Non-treasury Management Practices

1 Introduction

1.1 The Council recognises that investment in other financial assets and property primarily for financial return, taken for non-treasury management purposes, requires careful investment management. Such activity includes loans supporting service outcomes, investments in subsidiaries, and investment property portfolios.

1.2 The Council will ensure that all its investments are covered in a capital strategy, investment strategy or equivalent, and will set out, where relevant, the Council's risk appetite and specific policies and arrangements for non-treasury investments. It is recognised that the risk appetite for these activities may differ from that for treasury management.

1.3 The Council will maintain a schedule setting out a summary of existing material investments, subsidiaries, joint ventures and liabilities including financial guarantees and the organisation's risk exposure.

1.4 The Council recognises that many of the principles underlying treasury management practices will apply to non-treasury investments as they do to treasury investments. However, some aspects are likely to differ significantly.

1.5 It is recognised that the Council may make investments for policy reasons outside of normal treasury activity, and these may include:

- Service investments – these are held clearly and explicitly in the course of the provision, and for the purposes of, operational services, including regeneration
- Commercial investments – these are undertaken for mainly financial reasons. They may include:
    - Investments as part of business structures, such as loans to and shares in subsidiaries.
    - Investments explicitly taken out with the aim of making a financial surplus for the council and include commercial properties

1.6 The investment practices for non-treasury investments detailed below will be complied with by all officers and agencies responsible for such investments. These practices will evolve over time and will be subject to annual review.

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2 Risk management (NTMP 1)

2.1 Investment of the Council's cash surpluses and reserves is governed by the CIPFA Treasury Management Code of practice and MHCLG Statutory Guidance. These require authorities to prioritise security and liquidity over yield. Compliance, aims to protect the value of sums invested and ensure funds are available to spend as spending commitments arise. Investment in equity, bonds or property are likely to fail the security and liquidity tests and are therefore considered inappropriate for short term cash surplus and reserve fund management purposes.

2.2 Commercial property covers a broad range of property uses and types including, retail outlets, office accommodation, warehouses, industrial units and residential accommodation.

2.3 Risks associated with commercial property ownership include:

- Close correlation between value and changes in **GDP**. Values fall significantly in a downturn. Values rise when the economy is growing.
- Property is **illiquid** both in terms of transaction times and price transparency.
- **Tenant covenant strength** will impact on ability to meet rental payments, lease renewal, exercise break clauses and CVA.
- **Valuations** are not a guarantee of sale price and may be subject to investor confidence / sentiment.
- **Stock, sector and geographic** risk will all impact on the value of a particular property.
- Subject to **environmental risk** such as flooding and land contamination.
- **Interest rate** changes not only affect the cost of borrowing but also bond / equity prices which may impact on the relative attractiveness of property.
- Changes in **legislation and regulation** e.g. energy efficiency may involve additional cost to the investor.
- Changes in **taxation** (stamp duty / SDLT) may affect value.

2.4 Risks will be explored in the property acquisition business case and through regular monitoring of the property market post acquisition. Nevertheless, risk will persist.

2.5 A risk assessment is provided at **[Appendix 1]**.

3 Decision making, governance and organisation (NTMP 2)

3.1 Any new commercial property investment will be subject to a business case that meets HM Treasury Green Book standards. The report seeking Capital Plan budget provision will follow the normal budget approval process (FIPAB, Cabinet and Council).

3.2 Day to day management of commercial property investments is delegated to the Central Services Director (CSD). The CSD will undertake that management using in-house resources or appoint specialist external agents where appropriate. Functions include:

- Collection of rent & service charges.
- Establishing lease terms
- Advertising vacant units
- Negotiating tenant lease agreements
- Monitoring the commercial property market
- Undertaking annual property revaluations

3.3 New lease agreements will be certified, without delegation, by the CSD. Any rent free periods and other tenant inducements will be reported under the reporting arrangements detailed in NTMP 4.

3.4 The Director of Finance and Transformation will undertake a periodic reconciliation of income and expenditure. Internal audit, subject to a risk assessment, will review commercial property activity.

4 Performance management (NTMP 3)

4.1 Baseline performance requirements for commercial properties will be drawn from the business case submitted as part of property purchase approval. Gross income, service costs and tenant arrears will be monitored against baseline on a quarterly basis. Variation from a pre-determined tolerance level will trigger a report to the Council's Management Team and, if appropriate, will be escalated in accordance with NTMP 4.

4.2 Performance of the Council's commercial property function and that of any associated external support will be monitored and reviewed annually to ensure best practice and value for money are being achieved.

5 Reporting and management information (NTMP 4)

5.1 An information report setting out the performance of the Council's commercial property investments will be prepared by the Director of

Central Services and submitted to each meeting of the Finance, Innovation and Property Advisory Board. Reports will be subject to prior consideration by the Council's Management Team.

5.2 Reports will include:

- A commentary on commercial property market conditions
- Gross income against budget
- Income performance against benchmark
- Operating costs
- Changes in occupancy
- Changes to existing lease agreements / new lease agreements
- Tenant arrears
- Market value (to be reported annually).

