Investment Strategy

~~November 2019~~ December 2021

1. Introduction

The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code, the CIPFA Treasury Management Code of Practice (the Code) and Investment Guidance (the Guidance) issued by The Ministry of Housing Communities and Local Government (MHCLG) to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

In February 2018 the Secretary of State issued new guidance on Local Government Investments (the Guidance), which widened the definition of an investment to include all the financial assets of a local authority as well as other non-financial assets held primarily or partially to generate a profit. This wider definition includes investment property portfolios as well as loans made to wholly owned companies or associates, joint ventures or third parties. The Guidance applies for financial years commencing on or after 1 April 2018.

The Guidance requires the Investment Strategy to be approved by Full Council on an annual basis and sets out the disclosure and reporting requirements. Any mid-year material changes to the Strategy will also need to be subject to Full Council approval.

Due regard has also been given to the prevailing rules in relation to local authority borrowing from the Public Works Loan Board (PWLB) and, in particular, the impact of borrowing for the acquisition of commercial assets on the Council's wider borrowing requirements. Due regard has been given to the guidance published by HM Treasury on 25 November 2020 and, accordingly, the Council does not intend to buy commercial assets primarily for yield (even by using available reserves).

The Investment Strategy focusses on the following categories of investments:

- Investment to support local public services by lending to or buying shares in other organisations (known as **Service Investments**), and

- Investment to generate economic growth through providing facilities and infrastructure that will enable business start-up and growth, create employment opportunities and strengthen the local economy, including the management of the Council's commercial property estate (known as **Commercial Investments**).

The Council has set out within this Strategy its approach to risk and risk mitigation, including the requirement for fully tested and scrutinised business cases, sound due diligence indicators and the need for regular and formal reporting and the effective scrutiny of investment decisions and performance.

2. The Investment Strategy

2.1 South Cambridgeshire is located centrally in the East of England region at the junction of the M11/A14 roads and with direct rail access to London and to Stansted Airport. It is a largely rural district which surrounds the city of Cambridge and comprises over 100 villages and 1 town, none currently larger than 8,000 persons. It is surrounded by a ring of market towns just beyond its borders, which are generally 10–15 miles from Cambridge. Together, Cambridge, South Cambridgeshire and the Market Towns form the Cambridge Sub-Region. South Cambridgeshire has long been a fast growing district and in 2011 had a population of 146,800 persons (bigger than Cambridge itself) and has become home to many of the clusters of high technology research and development in the Cambridge Sub-Region.

2.2 The Council ~~recognises that it faces a unique set of challenges to deliver~~ is committed to support local public services, generate economic growth and ensure responsible investment. This commitment includes:

(a) Investment which can generate regeneration or economic development benefits as well as positive financial returns for the Council, including the services and infrastructure required to support the new communities on the strategic growth sites within the Greater Cambridge area, where the District will see the majority of the 22,000 jobs and 19,500 homes to be delivered between 2011 to 2031. ~~To meet this challenge, against further funding uncertainty from central government to deliver essential services, the Council has recognised the need to make investments to ensure it has the capacity to continue to grow and deliver essential services.~~ This category of investment includes the development of Investment Partnerships. Financial return is also a key objective (i.e. not subsidised provision) to generate a financial payback from investments and acquisitions.

(b) Investment to support local public services, including the wholly owned housing development company, South Cambs Ltd (Trading as Ermine Street Housing) in line with an approved Business Plan.

(c) Full compliance with the Responsible Investment Policy, reproduced at **Appendix 1**, that aims to ensure that environmental, social and governance factors are incorporated into investment decisions to better manage risk and generate sustainable long-term returns.

2.3 This Investment Strategy relates only to the General Fund; the Housing Revenue Account will develop its own investment strategy relating to maintenance and acquisitions.

2.4 The Council has taken independent advice during the development of the Strategy and continues to engage with commercial advisors and regulators to ensure that its officers and members are engaged in continual professional development in relation to property investment activities by local authorities.

2.5 **Aims:** The Investment Strategy aims to provide a robust and viable framework for the acquisition of commercial property investments and the pursuance of redevelopment and regeneration opportunities that contribute to Business Plan objectives and can deliver positive financial returns for the Council.

2.6 **Value:** The Investment Strategy identifies the sum of £153 million between 1 April 2021 and 31 March 2026 for Service and Commercial Investments that are ~~prime and close to prime commercial real estate investment, investment which can generate regeneration or economic development benefits as well as positive financial returns for the Council and for investment partnerships with third party developers to deliver new homes. These streams of investment are~~ outlined in more detail at Section 7. The Strategy also covers the existing portfolio of investments comprising of the following loans to third parties:

(a) A loan to Cambridge Ice Arena with a value of £2.4 million for a term of 25 years at a rate of 4.31%. The interest cost for the loan is based on a PWLB rate of 2.56% plus a margin of 1.75%;

(b) Loans to South Cambs Ltd, Trading as Ermine Street Housing (ESH), with a value of ~~£63.317 million (at September 2019)~~ £83.993 million (as at March

2021) at a rate of 3.78% (reviewed annually). The Council earmarked a total investment of £100 million to Ermine Street in its capital programme to enable the supply of 500 private rented housing stock; loans are based on an opportunity cost of 1% plus a margin of 2.78% (subject to review). At the point of drafting this strategy, loans to Ermine Street have been on the basis of interest only repayment; following the review by Savills, this may be reviewed to consider some capital repayment.

2.7 **Contribution:** The Council has an established commercial property estate that is managed in accordance with an approved Corporate Asset Plan. ~~invests in local commercial property with the intention that profits will be spent on local public services.~~ The following table provides details of the current portfolio by the various categories and purchase price:

Category	Fair Value £000
Offices	43,860
Industrial	2,900
Development Land	18,559
Other	0
TOTAL	**65,319**

2.8 **Security:** In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs. A fair value assessment of the Council's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for the capital investment. Should year end accounts preparation and audit processes value these properties below their purchase cost, then an updated Investment Strategy will be presented to Council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

In relation to third party loans, the Council will ensure that the total exposure to loans remains proportionate to the size of the Council. The Council has significant control over ESH being its only shareholder. However, the risk that the borrower, ESH, will be unable to repay loans provided by the Council represents a significant risk. In order to limit this risk, and ensure that total exposure to loans remains proportionate, an upper limit on outstanding loans to ESH has currently been set at £100 million. This will be kept under review. Accounting standards require the Council to set aside a loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's statement of accounts will, therefore, be shown net of this loss allowance.

2.9 **Financing the Strategy:** The Council will fund Service and Commercial and Regeneration Investments ~~the investment property acquisitions~~ by utilising the most appropriate and efficient funding strategy available at the time ofinvestment. The Council has the option of utilising prudential borrowing, capital receipts, and reserves and may consider other structures such as joint ventures ~~with pensions and insurance funds~~. Financing decisions will link to the Council's Medium Term Financial Strategy and Treasury Management Strategy.

As a condition of accessing the PWLB, Local Authorities must submit a high-level description of their capital spending and financing plans for the following three years,

including their expected use of the PWLB. As part of this, the Head of Finance will need to confirm that there is no intention to buy investment assets primarily for yield at any point in the next three years. This assessment is based on the Head of Finance's professional interpretation of guidance issued. When applying for a new loan, the Local Authority must confirm that the plans they have submitted remain current and provide assurance that they do not intend to buy investment assets primarily for yield.
The new borrowing rules, therefore, restrict the ability of local authorities to borrow from PWLB for pure investment in commercial property and the Council is aware that, if it intends to buy commercial assets primarily for yield (even by using reserves), then they will be prevented from taking any PWLB borrowing and will need to consider alternative sources of funding. The Council is not, therefore, permitted to reprofile the capital programme so that borrowing is only used on allowed projects, with internal borrowing used for commercial activities and will respect the guidance issued on investments. Accordingly, there is a presumption against primarily for yield investments, such as prime and close to prime commercial real estate investment.

2.10 **Risk Assessment:** The Council assesses the risk of loss before entering into and whilst holding property investments. The Council is engaged in the market through the proactive management of the investment portfolio, the asset valuation exercise and the economic growth activity and, through this, gaps/opportunities in the market are identified. Each asset is reviewed on an annual basis in order to review its performance, investment requirements and whether it should remain in the portfolio. The Council intends to develop a more detailed Acquisitions and Disposal Policy to sit alongside this Strategy.

The Council assesses the risk of loss before entering into loans with third parties. Loans to ESH will be provided on a commercial basis to comply with Subsidy Controls (previously State Aid Rules) taking into account the level of risk, with a clear schedule of repayment of interest and principal that enable ESH to deliver its Business Plan and meet the Council's overall objectives. External advisors will be brought in as required to support Council officers in assessing the legal and financial risks of making loans.

In relation to the commercial property estate, typical measures for monitoring individual assets and the portfolio as a whole are summarised in the table below:

Outcome/Risk	Potential Measure	Benchmarks
Individual acquisitions are achieving strategy objectives	• Gross and Net Initial Yield measured against targets for the investments (stress tested by providing pessimistic as well as realistic scenarios) • Net Present Value and Internal Rate of Return Calculations to show longer term financial returns • Cumulative Year break-even	• Industry benchmarks for type of investment • Other acquisitions in the portfolio • Overall portfolio and theme averages • Other Local Authorities
Acquisitions can be operationally managed effectively	• Operating expenses as a proportion of gross effective income • Operating expenses and debt service costs as proportion of effective income	• Established sector benchmarks
Acquisitions and portfolio are	• Asset by asset as well as portfolio measurement of asset	• Other acquisitions in the portfolio

appreciating in value	valuation against price paid and outstanding debt (initial borrowing minus accumulated Minimum Revenue Provision)	• Established sector benchmarks • Other Local Authorities
The Investment Strategy income target is being met	• Close and regular financial monitoring of average yield as well as growth of the portfolio	• Actual v. Budget - variance explained by average yield and portfolio use

The Council's established commercial property estate (see table at 2.6 above) provides some degree of diversification, allowing ~~intends to adopt~~ a risk spread profile. ~~but its commercial portfolio is, at this stage, limited and not diversified It is recognised, therefore, that the Council is potentially exposed to greater risk in the early period of the Investment Strategy through the absence of diversification.~~

The Council recognises, however, that there is a ~~As the portfolio develops, there will be a~~ need to assess the continuing appeal of the Council's existing property investments in the market. In some property investment classes this could be more significant than others, for example functional obsolescence in the industrial sector may have less impact on market appeal and rental growth than in the office sector. Economic obsolescence risk may be higher in markets which are more susceptible to social change and popular culture.

