

Investment Board

Summary Annual Report

Financial Year 2017/18



SURREY

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The council has made investments in property to enhance its financial resilience and safeguard services



Our Corporate Strategy, Confident in Surrey's future



Listen



Responsibility



Trust



Respect

The council's strategic framework for innovation and investment is supporting the development of new ideas and approaches to enhance the financial resilience of the council. This increased emphasis on developing income streams has led to the creation of the Investment Board to approve acquisitions that contribute to the achievement of the agreed investment strategy, to monitor the performance of the portfolio and ensure satisfactory performance and effective risk management. The financial returns delivered from investment will help to ensure that we continue to deliver quality services for our residents.

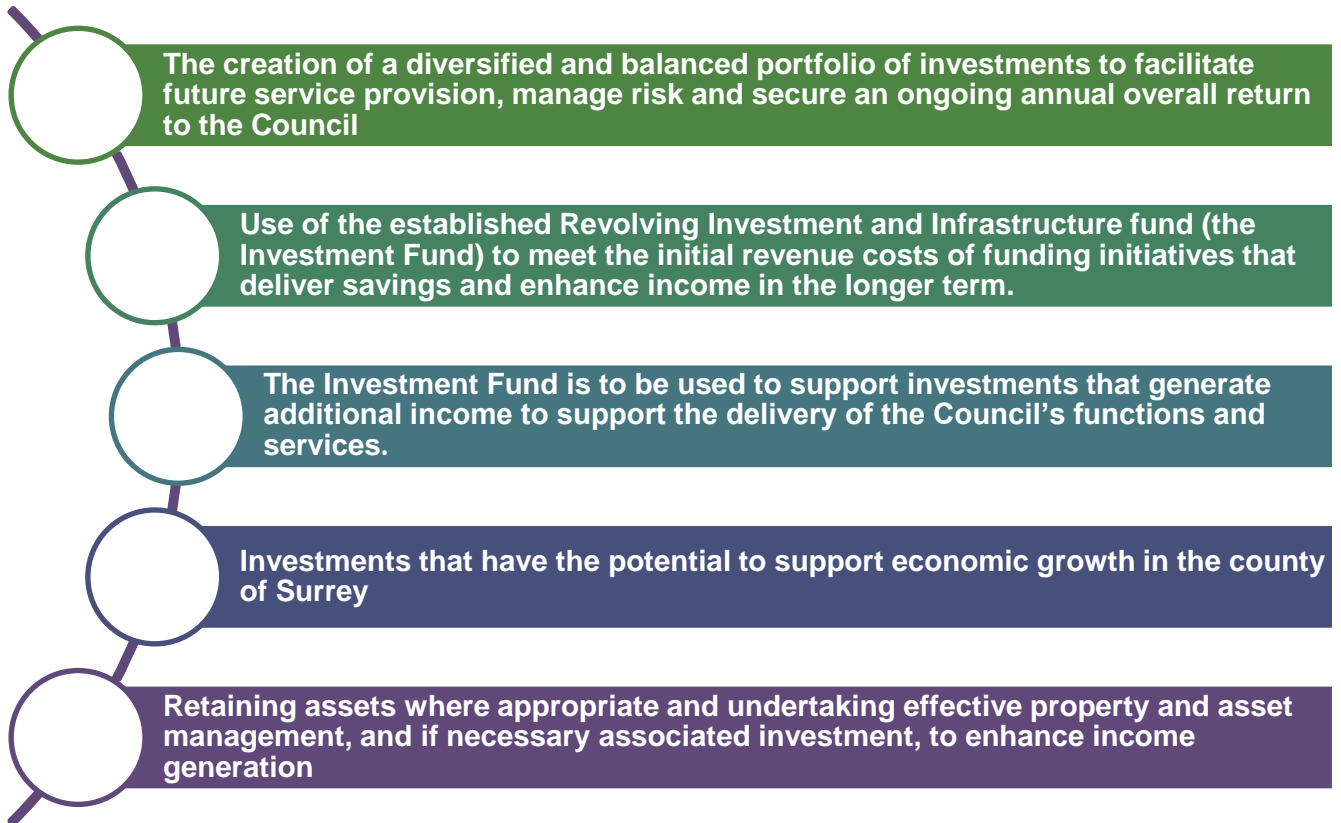
The Annual Report of the Investment Board provides an overview of the progress we have made in developing a property investment portfolio and enhancing the financial resilience of the council. The Investment Board is also responsible for evaluating and recommending non-property investments for decision by Cabinet or Cabinet Member, for example the council's equity investment in the Municipal Bonds Agency. The Shareholder Board produces an annual report about each company in which the council owns shares and therefore to avoid duplication this report of the Investment Board focusses just on the Property Investment Portfolio.



