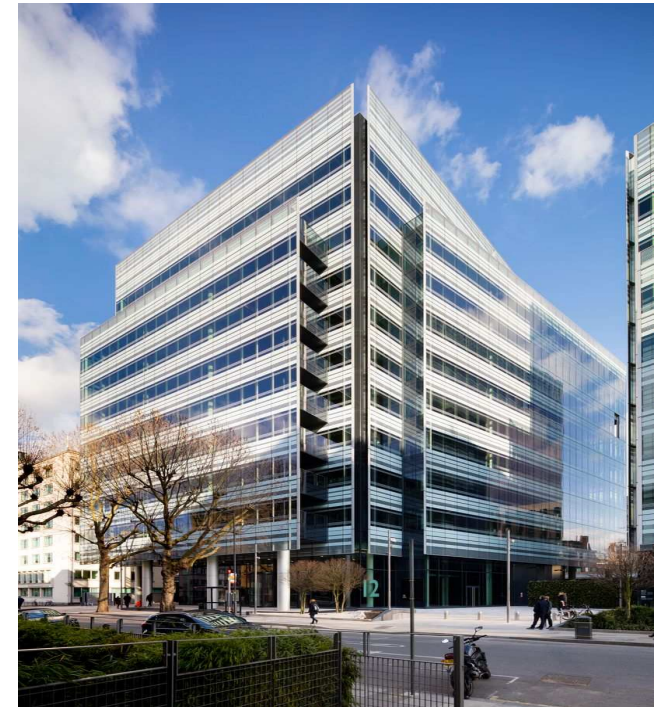


Spelthorne's approach to management of risk with respect to commercial property acquisitions