The economic landscape has changed immensely in the last 12 months, initially as a result of the uncertainty over the withdrawal process from the European Union, and recently the financial challenges as a result of the Coronavirus pandemic (COVID-19) which has had an impact on property markets with increased market uncertainty. The Royal Institution of Chartered Surveyors (RICS) considers market impacts and publishes regular guidance on property valuations, with recommendations to reflect the uncertainty (such as the insertion of Market Uncertainty Clauses [MUCs] within property valuations). Due regard should be given to the guidance issued given the continuing uncertainty around the property sector.

~~The Head of Commercial Development & Investment is responsible for ensuring that each investment decision is measured against the investment criteria set out in the Investment Strategy, which includes an assessment of risk.~~ Asset investment advice is provided by retained agents and, where necessary, additional specialist advice is procured from suitably experienced external advisers. This will include the provision of pre-purchase reports and building surveys and other due diligence required to support the business case. The advice by the retained agents will include an assessment of the market and how it will evolve over time, the nature and level of competition and the impact that any asset acquisition or disposal could have on the projected income generated. The retained agent advice is monitored against the specification of requirements detailed in the invitation to tender and contract.

2.11 **Liquidity:** Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. The Council has no immediate plans or needs to sell any of the property investment assets. However, lower yielding assets may be sold and replaced with higher yielding assets within manageable risk tolerances.

2.12 **Loan Commitments:** Although not strictly counted as investments, since no money has exchanged, loan commitments and financial guarantees carry similar risks to the Council. The Council has no such loan commitments or financial guarantees.

3 Proportionality

3.1 In setting a balanced budget (as required by statute) the Council takes into account the contribution of income that is generated by its investment activity and, in doing this, it recognises that such investment activity meets wider economic and service objectives of the Council. The table below shows the extent to which expenditure planned to meet the service delivery objectives and/or place making role of the Authority is funded by the expected net income from investments over the lifecycle of the Medium Term Financial Strategy.

Investment Net Rate of Return	2021/2022 Budget £000	2022/2023 Budget £000	2023/2024 Budget £000	2024/2025 Budget £000	2025/2026 Budget £000
Net Revenue Stream	21,722	22,182	19,566	20,306	21,063
Net Investment Income	5,031	6,306	6,720	6,959	7,197
PROPORTION (%)	**23.2**	**28.4**	**34.3**	**34.3**	**34.2**

3.2 An appropriate level of contingency within the General Fund Reserve is assessed annually as part of the outturn position each year. The Council also has a revenue contingency allocation of ~~£75,000~~ £250,000 ~~cover specified “precautionary” items~~ to enable unforeseen and "one off" needs (i.e. having no long term ongoing revenue commitment) to be considered for funding during the financial year. These contingencies cover any net reduction in income sources, including rental income from investment properties, compared to the levels estimated.

4 Borrowing in Advance of Need

4.1 Government guidance is that local authorities must not borrow more than, or in advance of their needs, purely in order to profit from the investment of the extra sums borrowed.

4.2 Where exceptionally the Council chooses to disregard the CIPFA Prudential Code and Government Guidance in respect of borrowing to fund investment activity, the rationale for this decision must be explained in the Strategy.

4.3 The Council has noted and has had regard to the Guidance and has no plans to borrow in advance of need and is, therefore, compliant with the CIPFA Prudential Code in respect of this matter. The Council will only depart from it in exceptional cases, within the parameters set out in this Strategy, for the purposes of delivering Business Plan objectives and maintaining a robust financial position. In these exceptional cases, the reasons for so doing will be fully explained, together with the Council policies for investing the money borrowed, including management of the risks, for example, of not achieving the desired profit or borrowing costs increasing.

5 Capacity, Skills and Use of External Advisors

5.1 The Guidance requires that elected members and officers involved in the investment decision making process have appropriate capacity, skills and information to enable them to take informed decisions as to whether to enter into a specific investment. In addition, it places a duty on the Council to ensure that advisors negotiating deals on behalf of the Council are aware of the core principles of the prudential framework and the regulatory regime in which the Council operates. This will be achieved by ensuring an adequate and effective training programme, obtaining appropriate advice to inform the decision-making process and by ensuring that procurement arrangements provide relevant information to potential advisers of the specific principles, regulations and governance relevant to the local authority sector.

6.2 The Council will appoint specialist advisors to provide training to ensure that relevant Officers and Members have the required skills to make informed decisions and assess the associated risks. This training will take place before any investment decisions associated with the Strategy are considered and on a regular basis to ensure that Officers are engaged in continual professional development in relation to property investment activity and that Members, as decision makers, have the skills, knowledge and relevant information to effectively assist the decision-making process. This will include training for new Members of the Council.

5.3 The Council recognises that investing in land and property to achieve business objectives and to generate returns is a specialist and potentially complex area. The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. Where skills, or capacity are lacking, the Council will engage the services of professional property, legal and financial advisors, where appropriate, to access specialist skills and resources to inform the decision-making process associated with this Strategy. The Council measures the impact of investment decisions on borrowing and affordability through Investment Indicators to ensure that the overall risk exposure remains within acceptable levels.

6 Governance Arrangements

6.1 It is necessary to have a framework for determining which properties and development opportunities should be invested in.

6.2 A designated Investment Selection Team (IST), structured as outlined in **Appendix 2,** provides the setting for senior property, finance, service and legal professionals to share details of investment proposals ensuring that the core principle of the CIPFA Prudential Framework and the regulatory regime within which the Council operates are adhered to.

6.3 The Investment Team has day to day oversight of asset management issues, and is responsible for reviewing the extent, condition and value of the Council's corporate estate in line with the approved Corporate Asset Plan 2020-2024 and supporting Asset Management Plan which is continually monitored by IST.

6.4 The IST will advise a designated Investment Governance Board (IGB) on potential purchases and development opportunities that meet the pre-determined selection criteria contained within the Investment Strategy. The IST will scrutinse investment opportunities identified by the Investment Team, based on the selection criteria set out in this Strategy, will carry out all necessary due diligence and will present a full business case to the IGB for approval. The structure of the IGB is also outlined in **Appendix 2**. The purpose of the IGB is to challenge and scrutinise investment opportunities identified by the IST, ensuring that only credible options are progressed. It also provides the forum for the strategic management of the overall portfolio of investments, consistent with the aims of the Strategy.

6.5 Investment decisions taken by Cabinet will be subject to the fulfilment of the minimum criteria set out within the Strategy, satisfaction with the business case and risk assessment, and will have regard to the recommendation of the IGB. Acquisitions and development opportunities that do not meet the minimum criteria set out within the

Strategy may still be considered, where they would bring other compelling benefits to the District, but would require Cabinet approval.

6.6 Cabinet is required to approve investment in new capital schemes prior to any expenditure being incurred (subject to 6.6 below) and Council approval will be required if additional, or the reprofiling of, funding is required. There may be occasions when an investment opportunity may be lost by the market need for speed; in these exceptional cases, decisions may be taken by the Leader after consultation with IGB and in accordance with the Access to Information Procedure Rules as set out in the Constitution and a full report will be prepared to inform the decision, fully outlining the opportunities and risks. The requirements relating to the giving of notice of the decision in the Forward Plan and for call-in of any decision shall apply unless the urgency procedures in the Council's Constitution are required to be used for urgent investment decisions.

6.7 To enable the timely and decisive decision making which is essential in this type of industry, to respond to opportunities as they arise, regular meetings of the IGB will be scheduled. The Council's Scheme of Delegations provides the basis for enabling Officers to progress investment opportunities, including due diligence checks and the submission of non-binding offers in line with market practice.

7 Service and Commercial Regeneration Investments ~~Streams~~

7.1 Investments will be focussed within the District, the Greater Cambridge Partnership area and the Travel to Work Area as shown in **Appendix 3**.

7.2 The Investment Strategy identifies the sum of £153 million for Service and Commercial Regeneration Investments as follows: ~~for potential commercial investments into three streams of activity outlined in 7.3 below. This provides (i) an allocation for Stream 1 investments in line with the potential investment pipeline, (ii) a £10 million per annum allocation in Stream 2 investments (e.g. energy storage projects or investments with regeneration benefits) and (iii) the capacity to deliver the level of investment with the two approved framework suppliers in line with Member Agreements. The projection of likely investments in all three streams as follows:~~

Funding Allocation	2021/2022 £'000	2022/2023 £'000	2023/2024 £'000	2024/2025 £'000	2025/2026 £'000
Loans to ESH	10,000	-	-	-	-
Investment Strategy	23,000	30,000	30,000	30,000	30,000
Total Investment	**33,000**	**30,000**	**30,000**	**30,000**	**30,000**

7.3 Investment relating to commercial premises will be directed towards the following types of investment ~~three streams of activity~~:

7.3.1 **Service Investments ~~Stream 1~~**

This category of investment is to support local public services. The Council may lend money or acquire shareholding in subsidiaries, suppliers, local businesses, local charities, housing associations, local residents and its employees to support local public services and stimulate local economic growth. The main risk when making these investments is that the borrower will be unable to repay the principal and interest due. The Council will, therefore, assess the risk of loss before entering into and whilst holding such investments and mitigate this risk where practicable.