David Hodge CBE
Leader of Surrey County Council

The Investment Strategy

The Investment Strategy was agreed by Cabinet in July 2013 and was developed in response to the requirement for the Council to enhance its financial resilience in the longer term. The main principles of the Investment Strategy are as follows;



The Investment Strategy provides the council with the ability to make investments that have the potential to support economic growth or deliver economic regeneration within the county. This may mean that schemes with lower returns are considered however all investments need to demonstrate a return in excess of the cost of capital in order to be affordable for the council. The council is also able to purchase properties that provide for long-term future service use, whilst delivering an investment return. These assets provide flexibility in the estate whilst delivering an investment return.

Cabinet approved the business case for the creation of the Property Company and its associated subsidiaries in May 2014 in order to enable it to invest in property outside the county and to invest for the commercial income return. The companies making up the Halsey Garton Property Group (HGP) were incorporated between June and July 2014.

The investment portfolio of the Council is therefore a combination of assets acquired or developed by the Council for future service need or economic development and those acquired or developed by HGP.

Governance

The Investment Board

- The Investment Board was created in March 2017 following the review of the Investment Strategy by Cabinet and in order to facilitate the further growth of the investment portfolio. Prior to this the Investment Advisory Board was in place to make recommendations for Cabinet approval.
- The Board and its role is noted in the constitution of the council. The Board works in accordance with its Terms of Reference (see Page 16) which are reviewed on an annual basis and in line with a Responsible Investment Policy (see Page 20)

The members of the Investment Board are the Leader, the Deputy Leader and three Cabinet Members chosen by the Leader. The Leader may also, from time to time, appoint one County Councillor to undertake a non-voting role. The board is supported by officers of the council.

Members

- Leader
- Deputy Leader
- Cabinet Members x 3 [Tim Oliver, Mel Few & Colin Kemp]
- Non-Voting Member [Nick Darby]

Advisors

- Chief Executive
- Director of Finance (Section 151 Officer)
- Legal Services Manager (Monitoring Officer)
- Chief Property Officer
- Head of Strategic Finance (Board Secretary)
- Supported by external specialist professional advisors

The board is responsible for –

- Ensuring that investment opportunities are thoroughly evaluated, ensuring that there is an appropriate balance between risk and reward and that the acquisition contributes to the achievement of the aims of the strategy.
- Approving property investment acquisitions, property investment management expenditure, property investment disposals and the provision of finance to enable the council's property company to purchase assets.
- Monitoring the progress made in respect of achieving an appropriately balanced and diversified portfolio of assets and its performance.

Investment Portfolio

Property Investment

Other Investment

The Investment Board is also responsible for evaluating and recommending non-property investments for decision by Cabinet or Cabinet Member depending upon value. These decisions are made in accordance with the protocol for “key decisions” as set out in the Council’s constitution, e.g. a Cabinet decision is required for an investment spend of £1m and over. The council’s non-property investment assets include debt & equity finance provided to FutureGov Ltd and equity investment in the Municipal Bonds Agency.

The Shareholder Board provides oversight for the council’s shareholdings – it safeguards the council’s interests and takes decisions in matters that require the approval of the council as owner or as a shareholder of a company. The Shareholder Board produces an annual report which provides information about each company and therefore to avoid duplication this report of the Investment Board focusses just on the Property Investment Portfolio.

The Shareholder Board is responsible also for the oversight of the property company HGP in the same way that is responsible for the oversight of other trading companies created and owned by the council. The link between the two boards is summarised in the table below.

Property Investment & Halsey Garton Property Ltd

Investment Board

- Approves the business case for asset purchase or development by HGP
- Approves the provision of finance (equity & debt) to enable HGP to purchase asset
- Reviews and considers the performance of the total property investment portfolio- assets held by both SCC and HGP
- Considers the financial results of HGP from the point of view of the council - e.g. the interest received from providing loans (debt finance) to the company and the expected annual dividend.