Objective



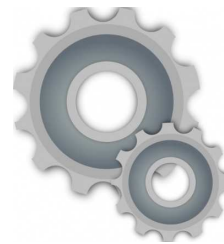
Illustration by Chris Gash



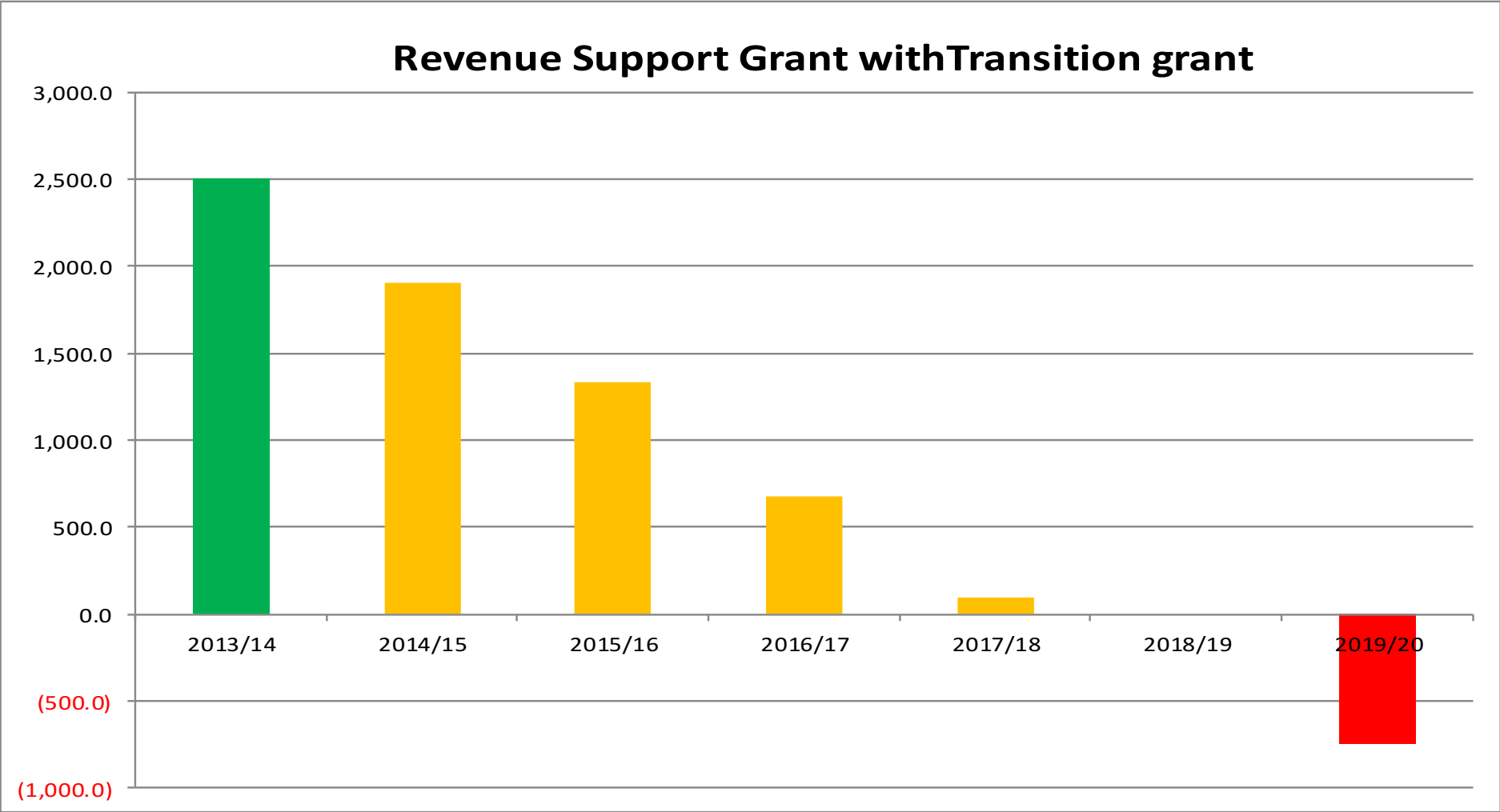
<http://cliparts.co/sherlock-holmes-c>

Agenda

- WHY: Cuts/budget pressures as investment activity drivers
- WHAT: Summary of acquisitions made
- HOW: Approach to acquisitions
 - Policies/Strategies
 - Strategic Property Investment Parameters statement
 - Treasury Management Strategy
 - Borrowing strategy
 - Process
 - Steps
 - Evaluation of tenants
 - Modelling exit strategies
 - External advisors
- Summary and questions



Reducing central government funding



Budget Pressures including housing and lost recycling credits

- SCC pressures (recycling, street lights, verges) in total adding approx. half million to budget gap
- Rising demand for B&B temporary housing accommodation
- Homelessness Reduction Act implemented in April 2018 adding additional responsibilities with significant resourcing implications
- Roll out of Universal Credit continuing which will mean by 2019-20 loss of the £0.5m overpayments net credit we have been achieving- delay in process benefits SBC
- Expectations around funding of Thames Flood Relief Scheme (£20 million?)

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SBC's annual revenue budget = approx. £13 million

“Given the funding cuts how can you afford to buy so much?”

- This is a common question
- It is precisely because of the funding reductions that we are looking for long term sustainable income streams
- We only borrow if a deal generates a significant annual revenue surplus to support the provision of services to residents
- This annual revenue surplus is calculated after deducting
 - Interest
 - Principal repayments
 - Supervision set asides
 - Sinking fund set aside contributions to build funds to cover potential refurbishment, rent free, void costs= ***provisions as risk mitigants***

Income returns delivered by acquisitions

	Purchase Cost incl SDLT & fees	Gross Initial Annual Rental	Net initial Yield	Initial Lease length (WAULT)	Initial Full Year financing Cost	First full year set aside for mgt & refurb provision	Initial net Revenue Surplus available to support Services
	£	£	%	Yrs	£	£	£
Commercial Investment Assets							
Completed							
BP Main Campus	381,532,600	15,666,000	4.12%	20	-11,785,753	-550,000	3,330,247
BP South West Corner	28,288,142	1,905,000	6.78%	12	-1,022,202	-150,000	732,798
Elmbrook House	7,579,100	477,000	6.35%	10	-99,087	-50,000	327,913
3 Roundwood Avenue*	22,766,190	1,426,000	6.26%	10	-817,988	-130,000	478,012
12 Hammersmith Grove	179,067,914	9,530,865	5.32%	13	-6,255,221	-1,125,000	2,150,644
WBC4	49,148,758	2,446,958	4.98%	15	-1,702,575	-200,000	544,383
Total above	668,382,704	31,451,823	4.71%		-21,682,827	-2,205,000	7,563,996