The Council has a wholly owned housing company called Ermine Street Housing (ESH). The Council's main objectives for creating the company is to provide good quality flexible rental housing and to meet housing needs and gaps in the housing by operating a commercial entity to manage both purchased and leased properties for the purpose of residential lettings. ESH acquire properties on the open market, borrowing at market interest rates via the Council, then lets the property at market rents to facilitate a reasonable pay back on the investment. ESH also brings the benefit of contributing to housing supply in the District with its implications for the economic and social well-being of residents and the local economy. The Council will provide capital loans to ESH on commercial terms to enable the company to deliver its objectives in line with an approved business plan.

~~Prime and close to prime commercial real estate investment let on long leases to good covenants which will provide a secure long-term income over and above their ability to pay back the purchase price debt. The minimum target yield for a stream 1 assessment is 5% per investment, excluding Minimum Revenue Provision (MRP) and the cost of borrowing.~~

~~The contributions from Stream 1 investments will include:~~

- ~~Yield / profit.~~
- ~~Long term capital uplift.~~

~~Commercial lease arrangements in relation to the Council's portfolio are ordinarily classified as operating leases. International Financial Reporting Standard (IFRS) 9 relates to treatment of various financial instruments. Sundry Debtor Balances are classed as a financial instrument and all financial instruments need to be subject to impairment when the expected recoverable amount is less than the actual amount outstanding. All outstanding amounts relating to leases will be recorded at the net recoverable amount after allowing for an appropriate provision for bad and doubtful debts (If any).~~

7.3.2 **Commercial Regeneration Investments ~~Stream 2~~**

This category covers investment which can generate regeneration or economic development benefits as well as positive financial returns for the Council. Financial returns for the Council may come in the form of increased business rates income, New Homes Bonus where the investment is within the District and residential letting income from Build to Rent developments. The minimum target yield for ~~a stream 2~~ commercial regeneration investments of this nature is 5%, excluding MRP and the cost of borrowing. IRR may also be appropriate as a measure of an investment's rate of return.

The contributions from ~~Stream 2~~ commercial regeneration investments will include positive financial returns for the Council, and may also include the following:

- ~~Investment loans to 3rd parties~~
- Assets that provide accommodation for essential businesses and services that are critical to the health of the local economy.
- Investing in climate and environmental initiatives, including ~~green energy investments within Stream 1~~ assets that can be developed to

deliver green energy generation, in line with business plan objective of being "green to our core", and investment in green energy bonds/funds in so far as they meet PWLB criteria.

- Investing in Social Capital
- Redeveloping Council owned assets
- Building homes and commercial premises
- Using public land and buildings to achieve long-term socio-economic development within the District and wider Greater Cambridgeshire Area, as identified in the Local Plan and **Appendix 3**.

To provide a longer term perspective for ~~Stream 2~~ commercial regeneration investments, the Internal Rate of Return (IRR) may be an appropriate metric to assess the strength of an investment. The IRR is the interest rate at which the net present value of all cash flows arising from an investment is equal to zero.

7.3.3 **Commercial Investments: Investment Partnerships ~~Stream 3~~**

Investment partnerships with third party developers to deliver new homes and regeneration opportunities that will include:

- Acquisition of 3rd party land
- ~~Include~~ Public sector and bank debt
- Incorporation of grants and other funding
- A sharing of risk and reward between partners

By the nature of these investments, returns are likely to be in the form of capital receipts from the sale of a constructed asset, potentially developed in phases depending on the scale of the project. These capital receipts will be identified in the capital programme as financing for priority capital projects determined by the Council. Capital projects may relate to the range of services provided by the Council, or for investments in redevelopment and regeneration projects that contribute to Business Plan objectives and which may deliver positive financial returns for the Council.

7.3.4 Further information about commercial investments (including Investment Partnerships), including the scope for investment, investment objectives, development methodology, green energy opportunities and risk management arrangements, is provided in **Appendix 4**, the expected business case coverage is identified in **Appendix 5** and investment assessment criteria for ~~all three streams are~~ commercial investments is shown in **Appendix 6**.

8. Prudential Indicators

8.1 The Guidance requires local authorities to develop quantitative indicators that allow Councillors and the public to assess a local authority's total risk exposure as a result of commercial property investment decisions.

8.2 Local Authorities are required to charge to their revenue account each year a Minimum Revenue Provision (MRP) to make provision for the repayment of debt, as measured by the underlying need to borrow. The MRP should be prudent and, although it is for each authority to determine the amount, the published guidance by the Government is "local authorities should align the period over which they charge MRP to one that is commensurate with the period over which their capital expenditure provides benefits". Provision has, therefore, been made for MRP in the performance indicators in line with the approved Capital and Treasury Management Strategies and based on the equal instalment method, amortising expenditure equally over the estimated useful life of the asset for which borrowing is required. The application of MRP will be adjusted to reflect the annual valuation of Investment properties and will be determined on a property by property basis

8.3 The approved Treasury Management Strategy does, however, confirm that where a loan is made to a wholly owned subsidiary of the Council, the loan is deemed to be secured on the assets of the company. Evidence of the ability to repay the loan will be based on the company's business plan and asset valuation, and no MRP will be made. Exceptionally, where capital expenditure is part of a loan agreement to other than a wholly owned subsidiary – such as the loan to Cambridge Ice Arena – MRP will be applied in these cases.

8.4 The indicators associated with the Council's proposed Commercial Property Investment Strategy are detailed below.

8.4.1 Debt to Net Service Expenditure (NSE) Ratio

This indicator measures the gross debt (as cash or loan financing) associated with Commercial ~~Property~~ Investments and loans to third parties as a percentage of the Council's net service expenditure, where net service expenditure is a proxy for the size and financial strength of a local authority.

Estimate £'000	2021/22	2022/23	2023/24	2024/25	2025/26
Third Party Loans (a)	96,900	96,828	96,256	96,184	96,112
Commercial Investments (b)	88,319	118,319	148,319	178,319	208,319
Funding Allocation (a + b)	185,219	215,147	245,147	275,147	305,147
Net Service Expenditure (c)	21,828	20,992	21,659	22,101	22,823
Debt to NSE Ratio (a+b)/c	**849%**	**1024%**	**1132%**	**1245%**	**1337%**

The indicator shows that the debt level proposed by the Strategy will be approximately 14 times the level of the Council's net revenue budget if the proposed investment in the Strategy is funded solely from cash or loan financing.

Given that the Strategy will take the risk profile of investments into account in the decision-making process and the Council sees property investments as a long-term investment. ~~this ratio is reasonable. A maximum limit of 1,4800% has been set for this indicator.~~

8.4.2 Net Commercial Income to NSE Ratio

This indicator measures the Council's dependence on the income from commercial property investments to deliver core services.

The commercial income is the gross income from all investments made through the strategy less all operational costs. ~~including the operational costs shown in indicator 8.4.7~~. All income forecasts should allow for void periods where applicable. The table below identifies gross income:

Estimate £'000	2021/22	2022/23	2023/24	2024/25	2025/26
Third Party Loan income (a)	3,271	3,461	3,461	3,461	3,461
Commercial income (b)	5,031	6,306	6,720	6,959	7,197
Total Net Income (less MRP) (a + b)	6,982	8,050	8,325	8,439	8,813
Net Service Expenditure (c)	21,828	20,992	21,659	22,101	22,823
Net Commercial income to NSE Ratio (a+b)/c	**32.0%**	**38.3%**	**38.4%**	**38.2%**	**38.6%**

The additional income generated from the investments set out within this Strategy will be equivalent to 38.6% of the Council's Net Service Expenditure by 2025/2026. ~~This ratio is considered reasonable and a maximum limit of 5% has been set for this indicator.~~

The ratio shows an increase over time and, given the potential risk in respect of reliance on this income, effective measuring of progress will be undertaken against income targets, both in terms of portfolio yield and size.
The indicator allows for MRP in accordance with the approved Treasury Management Strategy with the following allowance for each year:

Estimate £'000	2021/22	2022/23	2023/24	2024/25	2025/26
Minimum Revenue Provision	1,320	1,717	1,856	1,981	1,845

8.4.3 Investment Cover Ratio

This indicator measures the total net income from property investments compared to interest expense:

Estimate £'000	2021/22	2022/23	2023/24	2024/25	2025/26
Net Commercial income	5,031	6,306	6,720	6,959	7,197
Interest cost	910	2,345	2,606	2,911	3,242
Investment cover Ratio	5.52	2.69	2.58	2.39	2.22

The net investment cover ratio increases throughout the medium term. This is because interest payable is growing at a faster rate than commercial income due to the externalisation of some debt. Current loans are shorter term loans and the ratio in 2021/22 reflects this.

For commercial investments from 2022/23 ~~within Streams 1 to 3~~, the rate of 2% (reflecting current medium to long term PWLB rates) is used to determine the interest expense in the above ratio through to 2025/2026. The interest rates on loans to third parties are determined on a case by case basis. ~~range from 4.31% to 3.78%.~~ The assumptions will be revised in future years as the size of the portfolio develops.

8.4.4 **Loan to Value (LTV) Ratio**

This indicator measures the amount of debt compared to the total asset value. In the period immediately after purchase it is normal for the directly attributable costs of purchasing commercial property investments to be greater than the realisable value of the asset (e.g. because of non-value adding costs such as stamp duty). Current market advice indicates that commercial property values are likely to be volatile for a while due to the effects of the pandemic and Brexit, however, borrowings will be repaid.

