ASSET INVESTMENT STRATEGY

Prepared by CBRE Investment Advisory for
Trafford Borough Council

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This investment strategy has been prepared by CBRE Investment Advisory, part of CBRE Limited.

EXECUTIVE SUMMARY

INTRODUCTION

CBRE Investment Advisory has updated the Investment Strategy for Trafford Borough Council ("Trafford" or the "Council"), originally drafted in September 2017, to better align with Council's strategic priorities and values, protect against near-term market uncertainty and incorporate recent guidance on Local Authority finances.

We understand that the Council needs to make investments that promote their overarching goals while creating sustainable income to fund local services. It intends to do this by borrowing from the PWLB and investing in real estate and infrastructure projects, primarily via a development lending strategy, and occasionally equity.

INVESTMENT OBJECTIVE

The Council's revised primary Investment Strategy objective is:

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

In order to meet this objective, the following actions will be taken:

- To promote TBC's Strategic Priorities:
  - 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.
  - A wider list of 21 "Preferred Development Attributes" has been created that will be prioritised in transaction selection and incentivised through the investment structures
- Create a suitable income stream to support local services:
  - Making investments at a risk and return level appropriate for the Local Authority has always been a key element of the Investment Strategy.
  - The same processes and sign off requirements that have been created and enhanced over the past 3 years will remain in place.

FURTHER UPDATES

Additionally, the following updates will be incorporated:

- The investment zones have been updated to favour in-borough investment.
- Minimum returns updated related to the Council's cost of funds.
- Including infrastructure projects in the type of project which can be funded by lending (predominantly low carbon and renewable energy generation).
- Temporary reduction in leverage levels of development debt investments until uncertainty around COVID-19 has passed.
- Incorporating the latest government consultation on local authority finance and CIPFA guidance into the strategy (already being implemented in practice).
- Narrowing of real estate direct investment criteria (already being implemented in practice).

The order of geographic preference for investment is:

1. Trafford Borough Council;
2. Trafford Borough Council Economic Area (Neighbouring Council's and Greater Manchester).

INVESTMENT STRATEGY

In the near-term, the focus of the investment strategy will be on real estate and infrastructure development lending, which is able to meet the above investment objectives while providing good returns to the council and protection against changes in market values.

Direct investment into strategic assets in-borough, such as those which allow the Council to regain control of strategic sites or where the Council can buy in the long leasehold on Council owned freehold sites, will also be considered.

INVESTMENT TYPE

Direct Investment

In line with the new objectives, investment into direct real estate would occur in two scenarios:

1. To buy a site in Borough to develop (either themselves or with a development partner) to repurpose or regenerate the asset and surrounding area.

2. Purchase strategic property that will assist land assembly in Borough or provide additional value due to marriage value / other strategic value enhancements.

It is noted that purchasing real estate exclusively for income is no longer within the Investment Strategy.

Development Lending

Financing developments and infrastructure projects that can generate and accelerate regeneration and development through the provision of local flexible finance. This investment product provides good risk-adjusted returns and helps to fulfil development and regeneration objectives along the criteria set out previously.

For development lending, high quality schemes and developers with a strong track record will be targeted. The level of experience for the developer may be lower if a project is in Borough.

We will focus on senior lending, set appropriate covenants on all loans to ensure the Council has sufficient headroom, and target a minimum a minimum interest rate of 2.50% + the Councils Cost of Funds.

These facilities will typically be for a period of up to 3 years, though there is flexibility in this for the right opportunities.

Flexibility

The investment tactics will be reviewed and adjusted in line with market conditions.

INVESTMENT OBJECTIVES

Trafford Borough Council ("TBC" or the "Council") enlisted the services of CBRE Investment Advisory (CBRE) in July 2017 as its retained strategic real estate Investment Advisor.

PREVIOUS OBJECTIVES

Before advising on any investment strategy it is imperative that objectives are clearly defined so that, where possible, performance can be benchmarked and measured.

Previously, the primary objective has been to "Generate a sustainable income to support the Local Authority's wider service delivery".

The secondary objective was (so long as the primary objective was satisfied) 'if an investment could also generate a secondary economic or social benefit, then this was considered a desirable quality by the Council. Importantly, if too much emphasis is placed on these secondary objectives the Council will not be able to achieve its primary objective.'

This Investment Strategy has successfully created a suitable income stream for the Council. The Council now has experience and good processes in place to carry out these types of investments.

UPDATED OBJECTIVE

To promote TBC's strategic priorities while creating a suitable income stream to support local services.