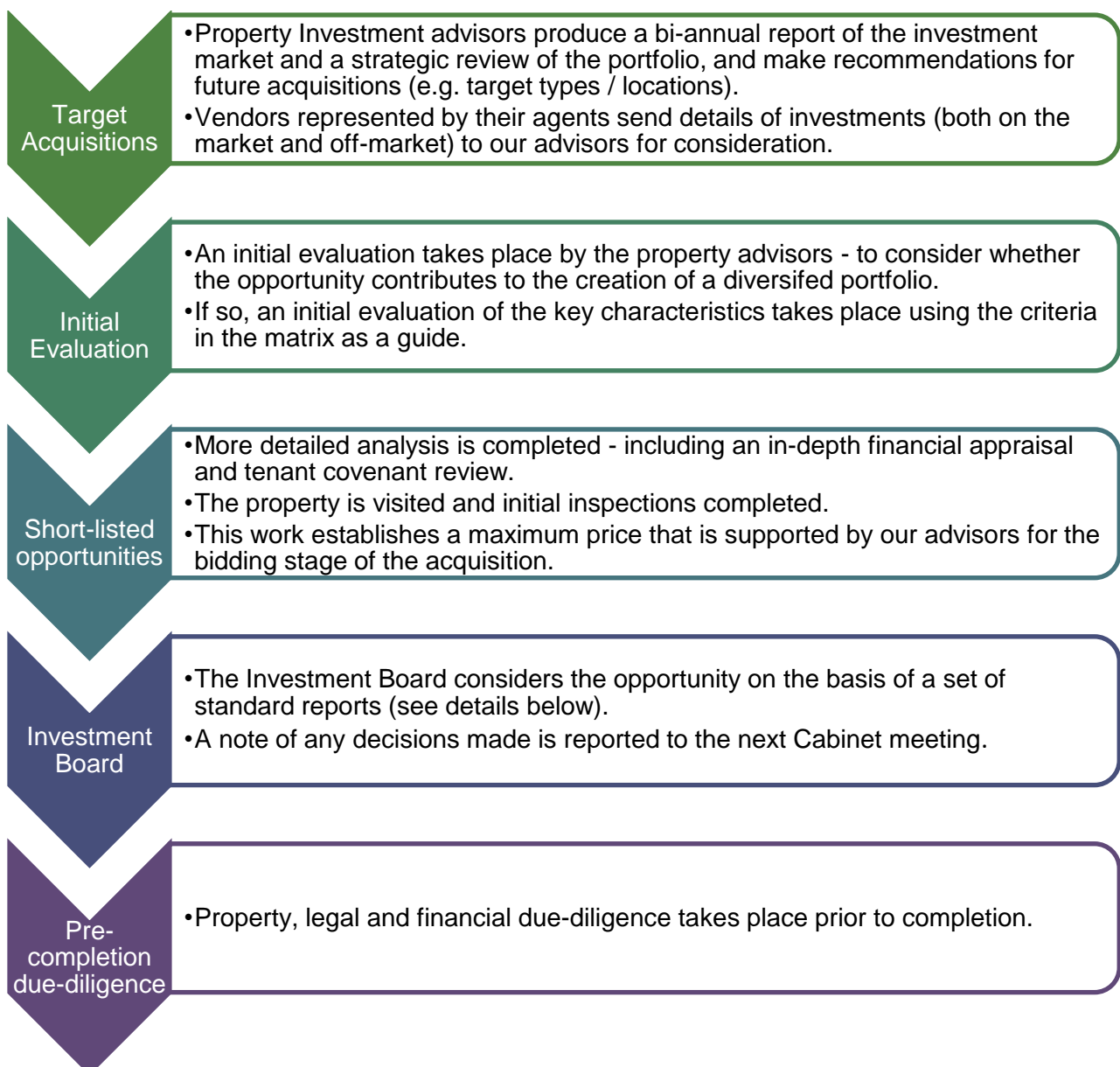
Shareholder Board

- Receives and considers the year-end financial accounts of HGP and approves the proposed dividend
- Approves the annual business plan
- Appoints and removes Directors
- Approves changes to the Articles of Association
- Reviews the financial results of HGP from the point of view of the company - e.g. rents received less expenses including interest payable to the council and administration costs.

Investment Governance

Acquisition selection and appraisal

The Investment Board have delegated authority to approve property investment acquisitions and developments that are in accordance with the Investment Strategy. All investment expenditure is approved on the basis of a robust business case, developed using appropriate specialist property investment advisors and which gives due and proper consideration of the balance between risk and reward and an assessment of the underlying security of the investment. In order that the council undertakes borrowing in accordance with the Prudential Code which requires that borrowing is affordable, sustainable and value for money, all investments are required to demonstrate a return in excess of the opportunity cost of capital and other associated costs of delivery. The diagram below outlines the process for acquisitions-



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Investment Appraisal Reports

The following standard reports are presented to the Investment Board for each potential acquisition-

Investment Report

- A narrative report providing details of the opportunity including, for example, its location, age and tenure. The report discusses key risks and provides information about the tenants and their financial covenant. It provides a summary of the expected returns and describes the scenarios that have been evaluated. If agreed, the report comments on the heads of terms for the purchase.



