Cambridge City Council **Item**

To:	Executive Councillor for Finance and Resources: Councillor George Owers
Report by:	Dave Prinsep, Head of Property Services
Relevant scrutiny committee:	Strategy & Resources Scrutiny Committee 19/1/2015
Wards affected:	All

COMMERCIAL PROPERTY INVESTMENT
Key Decision

1. Executive summary

1.1 The Council's commercial property portfolio has consistently produced good rates of return compared to Treasury Management investments over the past few years. This reflects recent exceptionally low bank interest rates on cash investments and that the Cambridge commercial property market has proved resilient.

1.2 The Budget Setting Report for 2015/16 recommends the allocation of £8m for investment in commercial property to generate additional income of £400,000 p.a.from 2016/17.

1.3 Alternatives to direct investment in commercial property could be a property fund or investing in our existing property portfolio. For the reasons set out in the report, it is recommended that the funding available is invested directly in acquiring new property.

1.4 The Council previously set aside £515,000 for commercial property investment and this may be pooled with the newly allocated funding.

2. Recommendations

The Executive Councillor is recommended that:

2.1 The Council allocates £8m for investment in acquiring commercial property, subject to the 2015/16 Budget Setting Report being approved;

2.2 Authority is delegated to the Head of Property Services to acquire commercial property up to £8,515,000 (inclusive of acquisition costs) in consultation with the Executive Councillor for Finance and

Resources, the Chair and Opposition Spokesperson for Strategy & Resources Scrutiny Committee and the Head of Finance.

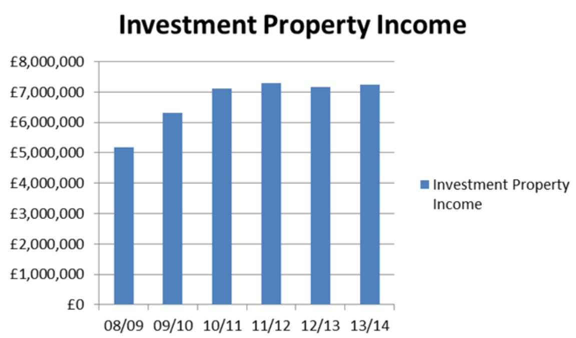
3. Background

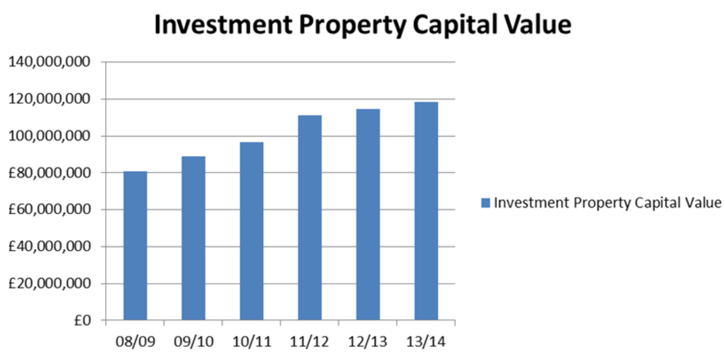
3.1 The Council owns significant commercial property interests including city centre and local shopping centres, industrial estates, retail units, offices, public houses, industrial land and leisure facilities. The portfolio produces a significant income to the Council which is used to deliver the Council's other priorities.

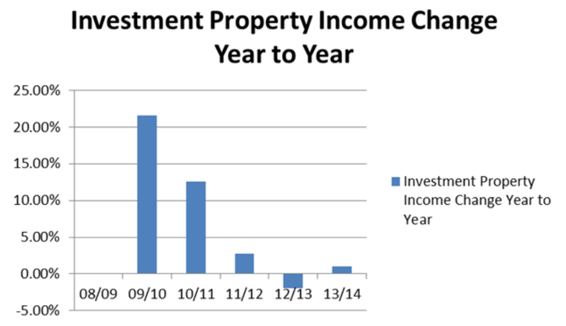
3.2 Cash held by the Council is invested in accordance with the Treasury Management policy so that it is relatively risk free, available when required and produces a return on investment. This cash comprises the Council's reserves, revenue received but not yet spent and planned future capital expenditure needs.

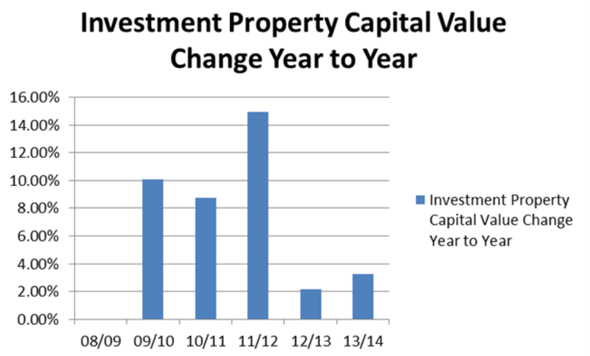
3.3 Due to recent low interest rates, these cash investments produce relatively low returns. The Executive Councillor for Finance and Resources at the Strategy & Resources Scrutiny Committee on 8th July 2014 approved that up to £10m of Treasury Management funds could be invested in a special local authority property fund managed by CCLA to achieve higher returns.

