Appendix 5

Asset Investment Strategy

TRAFFORD COUNCIL

December 2021

Contents

Executive Summary

Introduction

CBRE Investment Advisory has updated the Investment Strategy for Trafford Borough Council (“Trafford” or the “Council”), originally drafted in September 2017 and last updated in October 2020.

Each update is intended to better align the Investment Strategy with Council’s current 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 a 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.

The Current Strategy

The strategy was last updated in October 2020 at which point there were significant updates to the Investment Strategy. The below updates were incorporated, and a comment is made where they are retained or amended.

Investment Objective

“To promote TBC’s Strategic Priorities while creating a suitable income stream to support local services.”

> The investment objective is to be retained.

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

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.

> The Council has renewed corporate priorities. The strategy has been updated to incorporate these.

A wider list of 21 “Preferred Development Attributes” has been created that will be prioritised in transaction selection and incentivised through the investment structures

> The development attributes will be retained as they remain relevant to the updated Strategic Priorities.

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.

> These are to be retained.

Further Updates

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).

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 (which had already being implemented in practice).

The order of geographic preference for investment is firstly Trafford Borough Council, and secondly Trafford Borough Council's Economic Area (Neighbouring Council's and Greater Manchester).

COVID-19 Temporary Measures – Reduction of leverage from 80% LTC and 70% LTV to 75% and 65% respectively. Can be waived for in-borough transactions.

> These are to be retained.

Investment Approach

Near-term focus 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 likely to take form of strategic assets in-borough.

> These are to be retained.

Additions to the Strategy in 2021

In addition to the above we propose that the following additions are made to the Investment Strategy. These are outlined in more detail in the main body of the paper.

Reducing the Minimum Transaction Size for in Borough investments

Currently the minimum transaction size is £10.0m. The new minimum is to be £5.0m for in-borough investments.

Inclusion of Social Investments

Targeting a £40.0m allocation towards social investments to help the Council to achieve its wider objectives.

Greater Manchester Low Carbon Match Funding

Ability for the Council to club with the Greater Manchester Low Carbon Fund to provide match funding to support projects focusing on the generation and distribution of low carbon energy in Greater Manchester.

Investment Objective

The Council will retain the existing investment Objective:

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

Rationale

The Council has for some time sought a holistic approach to its investments, to 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.
– Creating an allocation within the fund aimed at deployment against social investments.
– 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.

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

The definition of strategic priorities, as outlined in the Investment Objective, is defined in the next section.

Strategic Priorities for Investment Strategy

Trafford Borough Council have adopted revised corporate priorities, due to extend from 2021 - 2024 These are defined by three Council Outcomes, and three Council Priorities that are intended to help meet the Council Outcomes. Together these six metrics make the 'Strategic Priorities' for this Asset Investment Strategy.

Council Outcomes

- All our residents will have access to quality learning, training and jobs.
- All our communities will be happy, healthy and safe.
- All our businesses and town centers will be supported to recover and flourish in an inclusive way.

Council Priorities

- Reducing health inequalities
- Supporting people out of poverty
- Addressing our climate crisis

Strategic Priorities

Each investment will evidence that it supports one or more of the Strategic Priorities, being either directly affecting the three outcomes or priorities of the Council.

Preferred Attributes

CBRE created 21 Development Attributes to align with the previous investment strategy. The development attributes remain relevant to the current strategy and Strategic Priorities.

Investments in projects that include some of the Preferred Development Attributes identified 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.

The way in which the Council Outcomes, Priorities and Development Attributes align are set out below:

Trafford Outcomes	All our residents will have access to quality learning, training and jobs	All our communities will be happy, healthy and safe	All our businesses and town centers will be supported to recover and flourish in an inclusive way
Trafford Priorities	Reducing Health Inequalities	Supporting People out of Poverty	Addressing our Climate Crisis
Development Attributes	1. Quality homes built 2. Affordable housing 3. Health and well-being uses or attributes 4. Development designed for end user experience 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	10. Public space created 11. Attractive design 12. Brownfield land developed, or a building with architectural or historical importance retained within the development 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	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 Characteristics

The below section outlines the investment characteristics and criteria that should be met for each transaction, in addition to those already outlined in meeting the objective.