RATIONAL FOR UPDATED OBJECTIVE

The Council now wishes to take a more holistic approach to its investments and ensure that the Investment Strategy aligns with the Council's wider social, economic and environmental objectives.

This can be done through:

- Using development lending to bring forward projects that compliment these objectives.
- Structuring lending transactions to incentivise borrowers to work towards objectives.
- Investing directly into regeneration projects that give the council more control over their outputs.

The following shall not be included in the Investment Strategy:

- High risk investments with a substantial possibility of loss; or

- The inclusion of grant, subsidy or sub-market pricing into the Investment Strategy.

The Investment Strategy shall continue to aim to supply a suitable net income for the Council to support services.

TBC's STRATEGIC PRIORITIES

DEFINING RELEVANT PRIORITIES

To define of the relevant Strategic Priorities and related goals for the Investment Strategy, we have had regard to:

- Trafford Borough Corporate Plan
- Greater Manchester Social Value Policy
- Town Centre Frameworks

These documents contain the following main themes:

Policy Document	Themes
Trafford Borough Council Corporate Plan – 7 Strategic Priorities	▪ Building Quality Affordable & Social Housing ▪ Health and Well-being ▪ Successful and thriving communities ▪ Children and Young People ▪ Pride in the area ▪ Green and Connected ▪ Targeted Support
Greater Manchester Social Value Policy	▪ Employment and economic sustainability ▪ Raise living standards of residents ▪ Citizen Engagement ▪ Build voluntary/community sector ▪ Promote equality and fairness ▪ Promote environmental sustainability
Town Centre Framework – Future priorities (N.B. this applies to Trafford Town Centres specifically, but we would seek to broaden this to the locations of investment)	▪ Heritage ▪ Physical Condition of Buildings ▪ Public Realm ▪ Transport and Access ▪ Car Parking ▪ Disabled Access ▪ Leisure ▪ Offices/Commercial ▪ Housing ▪ Markets

STRATEGIC PRIORITIES FOR INVESTMENT STRATEGY

From the Strategic Priorities, we have identified the following five priorities which include applicable outputs for real estate or infrastructure projects:

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

The remaining Strategic Priorities will be supported by the income created for services by the Investment Strategy.

CBRE

PREFERRED DEVELOPMENT ATTRIBUTES

CBRE has created a list of 21 "Preferred Development Attributes" that could be delivered by real estate or infrastructure developments and that fit well with the Council's goals.

These have been categorised by their alignment with the 5 Strategic Priorities identified. An additional category has been included, "Promotion of Fairness".

Criteria	Preferred Project Attributes
Building Quality, Affordable & Social Housing	1. Quality homes built 2. Affordable housing
Health and Wellbeing	3. Health and well-being uses or attributes 4. Development designed for end user experience
Successful and Thriving Communities	5. Job creation 6. Key development for the area 7. Local sub-contractors employed 8. Forms part of a regeneration plan 9. Community uses included
Pride in the area	10. Public space created 11. Attractive design 12. Brownfield land developed, or a building with architectural or historical importance retained within the development
Green and Connected	13. Energy efficient design 14. Environmental impact assessed 15. Cycle / public transport promoted by project 16. Low carbon and renewable energy generation part of project 17. Energy storage part of project
Promotion of Fairness	18. Affordable commercial space included in development 19. Developer applies fair tax to their investment structure 20. Developer applies best practice supply chain policies 21. Developer has apprentices on their construction site

INVESTMENT STRATEGY

INVESTMENT CHARACTERISTICS

To date, Trafford have invested both directly in real estate via equity and indirectly into developments via debt. These strategies were originally intended to complement each other in providing consistent income, as development lending provided higher returning shorter term income, which was underpinned by direct investment which provided more secure longer-term income.

Given the new objective includes the promotion of other goals, largely by regeneration, the investment characteristics have been re-aligned.

Development lending currently appears to provide a better route to meeting the Investment Strategy's primary objective and shall be the focus of the Investment Strategy in the near-term.

However, direct investment into real estate, especially within Trafford's existing portfolio, should remain an option where that better serves the primary objective.

Development Lending

Financing developments can help to bring about or accelerate development through the provision of localised finance that is more flexible that other mainstream Lenders. This investment product provides good risk-adjusted returns and helps to fulfil development and regeneration along the criteria set out previously.