Estimate £'000	2021/22	2022/23	2023/24	2024/25	2025/26
Funding Allocation	185,219	215,147	245,147	275,147	305,147
Total asset values	188,900	222,700	257,100	292,200	328,000
LTV Ratio	1.02	1.03	1.05	1.06	1.07

Each year the Council will assess whether assets purchased via the Strategy retain sufficient value to provide security of investment using the fair value model in International Accounting Standard 40: Investment Property. If the fair value of assets is not sufficient to provide security for the capital investment the Strategy will provide detail of the mitigating actions that are being taken, or are proposed to be taken, to protect capital investment. The IST will also provide a liquidity assessment of the portfolio when undertaking the Fair Value assessment (see Section 2.7 of the Strategy).

8.4.5 **Target Income Returns (Yield)**

This indicator shows the target gross yield for each stream of investment activity and is a measure of the minimum expected return for the property investment portfolio. With regard to Commercial and Regeneration investments it is proposed that the target of 2.5% is set as a minimum on the understanding that the Council should aim for more. This is in recognition that in some cases significant non-financial benefits might be a good reason to accept a lower return than might be the case otherwise. Green investments may also deliver a lower return.

Target income returns	2021/22	2022/23	2023/24	2024/25	2025/26
Service Investments ~~**Stream 1**~~	2.5%	2.5%	2.5%	2.5%	2.5%
Commercial and Regeneration Investments ~~**Stream 2**~~	2.5%	2.5%	2.5%	2.5%	2.5%
~~**Stream 3**~~	~~5%~~	~~5%~~	~~5%~~	~~5%~~	~~5%~~

8.4.6 **Gross and Net Income**

For this indicator, "Gross Income" means the revenues received in the form of commercial rents before the deduction of management costs and interest repayments. "Net Income" means the net income available, after the deduction of management costs.

Estimate £'000	2021/22	2022/23	2023/24	2024/25	2025/26
Gross Income:	5,031	6,306	6,720	6,959	7,197
Net Income	4,599	5,865	6,271	6,501	6,729

The achievement of the target income required from the Investment Strategy will be closely monitored as part of the Council's budget monitoring process.

8.4.7 **Operating Costs**

Estimate £'000	2021/22	2022/23	2023/24	2024/25	2025/26
Operating Costs	432	441	449	458	468

The above operating costs relate to the cost of acquiring and maintaining the investments made through the Strategy. The costs shown reflect the estimated cost of internal staff, external asset management and a budget for feasibility work to conduct due diligence prior to investment.

8.4.8 **Vacancy Levels and Tenant Exposures**

Estimate	2021/22	2022/23	2023/24	2024/25	2025/26
Void levels	3%	3%	3%	3%	3%

This indicator measures and sets a maximum threshold ~~targets~~ for the vacancy ~~void~~ periods and tenant exposures within the property portfolio.

The target of 3% reflects the strong tenant covenant strengths that will be required under the ~~Stream 1~~ commercial investment criteria. Void periods will be factored into the financial appraisals as part of the assessment criteria where relevant, therefore this indicator may be revised once investments are made.

9. Overall Portfolio Management

9.1 The Council has established a robust and ambitious strategy for capital investment. The level of investment anticipated and the returns from that investment are significant and, as the strategy outlines, significant potential rewards come with equally significant risks. Closer performance management over and above the prudential indicators at Section 8 above and identified in the Capital Strategy will, therefore, be undertaken to help address potential fundamental risks such as:

- The financial returns as set out in the strategy are difficult to achieve resulting in lower than budgeted investment and rental income.
- Delays in investment, for any other reason, result in lower than budgeted investment and rental income;

- Wider economic impacts depress the value of investments in the short-term reducing balance sheet health;

- Access to borrowing is restricted by Government changes to PWLB lending rules.

9.2 The additional monitoring of the Investment Strategy and its resulting impact on Balance Sheet health will comprise:

9.2.1 The relationship between the Capital Financing Requirement, asset valuations and the Capital Adjustment Account and Revaluation Reserve as shown on the balance sheet, and

9.2.2 Measures of portfolio progress:

	Budget £	Actual £	Variance £
Service Investments:			
Capital Invested			
Yield			
Rental Income			
Commercial Regeneration Investments:			
Capital Invested			
Yield			
Rental Income			
Commercial Property Estate:			
Capital Invested			
Yield			
Rental Income			

Appendix 1: Responsible Investment Policy

1. INTRODUCTION

1.1 This Responsible Investment Policy details the approach that will be followed in fulfilling the Council's commitment to integrate sustainable environmental policies across all areas of the Councils operations and activities. It also covers other responsible investment issues, which are set out below.

1.2 The policy will be reviewed annually as part of the annual refresh of the Treasury Management Strategy before being approved by Cabinet and Full Council.

2 PRINCIPLES

2.1 Responsible Investment is an approach to investing that aims to incorporate environmental, social and governance (ESG) factors into investment decisions, to better manage risk and generate sustainable long-term return.

2.2 The Principle for Responsible Investment (PRI) is the world's leading advocate for responsible investment. The PRI enables investors to publicly demonstrate commitment to responsible investment with signatories committing to supporting the six principles for incorporating ESG issues into investment practice.

2.3 The six principles are as follows:

- We will incorporate ESG issues into investment analysis and decision-making processes.
- We will be active owners and incorporate ESG issues into our ownership policies and practices.
- We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- We will promote acceptance and implementation of the Principles within the investment industry.
- We will work together to enhance our effectiveness in implementing the Principles.
- We will each report on our activities and progress towards implementing the Principles.

2.4 The principles are based on the notion that ESG issues, such as climate change, can affect the performance of investment portfolios and should, therefore, be considered alongside more traditional financial factors if investors are to properly fulfil their fiduciary duty.

3 PRINCIPLES

3.1 The Council takes a long-term approach to investing core balances and believes that businesses that are governed well and run in a sustainable way are more resilient, able to survive shocks and have the potential to provide improved financial returns for investors. ESG issues can have a material impact on the value of financial assets and on long-term performance of investments and, therefore, need to be considered in order to better manage risk and generate sustainable, long-term returns.

3.2 Well-managed organisations with strong governance are more likely to be successful long-term investments.

4 POLICY OBJECTIVES

4.1 As a long-term investor and asset owner the Council will, therefore, hold companies and asset managers to account regarding environmental, social and governance factors that have the potential to impact corporate value. The Council will incorporate ESG factors into investment analysis and decision-making, enabling long-term sustainable investment performance.

4.2 As a shareholder, the Council has a responsibility for effective stewardship of the companies it invests in but also acknowledges that it has limited influence over individual companies being a small unit holder in a large fund pooled with many other institutional investors. Asset managers, who also take their stewardship role seriously, through dialogue and use of voting rights, are key influencers for more responsible corporate behaviour and long-term sustainability. The Council's preference is, therefore, for active ownership of companies to rest with asset managers and for asset managers to engage with companies on behalf of the Council and other investors to improve the environmental and social performance of the asset or company in which they invest.

4.3 The Council will practice active ownership through its choice over asset managers and asset management strategies. The Council will monitor and report the approach taken by asset managers in integrating ESG risks and opportunities into their modelling as part of their value assessment.

5 GOVERNANCE

5.1 The Responsible Investment Policy is owned by the Investment Governance Board and approved by Cabinet and Full Council. The Chief Operating Officer is accountable for implementation of the policy, with the Head of Finance responsible for other treasury management policies and practices.

6 APPLICATION

6.1 The policy beliefs are applicable to the Council's long term strategic investment portfolio only. ESG integration and reporting in short term low volatility net asset money market funds is less developed so the scope of this policy does not extend to them but will be kept under review. However the Council will expect funds to be signatories of the Stewardship Code 2012 and working towards the 2020 Code that is being implemented in 2021.

6.2 External asset managers used by the Council should have Responsible Investment and ESG policies in place and a high UN PRI Assessment Score (awarded annually). A high score is defined as the highest possible bands being A or A+.

6.3 The Investment Governance Board will receive annually a report detailing how each asset management firm integrates ESG risks into their financial assessment and decisions. This will include a summary of the annual United Nations Principle for Responsible Investment (PRI) Assessment Scores

~~Appendix 1: Property Investment Stream 1~~

1. Objective

~~The objective of the Stream 1 investment criteria is to establish a framework for the identification of commercial property investments which, if acquired, would contribute to established Business Plan priorities and provide the Council with a positive rental return and capital growth.~~

~~The investment criteria are designed to ensure that funds are invested in properties that deliver yield and security commensurate with the Council's risk appetite.~~

~~Each potential investment will be evaluated to ensure the income received is sufficient to provide an acceptable rate of return following the payment of borrowing costs, acquisition costs, management fees and any running costs. Borrowing from the PWLB will not be considered where it is intended to buy commercial assets primarily for yield.~~

~~Purchases will take regard of the need to diversify the Council's property portfolio to manage risks across the entire portfolio.~~

~~The Council will procure external advisors to act on its behalf for the acquisition of investments, who will provide pre-purchase reports and building surveys to support the business case. These consultants will be managed by the Commercial Development & Investment Team, who will be responsible for monitoring the service that is provided.~~

2. Market Analysis and Background

~~As with other forms of investment at their most basic level, property investment is a trade-off between risk and return. A traditional well diversified property portfolio (spread across different property sectors and geographical regions) will deliver long term rental and capital growth with relatively low risk. Prime property in the target regions covered by this Strategy will typically provide an initial yield of between 5-7% with the additional prospect of capital growth leading to a higher total return to the Council.~~

~~The Strategy will adopt the same underlying principle of diversification in acquiring property investments offering a similar return profile. The three main property sectors will be included (industrial, office and retail) and in turn, these will be additionally diversified on criteria including location, the lease term and lot size. When added to the existing portfolio this will assist in protecting the Councils overall risk and return profile should an individual property investment cease to be income producing (for example, it is undergoing refurbishment or awaiting a new tenant).~~