Routes to Investment

Historically 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.

The revised objective includes the promotion of other goals, largely by regeneration. Therefore, the investment characteristics emphasise development lending as a more logical route to meeting the Investment Strategy's primary objective and shall be the focus of the Investment Strategy in the near-term.

Direct investment into real estate, especially within Trafford's existing portfolio, remains 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.

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.

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) – Time and cost around managing and maintain the physical real estate.	– 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	1.57% pa. (50 year)	1.58% pa. (3 year)
MRP	2.00% pa. (50 year)	0.00% pa.*

Admin	0.20% pa.	0.20% pa.
Total	3.77% pa.	1.78% pa.

*The Government is currently undertaking a consultation on MRP requirements and its use against debt products. The consultation is due to conclude in February 2022; any relevant outcomes will be updated in the investment strategy.

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 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 per facility, to ensure they are additive to the Council's investment portfolio.
– We will reduce the minimum size of investment to £5.0m for in-borough investments to allow the Council to support appropriate local projects.

Updated leverage levels for COVID-19

– Within the 2020 strategy, temporary leverage levels were implemented in recognition of the economic uncertainty being higher than usual because of the Covid-19 pandemic.
– It was 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%.
– These temporary leverage levels are regularly reviewed. At present they are still considered to be appropriate and are therefore retained.

Direct Investments

Equity investment will 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.

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.

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 with certain build costs.
– High certainty over future income streams.
– Experienced third-party due diligence.

Social Investments

New to the investment strategy in 2021 is the inclusion of a social investment strategy. This has been developed in recognition that the Council has wider social objectives that real asset investment has not traditionally targeted, but where opportunities do exist. This is particularly relevant for an investor such as the Council who has a strong local presence and local strategic partnerships.

The social investment strategy will:

– Target commercial returns, but with a minimum of 2.00% + PWLB (a 50 basis point reduction to the overarching target returns listed above).
– Target an allocation of £40.00m towards social investments.

Examples of social investments could include (though are not limited to):

– Provision of long term high leverage (up to 10 years and 100% LTC) to established local charities with a particular housing need. The Council would sweep housing benefit receivable by the charity throughout the loan term to service the loan.
– Investment into local 'meantime' housing projects which aim to establish housing on temporarily underutilised sites, such as large development sites awaiting master planning, or disused car parks etc.

Geographic 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 Councils and Greater Manchester)

Prioritising In-Borough Investment

In order to prioritise investment within borough, the following measures were introduced and will be retained:

– 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.

Greater Manchester Low Carbon Fund - Strategic Partnership

The Greater Manchester Low Carbon Fund is an ERDF funded investment strategy focussed on supporting low carbon projects. The fund has a £15.00m allocation to be invested within Greater Manchester against Investment Priority Axis 4a- promoting the production and distribution of energy derived from renewable sources.

The fund is constrained by the need to be match funded, and can therefore provide up to a maximum level of 50% LTC of eligible project costs.

The Council will have the opportunity to support the fund on projects deemed equally appropriate for the Council by providing match funding to increase the overall leverage that can be offered.

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.

The only update since the last Investment Strategy is that PWLB guidance which has moved from consultation to publication, though the themes remain the same.

Chartered Institute of Public Finance & Accountancy (CIPFA) Guidance, Consultation 2021

This guidance has not been officially updated since the publication date, though there are amendments currently under consultation. The consultation period ended on 16th November 2021, but the report is yet to be published.

Original drafting requirements:

- 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.

Relevant updates under the consultation:

- Objective is that investments are affordable and proportionate, all borrowing is prudent and within sustainable levels and the risks associated with commercial investments are proportionate to their financial capacity.
- Local authorities must not borrow to invest primarily for financial return.
- The risks associated with investments for commercial purpose are proportionate to their financial capacity.

PWLB Guidance – Published in November and revised August 2021

Borrowing is permitted under the following definitions and categories:

- Service delivery
- Housing
- Regeneration
- Preventative Action
- Treasury Management

Investments primarily for yield are not supported.

Thank you

For more information

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