West Berkshire Council

Property Investment Strategy

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Contents

Introduction

This document has been prepared by Jones Lang LaSalle (JLL) for West Berkshire Council (WBC) and its Members.

It sets out the investment strategy and criteria to be adopted by West Berkshire Council to meet its objectives of creating a balanced property investment portfolio, from which to derive a long term, sustainable revenue stream.

The target investment is stated as being a minimum of £25m rising to potentially £50m plus. JLL have adopted this target range in developing the property investment strategy for West Berkshire Council as provided herein.

Please note that all yields referred to in this report (unless otherwise stated) are net of purchase costs and exclude the cost of debt.

JLL is a leading specialist property advisor covering both capital and occupational markets across the UK and is regulated in the conduct of its business by the Royal Institution of Chartered Surveyors (RICS).

Core Objectives

Set out below are the core objectives of the investment strategy:

- **To invest in commercial property to generate a sustainable and predictable income return**
- To acquire standing commercial property investments that generate an immediate income, through being let on commercial terms, or from properties which are contracted to be let
- To provide an income yield (return) with a clear margin over the cost of capital, in a form which is sustainable, and has the potential to increase through future rental growth
- To achieve an even balance of risk and return through portfolio diversification
- To acquire investment grade properties possessing characteristics that retain liquidity and preserve capital (notwithstanding market movement)

Investment Strategy

The strategy is defined in two sections:

Section 1 details the core strategic investment policy to be adopted by West Berkshire Council.

Section 2 details the investment guidelines to be used by the Investment Board and the Investment Advisor to assess the merits of a given investment and to create a balanced property investment portfolio with intrinsic risk diversification.

Section 1 – Investment Policy

The West Berkshire property investment policy is structured according to the following core principles:

- Investments to be made in direct commercial real estate
- UK wide target market to include West Berkshire Council area
- Investments to be purchased freehold, with good and assignable legal title. Leaseholds only considered where held under long leases at a peppercorn or low fixed rent
- Institutional grade income producing properties to be acquired, let on conventional lease terms and secured against good to strong covenants (Standard & Poor's credit rating BBB- to AAA)
- Target portfolio running yield of 6.0%+ once fully invested
- Asset level internal rate of return (IRR)* averaging not less than 5.0% p.a. over an assumed 5 year hold period
- No investment in speculative development
- No investment in areas within Flood Zone 3 or with a high land contamination risk

** Internal Rate of Return (IRR) = the rate of return that discounts the investment cash flows to a net present value of zero.*

Section 2 – Investment Guidelines

The following investment guidelines are to be adopted within the property investment policy of West Berkshire Council. These guidelines are designed to aid investment decisions as well as create a balanced property investment portfolio that manages risk through diversification.

Portfolio Structure

Categories	Target Weighting	Target Yield	Asset Profile
Core	**50%**	5%+	Let on long leases to good covenants. Modern buildings well located. Liquid assets. *Example* Sainsbury's supermarket let for 15 years.
Core Plus	**33%**	6%+	Mix of long and short leases can be single or multi let buildings with varying tenant profiles. Good asset management opportunities to improve value. Liquid in stable markets. *Example* Multi-let industrial estate with varying tenant lease expiries.
Opportunistic	**17%**	8%+	Assets that can be re-positioned through refurbishment or change of use. Generally illiquid in early years until potential released. *Example* Office building with conversion potential to residential.

Sector Weightings

Sector	Target Weighting	Asset Profile
Industrial/Warehouse	**25%**	Includes both single let and multi-let industrial estates. Logistics warehouses and trade parks.
Alternatives	**20%**	Student accommodation, petrol stations, data centres, hotels, car parks, etc.
Retail – Warehouses/Supermarkets	**20%**	Solus warehouses or small terrace/park. Small in town or out of town supermarkets such as Sainsbury's Local or Aldi etc.
Offices	**20%**	Modern, single or multi-let in strong regional centres with low physical obsolescence.
Retail – High Street	**10%**	Prime units in regional centres or strong secondary towns.
Other	**5%**	Property related infrastructure investments such as wind farms or in-direct property investment funds such as airport or shopping centre funds.

Asset Risk Diversification – Guidelines

Attribute	Why	Risk if attribute not present
Lot Size - £3m to £10m	If investing £25m to £50m no single asset should be over 20% of the portfolio by value	Exposure to single asset risk
Income risk– *exposure restricted to maximum **10%** of total income accounted for in any one tenant once fully invested*	Manages income risk and security through tenant diversification and lease length	Exposure to tenant failure, voids and potential negative cash flow
Location (town/city) – *No more than **25%** invested in any one town.*	Spread of risk through investment diversification in different micro-locations	Over exposure to locational risk where negative impacts of weak or low growth could affect total performance
Sector (retail/office etc.) *No more than **30%** held in a specific sector at any time*	To create greater portfolio balance with different sectors holding different risk v return profiles	Over exposure to an under-performing sector
Regional Weighting *No more than **35%** held in a specific UK region at any one time.*	To provide a spread of risk to balance performance from regional spread. Different regions within the UK often perform (grow) at different rates and at different times within an economic cycle	Exposure to regional under-performance through lower economic growth

Investment Strategy: Annual Review

As part of any investment strategy it is very important to keep the investment criteria and guidelines under review. A failure to do so may result in the portfolio under-performing the market or its risk profile increasing due to changes in both the macro-economic and micro-economic position around the real estate market.

The WBC investment policy should include an annual strategy review undertaken by the investment advisor or a professionally qualified company active in the UK property investment markets.

The annual strategy review should cover:

Section A - Investment

1. A market update on investment trends, activity and forecasts
2. An update on the occupational markets
3. A review of current investment strategy
4. Re-confirmation of investment criteria and asset target weightings
5. Identification of any re-alignment required to match market changes and forecasts
6. Benchmarking the existing portfolio and asset level investment returns
7. Reporting on performance of the portfolio and individual assets
8. Reporting on any KPI or performance criteria
9. Provision of annual property business plans to evaluate added value opportunities
10. Provision of a review of portfolio activity and the added value created over the previous 12 months
11. An update of five year cash flow forecast
12. An update of Work/Hold/Sell asset designation

Section B – Management

13. Reporting on portfolio management performance including rent collection rates, bad debt provision and service charge reconciliations
14. Advice on all critical lease dates, break options, rent reviews and lease expiries
15. Reporting on any health and safety incidents and insurance claims
16. Reporting on dilapidations claims and status
17. Capital expenditure requirements over the preceding 12 months

This will provide WBC with a clear understanding of the portfolio's position and management, its risk and return profile and any latent value that can be driven out through strategic asset management. A regular review of the five year cash flow is important to understand future working capital requirements, as well as assessing the accuracy of the predicted rental income.

Portfolio Valuation

An annual external valuation is be undertaken to enable WBC to benchmark the property portfolio/asset performance as well as ensure that current book values are in line with prevailing market values.

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