3. Property Acquisition Methodology

~~Identification, consideration and recommendation of assets suitable for acquisition will be undertaken by the IST in conjunction with outside specialist guidance and professional support, procured in accordance with the Council's established Contract Procedure Rules.~~

~~The IST, through the designated Head of Commercial Development & Investment and appointed agents, will undertake a search of the market which will include approaches and introductions of opportunities direct from the sellers, their agents and third parties. Introductions from third party agents will be accepted on a first come first served basis by verbal or written communication to the Head of Commercial Development & Investment.~~

~~Investment opportunities will initially be submitted to IST for consideration and subsequently to the Investment Governance Board (IGB). If after the introduction is made, the Council wishes to pursue the purchase further written agreement on the "basis of engagement" and fees will be required.~~

~~The use of independent consultants will be required to assess properties prior to bidding and any purchase will be subject to due diligence on all physical, financial and legal aspects of the property to address its suitability as an asset for long term security and growth.~~

~~All investments considered for purchase that meet pre-determined criteria and strategy aims (see section 4 below) will undergo qualitative and quantitative appraisal to establish portfolio suitability which will consider rental levels, location, property type, rent review and lease expiry pattern, tenant(s), industry sector, tenure, lease covenants, market exit constraints and physical and environmental factors. In addition, 3rd party advice will be called upon where specialist market knowledge is required. It is recognised that some of the cost of feasibility work and technical appraisal and assessment will be abortive.~~

~~Property investment markets are, in general, controlled by national and regional commercial property agencies and establishing links and relationships with several such property agents is the best method of sourcing suitable properties for acquisition. Staffing resources will need to be made available to source suitable property assets for acquisition that match the criteria set under the Strategy. This can be done by both recruitment into the IST team and by employing additional external expertise as required.~~

~~All commercially based investments involve risk and, at each stage of the process, the commitments made will be at risk as there can be no guarantee that a fully successful development will be achieved. The terms of the agreement between the parties will seek to mitigate the inherent risks. Moreover, the timing of the exercise can also be a critical factor in achieving optimum success, particularly in terms of market conditions, the state of the national economy and levels of investment confidence within the development industry.~~

4. Minimum Investment Criteria

~~For a Stream 1 property investment to be considered by the IGB for recommendation to Cabinet for approval it must:~~

~~**4.1** Achieve a minimum weighted score of 100 from the investment criteria matrix shown in **Appendix 1 (1a)**;~~

~~**4.2** Have a Net Initial Yield of 5% after making allowance for purchase costs;~~

~~**4.3** Be accompanied by a full business case prepared by the IST.~~

~~Each potential property investment will undergo a qualitative and quantitative appraisal, together with a risk assessment, to establish portfolio suitability and the legal and financial implications of the purchase.~~

~~The findings of these appraisals will be reported to the IGB as part of the business case.~~ **Appendix 1 (1b)** ~~details the specific areas that will be included in the business case as a minimum.~~

~~All acquisitions, where relevant, will be subject to building and plant survey, independent advice and valuation.~~

~~An investment opportunity that does not meet the minimum criteria under investment stream 1 may have separate investment or regeneration benefits and, therefore, may be considered separately under Stream 2 of the strategy.~~

5. Risk Management

~~**5.1** **Financing Risk:** As with all investments, there are risks that capital values and rental values can fall as well as rise. To mitigate against future unfavourable market forces, Stream 1 acquisitions will be made on the basis that the Council is willing and capable of holding property investments for the long term i.e. 35 years +. This will ensure income and capital returns are considered over the long term thereby smoothing out any cyclical economic/property downturns.~~

~~Where the purchase of a property is reliant on increases in borrowing the business case will factor in fixed rate borrowing costs. By utilising fixed rate borrowing options the Council will be protected from future increases in financing costs. The Council can~~

~~mitigate the limitations that come with the term commitment characteristic of fixed rate options through using a portfolio of loans of different terms at different rates, as part of its wider Treasury Management Strategy, thereby creating options to 'recycle' loans for other purposes, should net disposals of assets held within the Investment Strategy exceed the value of net acquisitions.~~

~~**5.2 Portfolio Risk – void periods:** To mitigate the risk of void periods where the property is either partially or fully vacant, or a tenant has defaulted on its rental obligations, the investment portfolio will be actively managed. The investment criteria specified in the scoring matrix will tend to favour secure property investments i.e. high-quality buildings in prime locations, thus mitigating the risk of void periods on re-letting.~~

~~Void periods for commercial investment properties acquired under this Strategy will be monitored and vacancy levels will be reported to the IGB throughout the year so that they can be actively managed.~~

6. Portfolio Management

~~Newly purchased property acquired under this Strategy would be added to the existing portfolio and the Commercial Development & Investment Team (currently comprising the Head of Commercial Development & Investment, the Delivery & Innovations Officer and the Green Energy Investment Officer), would undertake asset and property management to maintain and improve the performance of an investment property; with established core staff supplemented, as required, by external commercial asset investment/management advisors from approved budgets. This would include ensuring statutory and regulatory compliance, tenant compliance, landlord responsibilities, securing receipt of rents, dealing with voids and insurance matters. The costs associated with these areas would be considered in the financial appraisal for the property acquisition.~~

~~The property asset management will be subject to an annual review and incorporated within the Asset Management Plan (Housing Revenue Account) and Corporate Asset Plan (General Fund) which are presented to Full Council annually.~~

Appendix 1 (1b) – Stream 1 Business Case

~~The IST will prepare a business case for Stream 1 investments where the minimum weighted score target has been met. The business case will include as a minimum:~~

Financial Appraisal

~~A detailed financial appraisal setting out the projected income and costs associated with a potential acquisition along with an assessment of the proposed financing options and associated risks and considerations. This will include an assessment of the net yield over various scenarios up to a 50 year period, and include the following inputs:~~

- ~~anticipated void periods at the end of the initial and subsequent occupiers lease(s);~~
- ~~anticipated Capital Expenditure required by the Landlord, taking into account the age and condition of the premises and Landlords repairing obligations;~~
- ~~assumptions in the approved Capital and Treasury Management Strategies.~~

Lease Classification

~~A lease should be classified, for accounting purposes, as an operating lease rather than finance lease, to ensure that all rental income can be treated as revenue income (rather than a mix of capital receipt and revenue income). Operating leases are those where the risks and rewards of ownership are retained by the lessor (the Council) and must meet certain criteria. The main criteria being that the lease term should not be for the major part of the property's economic life and at the start of the lease, the total value of minimum lease payments (rents) should not amount to a significant proportion of the value of the property.~~

Risk Management Assessment

~~A detailed risk assessment of the potential purchase, including but not limited to:~~

- ~~Specific risks associated with individual assets;~~
- ~~Tenant default on rental payment (covenant risk);~~
- ~~Risk of failure to re-let (void risks);~~
- ~~Costs of ownership and management;~~
- ~~Differing lease structures (e.g. rent review structure, lease breaks);~~
- ~~Sector risk (portfolio spread);~~
- ~~Provide an exit strategy financial assessment as a 'worse case' scenario;~~
- ~~Liquidity assessment/LTV ratio assessment.~~

~~Market Risks, including risks of structural change or market failure, which may affect the market as a whole or particular subsectors or groups of property:~~

- ~~Illiquidity upon sale (e.g. lot size, transaction times, availability of finance);~~
- ~~Failure to meet market rental expectations (forecast rental growth);~~
- ~~Failure to meet market yield expectations (forecast yield shift);~~
- ~~Risk of locational, economic, physical and functional depreciation through structural change;~~
- ~~Risks associated with legislative change (e.g. planning or changes in fiscal policy).~~

Portfolio Assessment

~~An assessment to establish suitability against the Council's existing property portfolio which will consider rental levels, location, property type, rent review and lease expiry patterns, industry sector, tenure, lease covenants, market exit constraints and physical and environmental factors.~~

Report on Title

~~To confirm ownership.~~

Appendix 2: Governance Arrangements

Full Council

Scrutiny & Overview

Cabinet

Investment Governing Board – approves recommendations within approved scheme of delegations, with recommendations to Council as appropriate

Chief Operating Officer

S151 Officer

Leader

Deputy Leader and Lead Cabinet Member for Finance

Investment Selection Team – develops commercial ~~Stream 1, 2 & 3~~ investment recommendations for IGB approval