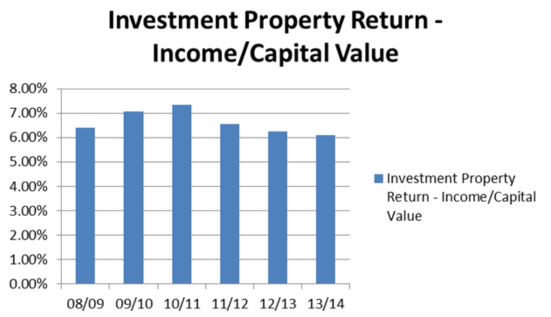
3.4 The Council's commercial property portfolio consistently produces returns above cash investments. The charts below provide an overview of the performance of the commercial property portfolio. It is likely that 2014/15 will show an increase in capital value above the previous year due to current demand for such property in Cambridge.

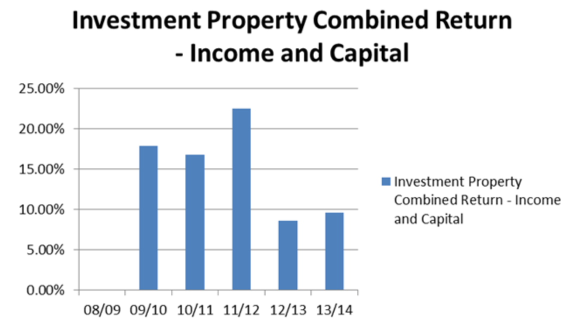












The above figures are based on the Council's Annual Accounts for the relevant years.

3.5 Cash investments generate lower returns as they are low risk, easy to access (liquid), are relatively short term, and transaction costs are low. Property investments generate higher returns but are riskier, it is more difficult to get money out (illiquid), are held for the longer term and have high transaction costs.

3.6 Investment in commercial property should be for at least 5 years but commercial property can be sold to release funds when required. Properties to be sold can be determined at that time with an opportunity to reshape the commercial property portfolio by disposing of underperforming properties or those that do not meet the Council's objectives.

3.7 Agents will be appointed to advise on and acquire suitable commercial property investments. The Council's objectives will be agreed with the agents and they will review the current portfolio so that any investment complements it.

3.8 Delegation is sought by the Head of Property Services to invest in commercial property. The property market is very competitive and success depends on timely decisions. The Head of Property Services will consult with the Executive Councillor for Finance and Resources, the Chair and the Opposition Spokesperson for Strategy and

Resources Scrutiny Committee and the Head of Finance before acquiring a property. Any acquisition will be reported to a later Strategy and Resources Scrutiny Committee.

3.9 An alternative to direct property investment is a property fund where multiple investors' money is invested in a variety of properties. This reduces risk by having a diverse property portfolio in terms of location, property type (e.g. retail, industrial), tenants and size of individual acquisitions. It also enables relatively larger acquisitions than may otherwise be the case for an individual investor as each investor's capital is pooled. Returns are usually on the basis of dividends and return of capital when the units are sold. The value of the units can go up or down depending upon how well the properties perform.

3.10 The CCLA recently gave a presentation about its property fund, "The Local Authorities' Property Fund", for Treasury Management purposes as proposed in the "Annual Treasury Management Report 2013/14" to Strategy & Resources on 14th July 2014. Further detail about the CCLA fund is included at Appendix A to give an overview of a typical fund. This is a relatively small fund in terms of financial value.

4. Implications

(a) Financial Implications

4.1 The Budget Setting Report for 2015/16 recommends that £8m be made available in 2015/16 for investment in commercial property with an income expectation of £400,000 p.a. ongoing from 2016/17. The Council previously ring-fenced £515,000 for reinvestment in commercial property and so this is available in addition.

4.2 Commercial property investments produce a range of returns depending upon the property market's perceived risk related to the income stream and capital values. Prime property in Cambridge can achieve initial yields (rent as proportion of capital value) as low as 3.5% reflecting very secure income, possible rental growth and hence potential capital value increases. The proposed income target of £400,000 p.a. reflects an overall initial yield of 5.3% when costs of acquisition are taken into account.

4.3 An acquisition may give rise to VAT implications. In order to protect the Council's Partial Exemption limit, a transaction would be treated as a Transfer of a Going Concern. This takes any transaction outside the scope of VAT with the exception that Stamp Duty Land Tax is payable on a VAT inclusive price.