Investment Matrix

- A standard scoring matrix which is used as a guide to decision making to ensure that opportunities are measured and assessed in a common manner. The matrix looks at the following characteristics-strategy alignment, location (both macro and micro), building quality and age, lease type & length, tenure, property management intensity and tenant repair obligations and whether there are any asset management opportunities.



Financial Analysis

- A financial analysis in a standard format demonstrating the long-term expected income returns from the opportunity. At least two scenarios are prepared - to show a better and a worse case. Both are prepared using prudent assumptions - for example no rental growth is usually assumed unless the lease provides for fixed uplifts or increases are based upon RPI or similar indices.



Pre-completion due-diligence

Once an opportunity has been approved further due-diligence takes place prior to completion of the purchase. This includes, for example, the completion of surveys, a review of title and tenant lease and a valuation report.

Investment Monitoring

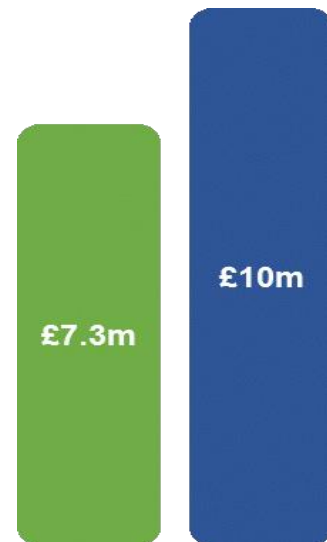
The performance of the investment portfolio is monitored on a monthly basis with summary results reported to Cabinet as part of the regular monthly financial monitoring report. The Investment Board receive detailed reports on a quarterly basis.

Property Investment Performance

The council's property investment portfolio has an asset value of c.£350m, which together with income from agreed acquisitions and developments, will deliver an income of £5.0m in 2018/19 growing to an **income of £7.3m** per annum by 2019/20 and enhancing the asset base of the council. This portfolio has already delivered a net income – of £3.9m in 2017/18 – bringing the total net income from the strategy to £5.4m to date.

These figures are net – after the deduction of all costs incurred including assumed borrowing costs,

The council has ambitions to grow the portfolio further as articulated in the report to Cabinet in March 2017 – to deliver an income of **£10m** per annum by 2020/21.



The current portfolio has been developed over a number of years with the rate of growth increasing more recently. The council has created a good reputation in the market by demonstrating our ability to complete acquisitions to agreed timescales and this means that the council and its property company are increasingly being invited to consider various potential acquisitions, including some that are off-market. Our ability to grow the portfolio further will be dependent upon the right opportunities coming to market.

The net income is reported after deducting assumed funding costs and all other costs associated with the investment. The council may fund its capital expenditure through the use of reserves, capital receipts and prudential borrowing. As the council does not hypothecate (match) these funding sources against individual projects or acquisitions, we assume that all the Council's activities in progressing the Investment Strategy will increase the requirement to borrow. The council therefore requires all investments to demonstrate a return in excess of the assumed cost of capital which it calculates based on assumptions in the MTFP which are adjusted if required for market conditions. The council charges the assumed cost of capital to each individual investment (including the cost of finance provided to HGP) in a similar way to an inter-company charge.

Property Investment Portfolio

The investment strategy means that the council is managing different financial risks. Investments will be subject to inherent economic and market risks, and therefore a balanced portfolio of investments is being created. The Investment Strategy notes a preference toward assets within Surrey that are of good quality, in good or growth locations however in order to create a diversified portfolio a mix of geographical locations will be required.



The IB monitors the portfolio to ensure that an appropriately balanced and diversified portfolio is created over time, across the combination of directly Council-owned assets and those owned by HGP. Officers, supported by independent specialist professional advisors, support the IB. These specialist advisors periodically evaluate the recommended portfolio of property investment, taking into account market conditions and achievable returns.

The IB also manage the portfolio in order to avoid over-reliance upon single tenants or types of tenants in terms of their impact as a percentage of the portfolio.