Chief Operating Officer

S151 Officer

~~Head of Commercial Development & Investment~~

Head of Economic Development and Investment

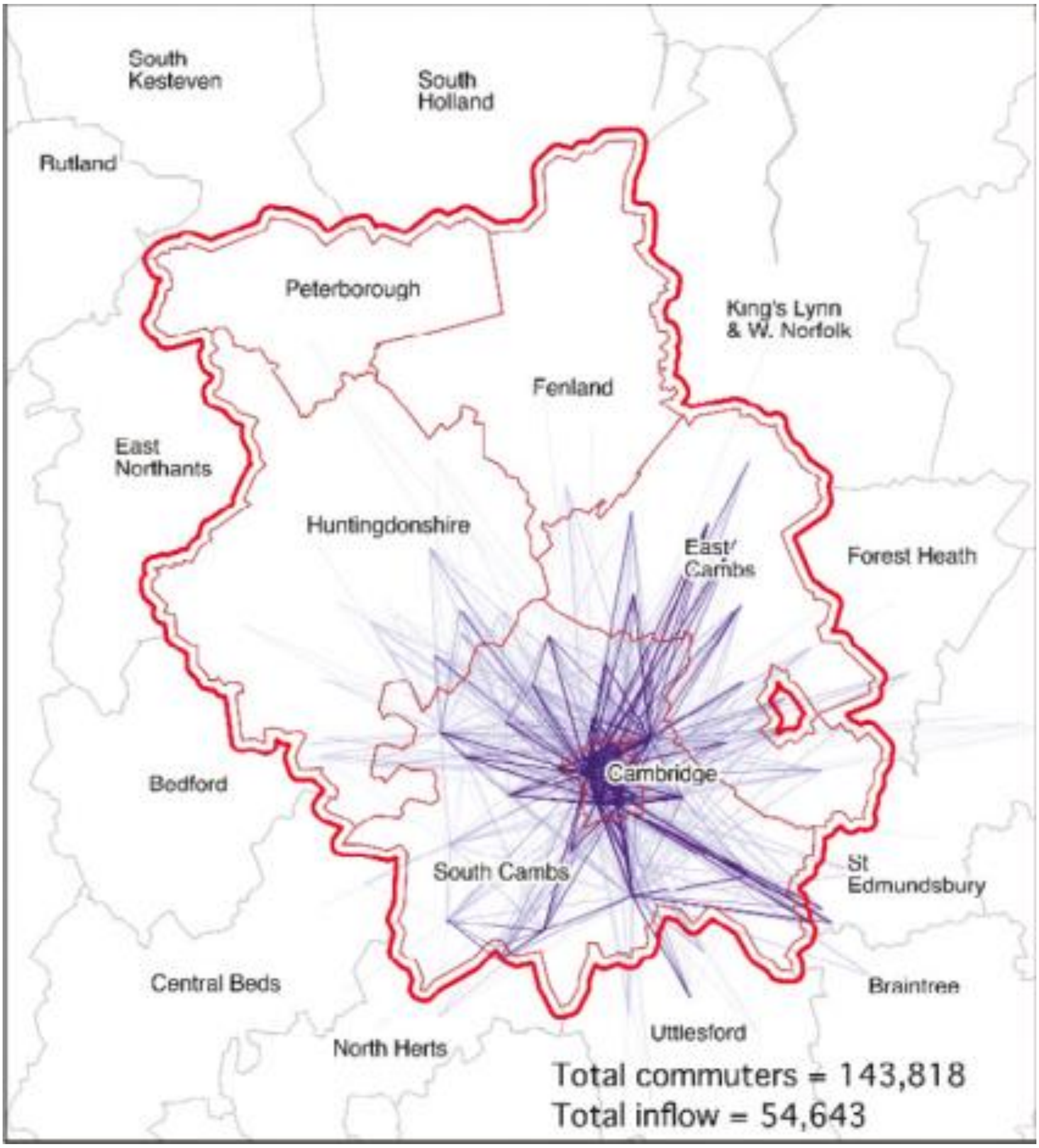
Head of Housing

Monitoring Officer

Appendix 3: Investment Area

Investment Target Area

The investment target area outside of the Local Plan boundary follows the definition of the Greater Cambridge commuting pattern, as identified in the Cambridgeshire and Peterborough Independent Economic Review (September 2018):



In the south of the district the commuting area could include a number of districts outside the county and consideration will be given to including those within the investment target area.

Appendix 4: Commercial Regenration ~~Property~~ Investments ~~Stream 2~~

1. Objective

The objective of commercial regeneration investments ~~the Stream 2 investment criteria~~ is to establish a framework for the identification of properties or land for redevelopment. These opportunities may deliver placemaking, environmental or economic development benefits, as defined in the Councils Business Plan, as well as positive financial returns for the Council in the form of future revenue income streams or capital uplifts. Future revenue income streams could include increases in retained business rates income and New Homes Bonus.

A key outcome of this category of investment will be the generation of economic growth through providing facilities and infrastructure. This includes the delivery of environmental benefits for the area.

Developed properties may be retained for the benefit of their long-term rental income and will become an investment asset after completion.

The decision on whether or not these investments would meet the overall objectives of this Strategy will be informed by a detailed financial appraisal. The commercial regeneration ~~Stream 2~~ investment criteria will be designed to ensure that the financial returns delivered from investments are commensurate with the deemed levels of associated risk. A higher risk investment will, therefore, require the delivery of greater financial returns.

2. Scope of Investment ~~Market Analysis and Background~~

Commercial Regeneration~~Stream 2~~ investment opportunities could come in a diverse range of forms. Examples include, but are not limited to:

- Assets that provide accommodation for essential businesses and services that are critical to the health of the local economy.
- Investing in climate and environmental initiatives, further exploiting and supporting green energy generation and maximising energy efficiency.
- Investing in Social Capital.
- Redeveloping Council owned assets.
- Building homes and commercial premises.
- Using public land and buildings to achieve long-term socio-economic development within the District and wider Greater Cambridgeshire Area, as identified in the Local Plan and Appendix 3 of this Strategy.

In line with Government guidance, commercial investment will need to be categorised for the purpose of “service delivery”, “housing”, “regeneration” or “preventative”. Given the new borrowing rules, there is a presumption against the acquisition of commercial assets primarily for yield, such as prime and close to prime commercial real estate investment (even by the use of existing reserves for this purpose).

Regeneration projects are permissible and are described in the guidance as having characteristics that fall into one of four areas:

(a) The project is addressing an economic or social market failure by providing services, facilities, or other amenities of value to local people and that would not otherwise be provided by the private sector.

(b) The Local Authority is making a significant investment in the asset beyond the purchase price: developing the assets to improve them and/or change their use, or otherwise making a significant financial investment.

(c) The project involves or generates significant additional activity that would not otherwise happen without the local authority's intervention, creating jobs and/or social or economic value.

(d) While some parts of the project may generate rental income, these rents are recycled within the project or applied to related regeneration projects, rather than being applied to wider services.

The "preventative" category can involve direct investments in companies or other assets to prevent social or economic decline (distinct from the regeneration category). The Government has defined this activity in the published guidance as action with all of the following characteristics:

(a) The intervention prevents a negative outcome, such as by buying and conserving assets of community value that would otherwise fall into disrepair, or providing support to maintain economic activity that would otherwise cease.

(b) There is no realistic prospect of support from a source other than the local authority.

(c) The local authority has an exit strategy and does not propose to hold the investment for longer than is necessary to achieve the objectives that justified the intervention.

(d) The intervention takes the form of grants, loans, sale and leaseback, equity injections, or other forms of business support that generate a balance sheet asset.

The Housing category covers the continuation of HRA schemes and General Fund housing activity, or housing delivered through Council owned companies and thus does not restrict the borrowing for the purpose of social or affordable housing.

Individual projects and schemes may have characteristics of several different categories of spending. In these cases, the Section 151 Officer will need to use his professional judgment to assess the main objective of the investment and consider which category is the best fit.

The categorisation does not prevent the Council from borrowing for projects that are primarily for other purposes, which also happen to generate a financial yield. The challenge will be finding projects that deliver much more than financial yield, such that the Section 151 Officer is satisfied that the investment is not primarily for yield and that the yield in such projects will be secondary to another prime purpose. This could include:

(a) Land assembly for development or regeneration purposes.

(b) Using borrowing to acquire or build new service assets (e.g. a new administrative office building, or a new leisure centre) and then re-purposing the existing redundant building into a 'yield' asset.

(c) Projects where the intention is to inject further investment beyond the initial purchase price; this could be through refurbishing or re-purposing the acquired asset. For example, purchasing an office building with the intention of converting it say into residential or other uses, for yield. Alternatively, acquiring a run-down industrial estate with a view to gaining vacant possession, demolishing it, and then redeveloping the site to create a new business or retail park.

(d) Ring-fencing revenue income from existing yield-based assets to invest on that asset, or other yield bearing assets, to improve investment performance and yields.

(e) Reviewing the existing 'legacy' property portfolio and identifying opportunities where investment could generate greater yields.

Every scenario will need to be reviewed on a case-by-case basis, and the S151 Officer will need to be satisfied that the scheme or acquisition meets the borrowing rules and will not fetter the ability to access PWLB borrowing.

~~As with other forms of investment there is a trade-off between risk and return. Given the more speculative nature of this type of investment activity the risks associated with this type of investment may, in some cases, be higher than those associated with Stream 1 activity. It may be possible to share risks and rewards of Stream 2 activities with adjoining councils and other public sector and private sector partners.~~

3. Property Acquisition/Development Methodology

Identification, consideration and recommendation of assets suitable for acquisition and/or development will be undertaken by the Invesment Team ~~designated Head of Commercial Development & Investment~~ in conjunction with internal resource and outside specialist guidance and professional support, as required, procured in accordance with the Council's established Contract Procedure Rules. This may involve approaches and introductions of opportunities direct from sellers, their agents and third parties. In such cases, fees may be payable if, after an introduction is made, the Council wishes to pursue the purchase further.

All investments considered for purchase will undergo qualitative and quantitative appraisal to establish portfolio suitability and risks. In addition, 3rd party advice will be called upon where specialist market knowledge is required. Any purchase will be subject to due diligence on all physical, financial and legal aspects of the commercial investment to address its suitability as an asset for long term security and growth. It is recognised that some of the cost of feasibility work and technical appraisal and assessment will be abortive.

These investment opportunities will initially be submitted to IST for consideration and subsequently to the IGB.

All commercially based investments and/or developments involve risk and, at each stage of the process, the commitments made will be at risk as there can be no guarantee that the investment will be secured or a fully successful development will be achieved. The terms of the agreement between the parties will seek to mitigate the inherent risks. Moreover, the timing of the exercise can also be a critical factor in achieving optimum success, particularly in terms of market conditions, the state of the national economy and levels of investment confidence within the development industry.

4. Investment Partnerships

This category of investment includes the identification of properties or land for development of new homes and other assets through Investment Partnerships. Investment Partnerships could come in a diverse range of forms. Examples include, but are not limited to:

- Building homes and commercial premises;
- pursuing redevelopment and regeneration opportunities;
- Enabling long-term stalled developments;
- Using public land and buildings to achieve long-term socio-economic sustainability for the District and wider Greater Cambridgeshire Area, as identified in the Local Plan and **Appendix 3** of this strategy.