(b) **Staffing Implications**

4.4 It is proposed to appoint agents to acquire a suitable property investment as they offer investment expertise not held internally and the fees for this are included in the above costs. Similarly, agents would probably be used for a disposal but these costs are not reflected above as it is assumed that these would be met from the proceeds of sale at that time.

4.5 The day to day management of an acquired property would probably be dealt with by the existing Property Services team within existing capacity on the basis that any acquisition would require low management input and was relatively local.

(c) **Equality and Poverty Implications**

4.6 An Equality Impact Assessment has not been conducted as this will be an acquisition of tenanted commercial property to generate an income stream. The accessibility of the property will be one of the factors to be considered in deciding between investments.

(d) **Environmental Implications**

4.7 Until a property is identified, it is difficult to assess the environmental impact. It is likely that the acquisition would be at a comparable or better Energy Performance Certificate rating than the existing commercial portfolio. The acquisition is therefore likely to have no climate change impact or a low positive impact.

(e) **Procurement**

4.8 It is intended to appoint an agent to acquire a property on behalf of the Council. Officers will comply with the Council's Procurement Policy in appointing an agent. As this is fairly specialised, agents will be expected to demonstrate good knowledge of the Cambridge and surrounding areas investment market, that they are frequently active in this area on behalf of clients and that they understand the Council's requirements in relation to an investment and how this might fit within the existing portfolio.

(f) **Consultation and communication**

4.9 This is a specialised area and so no public consultation has taken place. Internal consultation has taken place with Finance and Procurement.

(g) **Community Safety**

4.10 There are no Community Safety implications.

5. Background papers

These background papers were used in the preparation of this report:

Cambridge City Council Annual Statement of Accounts
The Local Authorities' Property Fund Scheme Information by CCLA
Bidwells' Retail and Leisure Data Book Autumn 2014
Bidwells' Business Space Data Book Autumn 2014

6. Appendices

Appendix A - The CCLA Local Authorities' Property Fund Profile

Appendix B – Confidential Appendix

7. Inspection of papers

To inspect the background papers or if you have a query on the report please contact either:

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The Local Authorities' Property Fund

Fund Profile – 30 June 2014

A specialist Property Fund available only to Local Authority Investors.

Price at 30.06.14	Net asset value
Income units	254.25p (xd)
Gross dividend yield	4.45%*

* Based upon the net asset value and historic annual dividend of 11.3183p, the gross income less management expenses.

Strong governance

The trustee is the Local Authorities' Mutual Investment Trust (LAMIT). LAMIT is controlled by representatives of the Local Government Association, the Convention of Scottish Local Authorities, the Northern Ireland Local Government Officers' Superannuation Committee and investors in the Fund. As trustee, LAMIT approves the investment strategy and the risk profile of the portfolio and reviews performance.

Unique accounting advantages

Unlike other property funds or direct property purchases, the Fund does not count as capital expenditure for English and Scottish Local Authorities. Dividends are treated as revenue income, but the General Fund is protected from fluctuations in the unit price. The investment is treated as an available for sale financial asset.

Meeting your needs

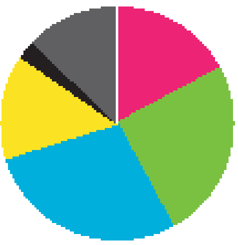
Suitable for Local Authorities with long term funds to invest to achieve an attractive income and capital growth over time.

The Property Fund is designed to achieve long term capital growth and a rising income from investments in the commercial property sector.

The portfolio is actively managed with a focus on asset selection. The intention is to boost returns by lease and tenant management and property improvement.

The Fund has a broad sector spread, with prudent diversification to keep risks under control.

Asset allocation by investment category 30 June 2014



Shops 17.2%
Offices 24.9%
Industrial & W'houses 28.1%
Retail Warehouses 14.5%
Indirect 2.6%
Cash 12.7%
Allowing for commitments made, the Fund is fully invested.

Total fund size £173 million
Borrowing facility £11 million

Property portfolio details

Top 5 properties = 35.6% of the portfolio

Top 5 tenants = 37.5% of rental income

Weighted unexpired lease term 6.0 years

Vacancy rate 7.2%

Asset allocation by region and category 30 June 2014

Fund Data and IPD Other Balanced Property Funds Index data as at 30 June 2014

Top ten property holdings – total 49.0%

London, Fenchurch Street
Lutterworth, Magna Park
Wakefield, Albion Mills Retail Park
Chichester, East Street
Nottingham, Castle Boulevard
Bishops Stortford, Stansted Road
Aberdeen, Fyvie Buildings
London, Picketts Lock
Birmingham, Junction Six
London, Threadneedle Street

Market update

The improvement in the market environment has continued and has broadened out. Although prime and trophy assets remain well supported, the strongest gains are now being seen from good quality secondary assets where investors are attracted by the superior yields and growth prospects. Transaction volumes have risen and competition for good stock is intense - an indication that valuations will continue to improve for the medium term. An encouraging development has been early indications of an improving occupier market; although void rates remain sticky, there is evidence of rising rents in a number of areas.

