Asset Investment Strategy

TRAFFORD
COUNCIL

January 2023

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 July 2022.

Recent updates:

- 2021 update better aligned the Investment Strategy with Council's current strategic priorities and values, protected against near-term market uncertainty and incorporated guidance on Local Authority finances.
- A further update was incorporated in 2022 to provide some flexibility to the strategy in instances where a potential transaction deviated from the parameters set out in the Investment Strategy, but where wider transaction characteristics help mitigate any potential risk associated with this. The intention was to allow the Council to engage in such transactions that meet the overall purpose and intention of the strategy.

There are no further strategy changes currently proposed for the strategy, which is currently operating successfully, with a strong portfolio of income producing investments and a healthy pipeline.

This document confirms the previous strategy and consolidates the 2022 changes into a coherent document.

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, refurbishment or pre-construction lending to bring forward projects that compliment these objectives.
- Structuring lending transactions to incentivise borrowers to work towards objectives.
- An allocation within the fund aimed at deployment against social investments.
- Investing directly into regeneration projects or strategy real estate assets that give the council more control over their outputs.

The following shall not be included in the Investment Strategy:

- Investment Lending;
- High risk investments with a substantial possibility of loss; or
- The inclusion of grant, subsidy or sub-market pricing.

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 corporate priorities from 2021 - 2024 These are defined by three Council Outcomes, and three Council Priorities. 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 has created 21 Development Attributes to align with the 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 minimum or 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	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	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

	7. Local sub-contractors employed 8. Forms part of a regeneration plan 9. Community uses included	15. Cycle / public transport promoted by project 16. Low carbon and renewable energy generation part of project 17. Energy storage part of project

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

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's investment has sufficient headroom to protect against potential losses in the future.

Direct Investment (Equity)

The Council also has an opportunity to invest in direct property. It has been established that, in line with the 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.

Pricing, Sector and Geography

Minimum Return

2.50% + the "Cost of Funds" to the Council for that investment.

Every transaction as a minimum shall hit the 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 exceed this return requirement. However, lower risk transactions that provide this return should be considered where appropriate.

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

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

Sector Preferences

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.

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 are in place:

- A 0.50% reduction in the return requirement for investing in-Borough.
- Waiving the temporary leverage reductions if required (see Lending Investments – Specific Guidelines below).

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.

Lending Investments – Specific Guidelines

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 or equivalent. Other lenders may make up the capital stack, but only as joint lender in a more junior position to the Council, or a co-lender.
- 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.

Temporary Restrictions of Leverage Levels

During this period of economic uncertainty, leverage levels on new transactions are reduced 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.

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. This could also include the addition to exiting assets of on-site renewable or retrofitting, along with a loan against the property.

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 Lending Investments

Investing in "Social" investments will be considered as well. The structure of these will be developed in 2023 by CBRE in consultation with local community groups, charities and innovators in these sectors. It is expected that these debt investments will be used in order to give community groups and charities a route to real estate acquisition, although the structure of this is to be confirmed.

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.
- Where considered appropriate, exceed the leverage maximums for Lending 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.
- Providing development funding to a community centre project.
- 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

Direct Investments – Specific Guidelines

Equity investment will take place under two main circumstances, both anticipated to be in-Borough:

- Council investment in a development, or
- To allow for strategic land purchase.

Investment styles:

- **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 or other expertise. Both parties would share in the upside and risks of the development.
- **Direct Investment:** the Council could choose to purchase land and develop themselves, or purchase land, work up planning and sell to a developer once planning is achieved, thus unlocking the land and accelerating the development.
- **Forward Funding 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. Furthermore, there is a prescribed fixed price payment plan as determined by a Development Agreement, so the costs are known from the outset.

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 (but not limited to):

- 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.

Investment Strategy Flexibility

The Investment Strategy includes parameters that help guide and inform the nature of Trafford's investments. These parameters include (though are not limited to) risk indicators such as leverage, return hurdles, ESG requirements, geographical constraints etc.