These opportunities may deliver regeneration or economic development benefits as well as positive financial returns for the Council in the form of future revenue income streams or capital uplifts. Future income streams may include:

- Rental income from Council Housing (HRA Affordable Homes);
- Rental income from Private Rented Sector Housing (PRS) through Ermine Street Housing;
- Capital receipts from Intermediate Home Ownership stair-casing;
- Capital receipts from Right to Buy and the sale of constructed assets;
- Increases in retained business rates;
- New Homes Bonus.

By the nature of these investments, returns are likely to be in the form of capital receipts from the sale of a constructed asset, potentially developed in phases depending on the scale of the project. Developed properties may, however, be retained for the benefit of their long-term rental income and will become an investment asset after completion.

The investment criteria will be designed to ensure that the financial returns delivered from investments are commensurate with the deemed levels of associated risk. A higher risk investment will, therefore, require the delivery of greater financial returns.

5. Green Energy Projects

The approved Business Plan 2020-2025 identifies the following Actions and Measures which relate to green energy investments within the 'Green to our core' priority:

Action	Measure

In response to the global climate crisis, we will continue to work towards a zero-carbon future by 2050	• Identify and deliver further opportunities to reduce carbon emissions from our estate and operations. • Develop planning policies consistent with zero carbon by 2050 for adoption in the Greater Cambridge Local Plan, in partnership with Cambridge City Council. • Identify and deliver opportunities to install publicly accessible electric vehicle charging points in priority locations in the district, working with partners. • Continue to pursue opportunities to invest in green energy schemes.
Retrofit our Council Commercial Property including South Cambs Hall with renewable energy generation and energy efficiency measures	• Complete retrofit of Cambourne office • Reduce mains gas and electricity demands from our Cambourne office by over 50% per year (from March 2021 onwards compared to baseline in 2019). • Reduce carbon emissions from our Cambourne office by 49% per year (from March 2021 onwards compared to baseline in 2019). • Undertake energy
Continue to transition to Electric recycling and waste vehicles, including the investigation of on-site solar panel energy generation and green power storage	• Implement depot changes to prepare for electric refuse collection vehicle (eRCV) charging. • Procure five eRCVs to replace diesel version. • Develop outline business case for onsite solar panel energy generation with partners. • Investigate power storage systems.
Support Parish Council and community group projects to reduce reliance on fossil fuels and move toward the zero-carbon target and help Double Nature through habitat enhancement, advisory support for community land acquisition, local green space designation and tree planting	• Deliver a third round of funding through our Zero Carbon Communities grant scheme, awarding grants totalling £100,000 to community-based projects. • Continue to strengthen the Zero Carbon Parish and Community Network through our programme of workshops, web based resources and e-bulletins for community based zero carbon and nature recovery initiatives.
Upgrade our stock of 1,800 streetlights to LED, which will reduce energy consumption and save Parish Councils money	• Install energy saving LED fittings in all Council owned streetlights

The Investment Strategy will develop projects identified in the Green Energy Programme, which is responsible for co-ordinating transformation activities within the South Cambridgeshire District Council commercial estate and assess these using the same criteria as other ~~Stream 2~~ commercial regeneration investments.

6. Minimum Investment Criteria

For a commercial regeneration ~~Stream 2 property~~ investment to be considered by the IGB it must:

(a) Deliver a rate of return commensurate with the deemed level of risk associated with the investment.

(b) Be accompanied by a full business case, using the outline business case template at **Appendix 5**. If relevant to the form of commercial regeneration investment, the investment criteria matrix at **Appendix 6**, should be used. The minimum score target will be determined by IST having regard to Business Plan objectives.

(c) Include an assessment of the carbon equivalent tonnes to allow proposals to be scored against the context of reducing the Council's carbon footprint.

(d) Include an assessment of the strategic fit of the investment proposed against the Objectives and Focus Areas contained within the 2020-2025 Business Plan.

The assessment criteria ~~for Stream 2 activities~~ needs to be agile enough to allow significantly different schemes to be assessed using the same overarching principles.

The investment opportunities ~~considered under Stream 2~~ could vary significantly and, due to the speculative nature of some schemes, there will be higher risks attached to some investment opportunities. Each potential ~~Stream 2~~ investment will undergo a qualitative and quantitative appraisal and risk assessment to establish the financial returns, financial and legal implications and risks associated with the purchase. The findings of these appraisals will be reported to the IGB as part of the business case.

An investment opportunity that does not meet the minimum criteria ~~under investment stream 2~~ may have separate investment or regeneration benefits and, therefore, may still be considered for progression, however, decision making in this case is to be reserved to the Cabinet. For investments where there is a variable revenue stream, such as some energy projects, or a long time gap between investment and first revenue, such as development projects, alternative valuation options, such as the Internal Rate of Return (IRR) may be appropriate as a measure of an investment's rate of return.

~~In addition to the investment criteria matrix in **Appendix 1 (1a)**, Stream 2 investments will be assessed for their strategic fit against the Objectives and Focus Areas contained within the 2019-2024 Business Plan.~~

~~5.1 Business Plan Objectives~~

~~The IGB will from time to time advise the target scores for the business plan objectives, and the weighting to be given to individual focus areas within each business plan area~~

7. Risk Management

7.1 **Financing Risk:** As with all investments, there are risks that capital values, rental values and development values can fall as well as rise. Where the acquisition or development is reliant on increases in borrowing the business case will factor in fixed rate borrowing costs commensurate with the anticipated holding period of the asset. By utilising fixed rate borrowing options the Council will be protected from future increases in financing costs.

Financial returns ~~from Stream 2 activities~~ may come in the form of capital receipts either in place of or in addition to revenue returns. This would need to be considered carefully as part of the overall Investment Strategy given the requirement to achieve net revenue returns of 2.5% overall.

7.2 **Portfolio Risk:** To mitigate portfolio risk, the Council will seek to maintain a diverse commercial property portfolio and, in this regard, future decisions on its established commercial property estate will have regard to diversification. Each asset is reviewed on an annual basis in order to review its performance, investment requirements and whether it should remain in the portfolio. Void periods for commercial investment properties held by the Council will be monitored and vacancy levels reported to the IGB during the year to ensure active management.

7.3 **Development Risk:** The Council assesses the risk of loss before entering into and whilst holding property investments, including adequate due diligence checks, surveys and technical reports to support the business case.

8. ~~Business Case~~

~~The IST will prepare a business case for Stream 2 investments where the minimum weighted score target has been met (**Appendix 6**).~~

~~The minimum score target will be determined by the Head of Commercial Development & Investment and their Team, in consultation with the Lead Member for Finance, once Business Plan objectives and focus areas have been finalise~~

~~Appendix 3: Property Investment Stream 3 – Investment Partnerships~~

1. ~~Objective~~

~~The objective of the Stream 3 investment criteria is to establish a framework for the identification of properties or land for development of new homes through Investment Partnerships. These opportunities may deliver regeneration or economic development benefits as well as positive financial returns for the Council in the form of future revenue income streams or capital uplifts. Future income streams may include:~~

- ~~Rental income from Council Housing (HRA Affordable Homes);~~
- ~~Rental income from Private Rented Sector Housing (PRS) through Ermine Street Housing;~~
- ~~Capital receipts from Intermediate Home Ownership stair-casing;~~
- ~~Capital receipts from Right to Buy;~~
- ~~Increases in retained business rates;~~
- ~~New Homes Bonus.~~

~~By the nature of these investments, returns are likely to be in the form of capital receipts from the sale of a constructed asset, potentially developed in phases depending on the scale of the project. Developed properties may, however, be retained for the benefit of their long-term rental income and will become an investment asset after completion. The decision on whether or not these investments would meet the overall objectives of this Strategy will be informed by a financial appraisal as described in Appendix 1.~~

~~The Stream 3 investment criteria will be designed to ensure that the financial returns delivered from investments are commensurate with the deemed levels of associated risk. A higher risk investment will, therefore, require the delivery of greater financial returns.~~

2. ~~Market Analysis and Background~~

~~Stream 3 Investment Partnerships could come in a diverse range of forms. Examples include, but are not limited to:~~

- ~~Building homes and commercial premises;~~
- ~~pursuing redevelopment and regeneration opportunities;~~
- ~~Enabling long-term stalled developments;~~
- ~~Using public land and buildings to achieve long-term socio-economic sustainability for the District and wider Greater Cambridgeshire Area, as identified in the Local Plan and~~ **Appendix A4** ~~of this strategy.~~

3. ~~Acquisition/Development Methodology~~

~~Identification, consideration and recommendation of assets suitable for acquisition and/or development will be undertaken by the designated Head of Commercial Development & Investment in conjunction with internal resource and outside specialist guidance and professional support, as required, procured in accordance with the Council's established Contract Procedure Rules. These investment opportunities will initially be submitted to IST for consideration and subsequently to the IGB.~~

~~All investments considered for purchase will undergo qualitative and quantitative appraisal to establish portfolio suitability and risks. In addition, 3rd party advice will be called upon where specialist market knowledge is required. It is recognised that some of the cost of feasibility work and technical appraisal and assessment will be abortive.~~

~~All commercially based investments and/or developments involve risk and, at each stage of the process, the commitments made will be at risk as there can be no guarantee that the investment will be secured or a fully successful development will be achieved. The terms of the agreement between the parties will seek to mitigate the inherent risks. Moreover, the timing of the exercise can also be a critical factor in achieving optimum success, particularly in terms of market conditions, the state of the national economy and levels of investment confidence within the development industry.~~

~~In addition to the investment criteria matrix in~~ **~~Appendix 1 (1a)~~**~~, Stream 3 investments will be assessed for their strategic fit against the Objectives and Focus Areas contained within the 2019-2024 Business Plan.~~