The total asset value of the current property portfolio, based upon the valuation exercise undertaken on 31st March 2018 and incorporating assets under construction is £346m. The portfolio incorporates assets held by the council and by HGP.

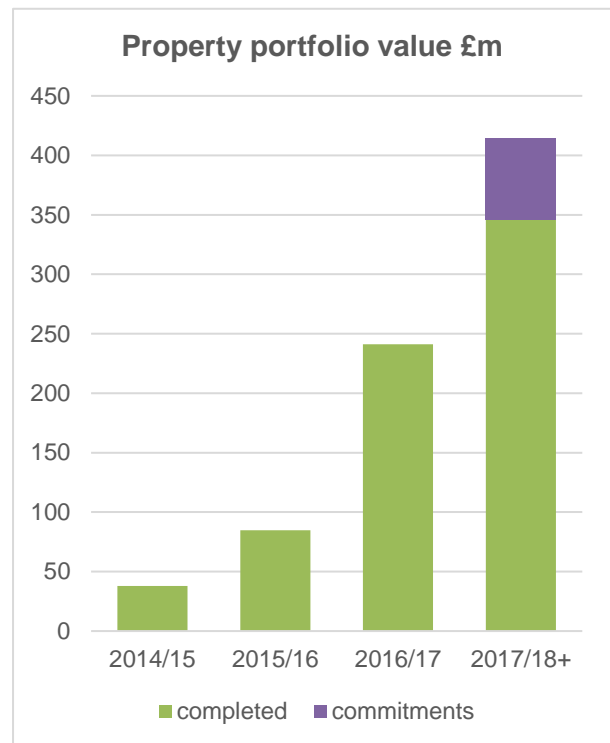


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The current portfolio has been developed over a number of years with the rate of growth increasing more recently – the portfolio includes purchases and the value of assets under construction or pending redevelopment.

Property Portfolio as at 31.03.2018	Asset Value £m
Offices	89
Retail	163
Industrial	75
Other	19
Total	346

Achieving a fully diversified portfolio will take time and will be dependent upon the opportunities in the market. Committed expenditure will grow the portfolio further – commitments include the completion of the development of the site in Crawley (known as Nexus) and the purchase of the commercial elements of the Farnham Brightwells scheme upon completion.



Property Purchases

The tables that follow provide a list of purchases made by both SCC and HGP up to 31st March 2018 as part of the Investment Strategy. These tables exclude the cost of development activity which is commercially sensitive.

Assets held by SCC	Purchase Price	Acquisition Date	Description
Abbey Moor, Chertsey	1,100	Sep-12	Golf Course (public 9 holes) & Club House
Ranger House, Guildford	13,700	Apr-13	Multi-tenanted town centre office
Kingfisher House, Egham	1,750	Apr-13	High Street shop
Waterman's House, Woking	695	Jun-13	Office redevelopment opportunity
Bridgehead House, Ashtead	1,075	Dec-13	Single tenanted office
Nexus Crawley	9,750	Mar-14	Land purchase
61 High Street, Staines	3,573	Apr-14	High Street shop
Pixham Lane, Dorking	34,545	Feb-16	Single tenant headquarters office
Brightwells, Farnham	3,000	Feb-18	Long leasehold land purchase

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Assets held by HGP	Purchase Price	Acquisition Date	Description
Hampton Park West, Melksham	10,455	Nov-15	Manufacturing and warehouse facility
Washford Mills, Redditch	7,451	Mar-16	Retail warehouse units
Hawkley Drive, Bristol	11,219	Apr-16	Manufacturing and warehouse facility
Manton Wood, Worksop	8,460	May-16	Distribution warehouse
Aztec West, Bristol	19,900	Jun-16	Single tenanted office
Wiggs House, Salford	7,760	Jul-16	Distribution warehouse
Friar Street, Worcester	11,800	Nov-16	Cinema and retail / restaurant units
Birmingham Rd (Travelodge), Stratford	9,200	Nov-16	Hotel and retail units
Willowbrook, Loughborough	18,850	Nov-16	Retail units (out of town location)
Oakgrove, Milton Keynes	26,461	Dec-16	Retail units (out of town location)
Stratham Street, Macclesfield	6,900	Dec-16	Retail warehouse unit
High Street, Winchester	15,825	Mar-17	High Street department store
Blenheim Park, Nottingham	2,852	Aug-17	Land purchase for warehouse development
Malvern Shopping Park, Worcestershire	75,038	Sep-17	Retail units (out of town location)