There is, however, an acknowledgement that every transaction is different, and there maybe instances where transactions have characteristics which sit outside of the aforementioned parameters, but which also possess other qualities which, when viewed on balance, help mitigate this non-compliance with the strategy. In these instances, the Investment Strategy should provide some flexibility to assess the transaction holistically and across all of its characteristics, and support those which are deemed to meet the aims and objectives of the Investment Strategy and at no extra risk (as advised by CBRE). This should also be analysed on a portfolio level against the Council's existing investments.

By way of an example of such instances:

- Allowing for an increase in leverage in instances where there is a forward purchase agreement in place to purchase the whole, or part, of the property at practical completion, thus reducing market and exit risk. This will be subject to the following conditions, which ensure that (a) market risk, (b) exit risk and (c) cost risk are all sufficiently mitigated:
    - The third party has a strong financial covenant which can be expected to remain strong through the term of the development;
    - The purchase price is unconditional other than on completing the development to a certain specification (i.e. not linked to lettings achieved, market values etc.);
    - There is at least 12 months headroom between the project monitors projected PC date and the longstop date of the forward purchase;
    - There is a strong contractor in place with a fixed price design and build contract to complete the scheme, matching the specification of the forward purchase;
    - The headroom between purchase price and the total loan facility represents a minimum of 15% of the fixed price build contract of the scheme.
- Allowing for lower financial return requirements where the transaction would deliver other, wider returns to the Council (be it economic development, social or environmental), such as necessary regeneration, delivery of services for residents, excellent (above market) environmental credentials etc.
- Allowing for investments that are located marginally outside of the geographic zones, but where it can be proven it is within the economic area of the Council (and Council residents) and will drive benefits to both.

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 the Council's Investment Strategy. The latest requirements from consultations and guidance documents are found below.

Chartered Institute of Public Finance & Accountancy (CIPFA) Prudential Code for Capital Finance, 2021

The Prudential Code was developed by CIPFA as a professional code of practice to support local authorities in the development and delivery of their programmes of capital investment. Local authorities are required by legislation to have regard to the Prudential Code when carrying out their duties.

The requirements of the Code have been reviewed and compliance has been ensured in the production of this strategy.

Relevant Code requirements, inclusive of those added in an update to the Code in December 2021:

- 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
- It is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority.
- Authorities with existing commercial investments (including property) are not required by the Code to sell these investments, however, authorities that have an expected need to borrow should review options for exiting financial investments (non-property commercial investments)

PWLB Guidance –Revised in May 2022

Borrowing from the PWLB by authorities is permitted under the following definitions and categories:

- **Service delivery** - expenditure on assets that form part of the authority's public service delivery
- **Housing** - includes all spending on delivering new homes, maintaining or improving existing homes, and purchasing built homes to deliver housing services
- **Regeneration** - direct investments in assets to generate additional social or economic benefits.
- **Preventative action** - a special category which involves direct financial support to local companies or acquiring assets as a way to protect jobs, prevent social or economic decline
- **Treasury Management** - includes the refinancing or extending of existing debt from any source, the externalisation of internal borrowing or borrowing to manage cashflow within year

Borrowing for the purpose of investing primarily for yield is not supported, and would disqualify the authority from borrowing from the PWLB during the same three year capital cycle, including for the purpose of unrelated expenditure such as service delivery.

Thank you

For more information

Andrew Antoniades
Executive Director, Head of Lending - Investment Advisory
07860 784 422
andrew.antoniades@cbre.com

Will Church
Executive Director - Investment Advisory
07832 368319
will.church@cbre.com

Henry Randolph
Senior Director - Investment Advisory
07511 65 66 37
henry.randolph@cbre.com

Shervann Miller-Ferdinand
Associate Director - Investment Advisory
07500 071 294
Shervann.millerferdinand@cbre.com