Direct Investment (Equity)

The Council also has an opportunity to invest in direct property. It has been established that, in line with the new objectives, this would occur in two scenarios:

1. To buy a site in Borough to develop (either themselves or with a development partner) to repurpose or regenerate the asset and surrounding area.
2. Purchase strategic property that will assist land assembly in Borough or provide additional value due to marriage value or other strategic value enhancements.

Strengths and Weaknesses

	Direct Investment (Equity)	Development (Debt)
Wider Advantages	Ownership of physical asset Ability to add value to investment (capital growth/improvement) Regeneration and Development Alternative uses for building/site Supporting local occupiers Can influence ESG agenda more directly	Typically, higher income return than direct investment. Helps to accelerate regeneration No MRP requirement LTV/LTC provides risk cover Downstream benefits from funding new development Current market opportunity Costs borne by borrower
Wider Disadvantages	Requirement to focus on regeneration assets increases risk levels Impact of MRP on returns Development can be lengthy and may need to bring in third parties (eg. Development Partners) Prime assets have low yields Susceptible to the full effect of negative market movement (capital falls)	Irregular returns (typically repaid at expiry of facility) Short investment period (1-3 years) Need to constantly recycle investments to generate a return Increasing competition in the sector has pressure on margins

Cost / Benefit analysis

As the Council intends to borrow from PWLB and other sources, the below table shows the cost of capital applicable to direct and debt investment.

The cost of funds applied to an investment will be updated based on the funding strategy applied for each investment.

	Direct Investment	Development Debt
PWLB Rate*	2.60% pa. (50 year)	1.92% pa. (3 year)
MRP	2.00% pa. (50 year)	0.00% pa.
Admin	0.20% pa.	0.20% pa.

Total	**4.80% pa.**	**2.12% pa.**

**PWLB Rates effective 29.09.2020 (Maturity)*

MEETING THE PRIMARY OBJECTIVE

The primary objective will be met in practice through the following approach to transactions selection and structuring.

Strategic Priorities

Each investment will evidence that it supports one or more of the 5 Strategic Priorities of the Council identified as being relevant to real estate or infrastructure.

Preferred Attributes

Investments in projects that include some of the Preferred Development Attributes identified above will be prioritised.

Investments will be structured to attempt to incentivise Borrowers to include items from the 21 Preferred Development Attributes where possible.

This may be via the inclusion of pricing reductions or favourable terms for achieving certain related goals, so long as the incentives are not considered to be below market pricing.

Sector Preferences

In terms of sector preferences, as the wider Council strategy seeks to provide homes, employment space and town centre regeneration, the Investment Strategy is not limited to specific real estate asset sectors.

Each opportunity will continue to be assessed on a case-by-case basis and the individual characteristics of the opportunity will be considered, alongside the wider sector features, strengths and weaknesses.

Also considered will be overall portfolio diversification to mitigate concentration in any one sector.

Infrastructure Investments

In addition to traditional real estate sectors, lending to support the development of infrastructure will be considered as a potential investment type. This will predominantly be the funding of low carbon or renewable energy generation, such as solar, wind or biomass projects. The same leverage and return criteria will apply as other development lending investments, and the investments will strictly require the following attributes:

- Developer / development manager with high levels of experience in the sector.

- Proven technology.
- High certainty over future income streams.
- Experienced third-party due diligence.

GEOGRAPHICAL CONSIDERATIONS

INVESTMENT ZONES

There is a preference to invest locally in order for local constituents to benefit from the development and regeneration brought about by the Council's Investment Strategy.

The order of preference for investment is:

1. Trafford Borough Council area
2. Trafford Borough Council Economic Area (Neighbouring Council's and Greater Manchester)

Prioritising In-Borough Investment

In order to prioritise investment within borough, the following will be introduced:

- A 0.50% reduction in the return requirement for investing in-Borough.
- Waiving the temporary leverage reductions (detailed later) if required.

This will ensure that the Council has more opportunity to invest within Borough.

In practice, it is likely that all new direct investments will be in-Borough investments as these will involve the Council bringing forward development directly or using their current in-Borough landownership to create value enhancement opportunities.

Trafford Borough Council Economic Area

Investment out of Borough but in this region will remain an important part of the strategy to avoid concentration of investment within too limited a geographical area.

INVESTMENT CRITERIA

The below section outlines the investment criteria that should be met for each transaction, in addition to those already outlined in the Investment Strategy.

MINIMUM RETURN

Every transaction as a minimum shall hit the following return requirement. While the minimum return must be met, transactions will be assessed primarily on how appropriate the return is for the risk involved and market pricing.

Most transactions will be expected to significantly exceed this return requirement. However, lower risk transactions that provide this return should be considered where appropriate.