~~The IGB will from time to time advise the target scores for the business plan objectives, and the weighting to be given to individual focus areas within each business plan area.~~

4. ~~Minimum Investment Criteria~~

~~For a Stream 3 property investment to be considered by the IGB it must:~~

- ~~Deliver a rate of return commensurate with the deemed level of risk associated with the investment;~~

- ~~Be accompanied by a full business case prepared by the IST, and other officers where relevant.~~

~~The scoring matrix for Stream 3 investments will be based on the targets for Stream 2 investments. Schemes with higher risks will be expected to deliver higher levels of return to cover the risk considerations, and only schemes that deliver the assessed rate of return will pass the minimum assessment criteria.~~

~~Each potential Stream 3 investment will undergo a qualitative and quantitative appraisal and risk assessment to establish the financial returns, financial and legal implications and risks associated with the purchase. The findings of these appraisals will be reported to the IGB as part of the business case.~~

~~An investment opportunity that does not meet the minimum criteria under investment stream 3 may have separate investment or regeneration benefits and, therefore, may still be considered for progression, however, decision making in this case is to be reserved to the Cabinet rather than the IGB. For investments where there is a variable revenue stream, such~~

~~as some energy projects, or a long time gap between investment and first revenue, such as development projects, alternative valuation options, such as the Internal Rate of Return (IRR) may be appropriate as a measure of an investment's rate of return.~~

5. ~~Risk Management~~

~~**5.1. Financing Risk:** As with all investments, there are risks that capital values, rental values and development values can fall as well as rise. Where the acquisition or development is reliant on increases in borrowing the business case will factor in fixed rate borrowing costs commensurate with the anticipated holding period of the asset. By utilising fixed rate borrowing options the Council will be protected from future increases in financing costs.~~

~~Financial returns from Stream 3 activities may come in the form of capital receipts either in place of or in addition to revenue returns. This would need to be considered carefully as part of the overall Strategy given the requirement to achieve net revenue returns of 2.5% from the investment strategy overall.~~

6. ~~Business Case~~

~~**6.1** The IST will prepare a business case for Stream 2 investments where the minimum weighted score target has been met (**Appendix 6**).~~

~~The minimum score target will be determined by the Head of Commercial Development & Investment and their Team, in consultation with the Lead Member for Finance, once the Business Plan objectives and focus areas have been finalised.~~

Appendix 5: ~~Stream 2 and 3~~ Business Case Outline

The business case will include the following as a minimum:

Reasons: Why is the investment needed?
Options: What are the options available?
Benefits: What would be the benefits of the investment? How would it help deliver the Business Plan objectives?

Investment Appraisal: A detailed financial appraisal setting out the projected income and costs associated with a potential acquisition along with an assessment of the proposed financing options and associated risks and considerations.

Risk Management Assessment: A detailed risk assessment of the potential investment, including mitigation measures that can be employed:

Specific risks associated with the proposed investment:

- Risk of failure (sales/letting void risks)
- Costs of ownership and management
- Differing ownership structures (e.g. wholly owned subsidiaries).
- Sector risk (portfolio spread)
- Provide an exit strategy financial assessment as a 'worse case' scenario
- Liquidity assessment
- LTV ratio assessment

Market Risks, including risks of structural change or market failure, which may affect the market as a whole or particular subsectors or groups of property:

- Illiquidity upon sale (e.g. lot size, transaction times, availability of finance)
- Failure to meet market value expectations (forecast value growth)
- Failure to meet market yield expectations (forecast yield shift)
- Risk of locational, economic, physical and functional depreciation through structural change
- Risks associated with legislative change (e.g. planning or changes in fiscal policy)

Portfolio Assessment: An assessment to establish suitability against the Council's existing property portfolio which will consider rental levels, location, property type, rent review and lease expiry patterns, industry sector, tenure, lease covenants, market exit constraints and physical and environmental factors.

Legal Status/Advice: Including the following:

- Report on title (to confirm ownership)
- Options for legal structures (e.g. use of wholly owned subsidiaries)
- Advice on SDLT and VAT linked to use of legal structure options

Estimated Timescale: Including the following:

- Proposed start date/Estimated end date/duration

Estimated Project Resources: Including the following:

- Identify role and name of officers
- Estimate the demand on officer time
- Identify resource gaps and whether these can be met
- Identify external resources required and estimated budget cost

Appendix 6 – Commercial Regeneration Investment Criteria Matrix

For appropriate transactions, the IST will score the ~~property~~ investment against the scoring criteria shown below. The criteria will apply to the acquisition of new and existing assets and in these cases the ~~in order of priority. The~~ minimum score for the investment would ~~Stream 1~~ at least 100 out of a maximum score of 184/

The criteria will not, however, cover all commercial investment scenarios, including regeneration opportunities and, in these cases, there a detailed business case would need to be prepared in line with the outline at appendix 6, balancing the level of return with the project risk ~~and the score. For example, a high return would reflect higher risk and consequently a lower score; conversely, a lower level of return would reflect a lower level of risk and a higher score.~~

The Investment Criteria Matrix is based upon CIPFA guidance and is comparable with methods used by other local authorities, such as New Forest, Kettering and Redditch, which all broadly follow a format recommended by CIPFA. The table below shows the suggested scoring criteria to be applied when considering an investment ~~property~~ opportunity.

Score		4	3	2	1	0
Scoring Criteria	Weighting Factor	Excellent / very good	Good	Acceptable	Marginal	Unacceptable
Location	~~12~~ 10	Major Prime	Micro Prime	Major Secondary	Micro Secondary	Tertiary
Tenancy Strength	~~10~~ 8	Single tenant with strong financial covenant	Single tenant with good financial covenant	Multiple tenants with strong financial covenant	Multiple tenants with good financial covenant	Tenants with poor financial covenant strength / vacant
Single/Multi Let	6	Single Let	2-3 Tenants	4-6 Tenants	6+ Tenants	Vacant
Occupiers lease length	5	Greater than 10 years	Between 7 and 10 years	Between 4 and 7 years	Between 2 and 4 years	Less than 2 years; vacant
Re-letting prospects (Void Period)	5	< 3 months	3-6 months	6-12 months	12-18 months	18+ months
Tenure	~~9~~ 4	Freehold	Lease 125 years plus	Lease between 50 & 125 years	Lease between 20 & 50 years	Lease less than 20 years
EPC/Sustainability	4	Highly Sustainable A-B	Mainly Sustainable C	Moderate but some works would be beneficial - D	Unlikely to be problematic when re-letting or selling - E	Unsustainable - F or worse
Repairing Terms ~~obligations~~	~~4~~ 3	Full repairing and insuring	Internal repairing – 100% recoverable	Internal repairing – partially recoverable	Internal repairing – no recoverable	Landlord
Building Quality / obsolescence	~~4~~ 2	Newly Built ~~(useful life 50+ years)~~	Recently refurbished (within the past 5 years)	Average condition and likely to continue to be fit for current use for 25+ years	Aged property with redevelopment potential	Nearing end of useful life / unlikely to continue when lease expires
Income Profile	2	10% Reversionary	0-10% Reversionary	Rack Rented	Over Rented -10%	Over Rented - 10%+
Lot size	~~2~~ 1	Between £6m and £12m	Between £4m & £6m or 12m and £18m	Between £2m & £4m or £18m and £20m	Between £1m & £2m or £20m & £25m	Less than £1m or more than £25m

Investment Criteria Definitions

Location - property is categorised as prime, secondary or tertiary in terms of its location desirability. For example, a shop located in the best trading position in a town would be prime, whereas a unit on a peripheral neighbourhood shopping parade would be considered tertiary.

Tenancy Strength – the financial strength and risk of failure of a tenant determines the security of the property's rental income. A financially weak tenant increases the likelihood that the property will fall vacant. Rating agencies, such as Dun & Bradstreet are often used to evaluate covenant strength, ranging from "5A" to "HH" to reflect company size based upon worth or equity, and a Composite Credit Appraisal from 1 to 4 to reflect the assessment of the firm's creditworthiness. The minimum acceptable financial strength for any given tenant will be determined through financial appraisal of company accounts and the use of appropriate methods of risk assessment and credit scoring. To minimise management and risk, the preference will be for single occupancy investments wherever possible.

Tenure – anything less than a freehold acquisition will need to be appropriately reflected in the price**.** If leasehold, is the lease free from unencumbered/onerous terms? Is the rent periodically reviewed to take into account inflation and upward market movement?

Occupational Lease Length – the lease term will determine the duration of the tenant's contractual obligation to pay rent. The most attractive investments offer a long lease with a strong tenant covenant. The lease term will reflect any tenant break clauses. The optimum lease length will depend on the sector, with commercial B1 offices typically 7+years and 10+ years for industrial. Retained agents will be expected to qualify the quality of the length lease in their pre-acquisition report.

Building Quality – a brand new or recently refurbished building with an anticipated life of at least 40 years will not usually require capital expenditure for at least 15 years. This is attractive for income investors requiring long term rental income with the minimum of ongoing capital expenditure.

Repairing Obligations – under a Full Repairing & Insuring Lease (FRI), the tenant is responsible for the building's interior and exterior maintenance/repair. The obligation is limited to the building's interior under an Internal Repairing & Insuring Lease (IRI). The preference will be to favour FRI terms (or FRI by way of service charge i.e. all costs relating to occupation and repairs are borne by the tenants and administered through a service charge).

Lot Size – to maintain portfolio balance the preference will be for no single property investment to exceed £12m for a single let property.

In addition to the above criteria the IGB should, when assessing the merits of an investment, specifically consider compatibility with all SCDC policies on matters relating to use such as: -

- Alcohol or tobacco production or sale;
- Animal exploitation;
- Environmentally damaging practices;
- Gambling;
- Pornography.