £'000 | Budget 2023/24 £'000 |
|---|-----------------------------|-----------------------------|-----------------------------|----------------------------|----------------------------|----------------------------|
| Gross Income | (5,191) | (14,041) | (17,795) | (15,933) | (15,138) | (12,976) |
| Maintenance and Admin Costs | 189 | 225 | 805 | 166 | 167 | 166 |
| External Fees | 810 | 1,654 | 840 | 103 | 103 | 103 |
| Financing Cost - Interest | 1,380 | 3,740 | 5,452 | 4,563 | 4,875 | 3,860 |
| Financing Cost – VRP | 954 | 1,595 | 2,241 | 2,251 | 2,251 | 2,251 |
| Risk Reserve | 189 | 3,704 | 2,085 | 1,244 | 1,225 | 1,879 |
| Net income to support revenue budget | (1,669) | (3,122) | (6,371) | (7,607) * | (6,517) | (4,717) |

| Cumulative to YE 2020/21 | £'000 |
|--------------------------|---------------|
| Risk Reserve | 5,978 |
| VRP | 4,790 |
| Total | 10,768 |

*2021/22 Forecast net income at P4 of £6.6m, a variance of £1m to this target

2021/22 Budget Forecast

- Budgeted to generate a net revenue benefit in 2021/22 of £7.6m. The forecast net income, however, is £1.0m lower, at £6.6m.
- Net income pressures of £4.7m had been identified in year, however, mitigations have been put in place to reduce this deficit by £1.9m. Giving the net position of £6.6m.

| Asset Investment Strategy Period 4 | Budget Variance £000 |
|---------------------------------------|----------------------------|
| Net Income target | (7,607) |
| Pipeline Recycling Target | 2,454 |
| Variable interest rates low | 854 |
| Joint ventures/shopping centres | 950 |
| HUT HQ Facility re-phasing | 632 |
| Castle Irwell earlier draw | (194) |
| Forecast Net Income | (2,914) |
| Reduced reserve contributions | (1,651) |
| HUT Group reserve smoothing | (632) |
| Pipeline Schemes | (1,417) |
| Net Income after mitigations | (6,614) |

Investment Monitoring

| Performance Metric | Frequency | How | Where |
|-------------------------------|------------|-------------------------------|----------------------------------|
| Net Income | Bi-monthly | Budget Monitoring Reports | Executive |
| Capital Expenditure | Bi-monthly | Budget Monitoring Reports | Executive |
| Asset Valuation | Annual | Statement of Accounts | Accounts & Audit Ctte, Executive |
| Local & Prudential Indicators | Bi-annual | Budget Report, Outturn Report | Council, Executive |
| Loan covenants | Quarterly | Loan monitoring - CBRE | IMB – by exception |

Risks and Mitigations

| Risk | Mitigation |
|---|---|
| <ul style="list-style-type: none"> Market /Sector | <ul style="list-style-type: none"> Annual update of Investment Strategy by external advisors to assess the market. Focus on diverse portfolio, low risk assets |
| <ul style="list-style-type: none"> Tenant Risk | <ul style="list-style-type: none"> Annual review of credit risk of tenants using D&B ratings (Risk Reserve to cover void losses) |
| <ul style="list-style-type: none"> Skills | <ul style="list-style-type: none"> Regular updates from external advisors, skills training for internal staff. Plans to introduce further Member training by CIPFA |
| <ul style="list-style-type: none"> Valuation Risk | <ul style="list-style-type: none"> Annual reviews; ensure sufficient headroom on debt investments i.e. Loan to Value covenants |
| <ul style="list-style-type: none"> Security | <ul style="list-style-type: none"> On debt deals ensure first legal charge on all property |
| <ul style="list-style-type: none"> Asset Condition | <ul style="list-style-type: none"> Use of external advisors to assess property condition issues (Risk Reserve created to cover future property related costs) |
| <ul style="list-style-type: none"> COVID-19 | <ul style="list-style-type: none"> Regular reporting and meetings with external advisors. Additional contributions made to Risk Reserve in 2020/21. Impact related to COVID-19 is believed to be short term. |

Risk Reserve

- To mitigate against any losses from unforeseen circumstances and provide for periods of reduced income, the Council sets aside a Risk Reserve on top of the net proceeds it takes to the revenue budget.
- The level of contributions to the reserve from the proceeds of each investment are calculated on an individual risk and requirement assessment made prior to the asset's acquisition.
- The Risk Reserve is currently at £6.0m, which is a level that is believed appropriate for the scale of the portfolio, and so budgeted contributions will instead be used to support the net income target of the strategy.

| Risk Reserve | 2021/22 £000 | 2022/23 £000 | 2023/24 £000 |
|----------------------|-------------------------|-------------------------|-------------------------|
| Reserve B/F | 5,978 | 5,346 | 5,346 |
| Contribution in year | 1,651 | 1,225 | 1,879 |
| Drawdown in year | (1,651) | (1,225) | (1,879) |
| Hut Grp Smoothing | (632) | 0 | 632 |
| Reserve C/F | 5,346 | 5,346 | 5,978 |

Prudential and Local Indicators

| Local Indicators for the Asset Investment Strategy | 2020/21 Actual £m | 2021/22 Estimate £m | 2022/23 Estimate £m | 2023/24 Estimate £m |
|---|-------------------------|---------------------------|---------------------------|---------------------------|
| Gross Commercial Income | 17.79 | 16.73 | 18.83 | 14.57 |
| This is the total estimated level of income to be received from the acquisitions of commercial property and provision of senior debt finance and is required to support new debt costs associated the transactions, with any balance supporting the overall revenue budget. | | | | |
| Net Commercial Income Stream | 6.37 | 7.61 | 6.71 | 4.81 |
| This is the estimated level of income net of any borrowing and other costs to be received from the acquisitions of commercial property and provision of senior debt finance. | | | | |
| External Interest Cost | 4.81 | 5.65 | 6.38 | 5.36 |
| This is the interest cost of the new debt required to cover the capital cost of the new commercial activity. | | | | |
| Minimum Revenue Provision (2.0% = 50 years) | 2.24 | 2.25 | 2.25 | 2.25 |
| This is the amount of income set aside as a provision for the repayment of the debt, required to cover the capital cost of the new commercial activity. | | | | |
| Risk Reserve | 2.08 | 0.96 | 1.23 | 1.87 |
| This is the amount of income set aside to reserve as contingency in the event of a reduction in commercial income levels. | | | | |
| Cumulative Investment Reserve | 5.98 | 6.39 | 7.62 | 9.50 |
| This is the cumulative amount of reserve set aside, after annual contributions and deductions, as contingency in the event of a reduction in commercial income levels. | | | | |
| Gross Commercial Income as proportion of Net Budget | 10.14% | 9.33% | 8.60% | 7.17% |
| This illustrates the proportion of the net budget which is supported by the new commercial income streams. | | | | |



TRAFFORD
COUNCIL

Discussion and Feedback