For direct investments, this shall apply to the IRR of the investment over an agreed timeframe.

For Lending investments, this shall apply to the “All-In Coupon” charged on the Facility:

- 2.50% + the “Cost of Funds” to the Council for that investment.

LENDING INVESTMENTS

Lending Investment Transactions will have the following attributes (in addition to those reference in the “Investment Strategy” section):

- Lending facilities to provide a maximum of 80% of the total project cost and 70% of projected end value of the development.
- As noted above, the all-in coupon of a transaction will need to meet the minimum return, in addition to being at a market rate for the risk involved.
- We will seek to enhance the Council’s returns, through a combination of other fees on the facility (including arrangement fees, exit fees, commitment fees and cancelation fees).
- Short and medium term opportunities considered. No one phase to exceed three years, but can have multiple phases in one development, such as development phase followed by stabilisation phase. The Council would consider short term (eg. 6 month) opportunities if they presented themselves and fit the wider objectives.
- All loans will be senior facilities, with a fixed first charge over the freehold interest. Other lenders may make up the capital stack, but only as joint lender or more in a more junior position to the Council.

- Quality residential, commercial and infrastructure schemes (see "Sector" above) will be targeted within the Borough, neighbouring Boroughs or Greater Manchester.
- We will look to support schemes where the developer has a good track record and where the property provides appropriate security for the loan.
- Transaction sized of £20m to £50m will be targeted. A minimum commitment of £10m will be set per facility, to ensure they are additive to the Council's investment portfolio.

Updated leverage levels for COVID-19

- Economic uncertainty is currently higher than usual because of the Covid-19 pandemic.
- It is suggested that Trafford Borough Council temporarily reduce leverage levels on new transactions by 5%. This would make the temporary maximum LTV Ratio 65% and a maximum LTC Ratio of 75%.
- This shall be reviewed on a regular basis as the situation develops.

DIRECT INVESTMENT

Equity investment will now take place under two main circumstances, either through Council investment in a development, or to allow for strategic land purchase.

This could include:

- Forward Fund a development: This opportunity will arise from a Developer seeking capital investment into a project. The usual structure involves the investor purchasing the land, committing to piecemeal payments throughout the development with a final balancing payment upon practical completion. The key benefit to the Council would be that all of the Development expertise are placed in the third-party Developer, so no internal upskill is required. Furthermore, there is a prescribed fixed price payment plan as determined by a Development Agreement, so the costs are known from the outset.
- Joint Venture: A Joint Venture could occur between the Council and one or more other parties. There is no single formula for a joint venture as each party can bring different attributes to the relationship. In borough, it is possible that the Council would contribute land and/or costs, and the JV Partner would provide development expertise. Both parties would share in the upside and risks of the development.

- Alternatively, the Council could choose to purchase land and develop themselves. This would involve in house expertise and, depending on the skill base of the Council at present, could require some upskill and/or external hires.
- The Council could also choose to purchase land, work up planning and sell to a developer once planning is achieved, thus unlocking the land and accelerating the development.

If the Council seeks to invest in real estate for strategic purposes, the investment criteria will depend on the reason for investment or strategy. For example:

- If the Council seeks to purchase an income producing property to take control of a piece of freehold land which might be a key site in future years, the Council will have regard to the investment characteristics of the property, the potential competition from other investors, and the Council's cost of capital. All of which must be analysed to submit a competitive bid.
- If the Council wish to buy in the long leasehold of a site where the Council already own the freehold in order to take control of a certain site, the Council will have regard to the price which other investors would be willing to pay for the long leasehold interest, the potential marriage value creation, and any other investment characteristics applicable to the property.

LOCAL AUTHORITY FINANCE GUIDANCE

GUIDANCE SINCE THE LAST UPDATE

As and when guidance on Local Authority Finance has been introduced it has been incorporated into investments made by the Council.

Below are the proposed requirements from the latest consultation and guidance documents. These will be officially included in the Investment Strategy, although they have already been adhered to in practice.

Policy Document	Proposed Requirements
Chartered Institute of Public Finance & Accountancy (CIPFA) guidance November 2019	▪ Not to borrow purely to profit ▪ Consider if the fair value could drop below Borrowing level ▪ Ensure margin reflects risk ▪ Ensure the investment is affordable / prudent
PWLB Consultation March 2020	▪ Borrowing should qualify as one of the following: 1. Service spending 2. Housing 3. Regeneration 4. Refinance ▪ Investment in the asset must be beyond the purchase price