5.3 Commercial property investment performance against budget will also be incorporated in the financial planning & control reports submitted to the May, July and September meetings of FIPAB.

5.3 Any extraordinary issues that are likely to generate a change in budget requirement will be subject to endorsement by Cabinet and approval by Council.

6 Training and qualifications (NTMP 5)

6.1 Members and officers involved in the property investments decision making process need to have appropriate capacity, skills and information to enable them to take informed decisions as to whether to enter into a specific property investment.

6.2 The Councils employs qualified property, legal and finance officers to manage activity and provide advice within their respective disciplines. Specialist external advisors will be engaged where appropriate. Member training will be provided in-house or by external agents when required.

Property Investment – Risk Register

Risk	Risk Areas	Likelihood 1(low) 6(High)	Impact 1(low) 4(High)	Total Score	Controls
Downturn in property market	Capital value and income potential reduce for purchased assets.	4	4	16	Continued monitoring of markets. Sale of Assets at a benchmarked threshold. Annual Valuation.
Upturn in property market	Purchase cost of potential assets increases.	4	3	12	Continued monitoring of markets. Adjusting purchase criteria to reflect market movement. Consider sales of assets for capital gain. Annual Valuation.
Increase in interest rates (borrowing)	Cost of borrowing where adopted increases with detrimental impact on income.	4	3	12	Ensure most competitive rate achieved if borrowing, fixed term if possible. Consider increased use of reserves to ensure loan to value ratios are acceptable.
Increase in interest rates (investment)	Lower rate of return when compared to other potential investments	4	3	12	Consider revising income return criteria upwards. Consider disposal of assets for re-investment.
Available opportunities	Market opportunities meeting investment criteria not available.	4	3	12	Identify opportunities early and move swiftly to acquire.
Changes in Tenant demand	Certain types of property may become less favorable with tenants.	3	3	9	Consider alternative use at acquisition. Construct a varied portfolio by use.

Risk	Risk Areas	Likelihood 1(low) 6(High)	Impact 1(low) 4(High)	Total Score	Controls
Obsolescence of Asset	Physical obsolesce in terms of building fabric and fit out.	3	3	9	Ensure full repairing and insuring leases are in place via pre-purchase due diligence. Have building surveys undertaken to establish condition of building.
Tenant default	Loss of rental income, increased costs incurred.	3	3	9	Undertake financial due diligence of tenants pre-purchase, obtain the best possible tenant covenants. Look for guarantors or cash deposits where covenants are considered weak. Consider multi-tenanted properties in order to diversify risk. Ensure robust credit control procedures in place. Monitor tenant company performance.
Void periods	Loss of rental income, holding costs incurred – rates, utilities etc. Costs of re-letting.	3	3	9	Monitoring tenancies as described above. Move quickly to appoint letting agents should a "void" period appear likely. Act expediently in concluding legal process of letting.
Government Legislation - Energy Performance (Minimum Energy Efficiency Standards, MEES)	From 1 April 2018 it is illegal for a landlord to grant a new letting of a commercial property that has an EPC of below E.	4	3	12	Undertake appropriate pre purchase due diligence to establish what the EPC rating of a property is and purchase accordingly. Identify if opportunities exist to increase the EPC rating appropriately.
Illiquidity of Property Assets	Asset identified for disposal to raise capital receipt or for reinvestment.	4	4	16	Ensure that assets are kept "sale ready" in terms of documentation and information.

Risk	Risk Areas	Likelihood 1(low) 6(High)	Impact 1(low) 4(High)	Total Score	Controls
Staff Resources	Lack of suitably professionally qualified staff.	3	3	9	Ensure that appropriately professionally qualified staff, with experience in Property Investment, are available to act on the Council's behalf.
Residential Properties – generally all of the above plus greater landlord input, more management intensive	Residential Properties generally require a more active landlord involvement, maintaining the structure and services of a property – maintenance costs and management costs are therefore higher.	4	3	12	Ensure that increased holding costs are factored into purchase valuations. Appoint external professionals to manage landlord and tenant processes. Ensure that tenant deposits are taken.

Assessing risks

Identified risks need to be assessed so that they may be evaluated to determine their severity and to present an overall picture of the extent of the combined risks on the achievement of the objectives. The Council recognises 3 levels of risk:

LOW	MEDIUM	HIGH
1 – 4	**5 – 12**	**15 – 24**

The scoring of risks will be carried out using a Likelihood & Impact matrix, see table below with accompanying definitions.

Likelihood	Almost inevitable	**6**	6 Medium	12 Medium	18 High	24 High
	Very likely	**5**	5 Medium	10 medium	15 High	20 High
	Likely	**4**	4 Low	8 Medium	12 Medium	16 High
	Unlikely	**3**	3 Low	6 Medium	9 Medium	12 Medium
	Very Unlikely	**2**	2 Low	4 Low	6 Medium	8 Medium
	Almost impossible	**1**	1 Low	2 Low	3 Low	4 Low
			1	2	3	4
Impact □			Negligible	Marginal	Significant	Critical