Strategic Property Investment Parameters



- Approved by Council December 2017
- Always undertake thorough due diligence in order to understand risk
- Preference is given to investing within borough, or in an adjoining area that is economically important to Spelthorne
- We have a clear view of the asset security curve
- We have a clear exit strategy, fully costed, at the various critical points in the investment (lease break points etc.)
- We do not make speculative investment for revenue-generation purposes. The properties should ordinarily be complete, free of any ongoing redevelopment work and occupied by creditworthy tenants with a minimum of 10 years' lease remaining

Strategic Property Investment Parameters



- A simple, three-side summary in plain English approved by Cabinet
- Sets out three reasons for investment in property (usually using borrowed funds)
 - Income generation, social investment, strategic purposes
- Local
- Asset security curve
- Exit strategy
- Worst-case planning
- Full occupation, strong tenants, reputable
- No interest rate exposure
- Operationally simple
- Ongoing contract and asset management team
- No to certain sectors
- No to high-risk/high-reward
- <1/100 flood risk
- Note:
 - An element of speculation may be appropriate for social investments (e.g. providing emergency accommodation and building affordable housing)
 - Social investments to benefit Spelthorne residents and not replace SCC obligations
 - Strategic investments supplement income generation/social investments

Staines-upon-Thames x 1
Ashford x 2
Sunbury x 4
Upper Halliford x 1
Heathrow x 1
Stockley Park x 1
Hammersmith x 1

**The furthest is
just 14 Miles
from the
Council offices.
All are within
Spelthorne's
economic orbit**



Treasury Management Strategy

- Originally designed with cash management, managed funds and instant access cash investments in mind, increasingly influenced by borrowing strategy
- Economic background as a macroeconomic risk (interest rates/returns, returns on investment in certain sectors/funds)
- Exposure limits (funds/fund managers)
- Revenue versus capital growth
- Borrowing strategy includes alternative sources of borrowing and asset sales to generate capital, long/short term, fixed/variable

- We take advice from independent, external specialists (ArlingClose)
- Regular reviews, reports, credit ratings, ongoing and ad-hoc advice

- Always build a robust exit strategy

Borrowing strategy



- Borrow bulk of funds from Public Works Loans Board (PWLB/part of Bank of England which lends to Councils) at rates nearly as cheap as Government can access
- Rates since Brexit referendum at historically low levels
- We fix rates so we know future financing liabilities
- We spread terms to mitigate interest rate risk.
- Diversifying funding sources to include other Local Authorities, banks etc.

Process - Steps



- Expert property advisors identify and analyse opportunities
- SBC finance prepare ROI inc. provisions and borrowing options
- Risk factors identified and quantified
 - Incl. credit scoring of tenants, S&P scoring, independent analysis of scoring
 - All “what ifs” documented and exit strategies documented
 - PoD and LGD documented
- Operational test for practicability and ongoing management
- Legal due diligence
 - Conveyancing, tenant lease contracts, QC opinion on “state aid” where appropriate
- Recommendation to Cabinet

As few as one in ten opportunities presented by them are considered by SBC...but improving

80 pages of tenant scoring and exit scenarios in a recent case



An iterative process leading up to and following Cabinet approval



Process - Evaluation of tenants

Thorough Standard and Poor's assessments on potential tenants

Ongoing monitoring of all tenants by S&P's alerts received if move outside of pre-determined limits

Look where possible for parent company guarantees/sureties

Advice from property advisers

Purchasing minimal shareholdings to give us company reports and voting rights

Modelling to ensure can withstand cashflow impact of a tenant getting into difficulties

Process - Modelling exit strategies



- Model impact of tenants getting into difficulties to ensure we can absorb without adverse impact on council revenue budget
- For most recent acquisition 6 different tenants, so modelled several different permutations – 2 independent reports/80 pages in total



Process – External advisors

- External, expert property consultants
- External, specialist investment consultants
- External, specialist legal experts
- In-house staff/councillors with appropriate industry expertise
- Newly hired, dedicated property development team
- Recognised credit scoring agency and now formally subscribe to their software and services
- Forensic accounting team on occasion, when public domain information on tenants lacking

Questions