Fund activity

Cash flow into the fund has continued at a high level and this has been matched by a series of acquisitions of good quality assets with attractive yields. Three properties have been added to the portfolio, an office block in Solihull, on a long lease with a 7% yield, an office property in Aberdeen with an income yield expected to increase to over 8% on lease renewal in three years time and an office in Nottingham, again on an attractive lease and with strong income growth potential. At the end of the quarter three other purchases were near to completion, these will effectively consume the current cash balance.

Fund news

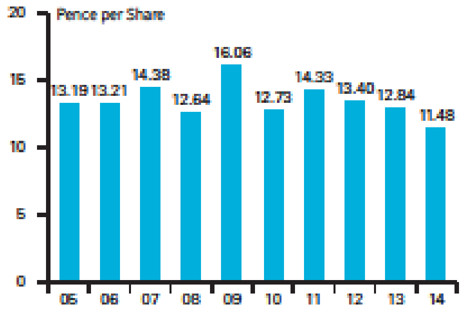
The total return for the quarter to June 30th was 4.2%, this brings the total for the past year to 17.7%. The equivalent benchmark return was 4.2% and 15.2%. The quarterly income payment was 2.9962p per unit.

Outlook

The uptrend in the sector has strengthened in recent months, we expect this positive momentum to continue for the balance of 2014 and into 2015. Over this period the valuation gap between trophy and top prime assets and the rest of the sector will continue to narrow due to outperformance by the latter group. We expect the nascent improvement in occupier markets to strengthen, bringing void rates down, if gradually and giving a boost to rental growth. Rental growth will be the next major influence on sector returns.

Dividend history of The Local Authorities' Property Fund

Years to 31 March



Calendar performance versus the benchmark

* The benchmark is the IPD Other Balanced Property Funds Index.

Source: CCLA – Please note that past performance is no guarantee of future returns.

Long term performance

Total return performance (net) 12 months to end of June

	2014	2013	2012	2011	2010
The Local Authorities' Property Fund	+17.7%	+2.6%	+6.9%	+7.9%	+28.7%
Benchmark*	+15.2%	+1.4%	+3.8%	+7.9%	+19.0%

* The benchmark is the IPD Other Balanced Property Funds Index.
Source: CCLA – Please note that past performance is no guarantee of future returns.

Costs and charges

Our policy is always to keep costs and charges low - we believe that high costs and charges have a very damaging cumulative effect on investor returns. We negotiate to keep expenses low and monitor dealing costs closely. We have no entry or exit fees, the only income taken by the investment manager is the annual charge of 0.65%.

Key facts

Bid/offer spread	7.3%
Dealing day	Month end valuation day*
Minimum initial investment	£25,000
Minimum subsequent investment	£10,000
Dividend payment dates	End January, April, July & October
Annual management charge	0.65% (deducted from income)
Unit types available	Income
Sedol number	0521664
ISIN number	GB0005216642

Income payments are now made gross of tax.
Any outstanding historic tax reclaims should be addressed to:

Glynis Free
Specialist Repayment Team
7 South
Ty - Glas
Cardiff CF14 8HR
Telephone 03000 580618 9.30am - 1pm

* Instructions for the issue or redemption of units must be received by CCLA no later than 5pm on the business day prior to the Valuation Date. If the valuation day is a Bank Holiday the dealing day will be the previous working day. Units are only realisable on each monthly dealing date and redemptions may not be readily realisable; a period of notice not exceeding six months may be imposed for the redemption of units.

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Important Information

Investors are not certain to make profits; losses may be made. Any forward looking statements are based upon our current opinions, expectations and projections. We undertake no obligations to update or revise these. Actual results could differ materially from those anticipated.

The Fund is an unregulated collective investment scheme established under a Scheme approved by H M Treasury under Section 11 of the Trustee Investments Act 1961 and is subject to provisions of a Trust Deed dated 6 April 1972 and a supplemental Trust Deed dated 13 September 1978. The Fund operates as an open-ended Fund under Part IV of the schedule to the Financial Services and Markets Act 2000 (Exemption) Order 2001.

CCLA Investment Management Limited (registered in England No. 2183088 at the office below) is authorised and regulated by the Financial Conduct Authority and is the manager of the Local Authorities Property Fund.