



# **Asset Strategy**

**2023 - 2028**

## Foreword

As the Investment Property Portfolio Holder for East Hampshire District Council, I and my fellow Cabinet Members are committed to creating an efficient and effective Investment Property portfolio. A portfolio which provides excellent value money for the East Hampshire constituents, maximises opportunities to generate income streams, enabling the Council to continue to deliver key services and further supports our ambitions to reduce our environmental impact and achieve net zero.

The Council's Asset Management Strategy sets the strategic framework within which our investment properties will be managed over the next five years. With refreshed governance already in place, this document seeks to ensure that the property portfolio is sustainably and efficiently managed. To achieve this, it is essential that we have an agile, innovative, and forward-thinking asset management strategy in place.

**Tony Costigan**

**Investment Property Portfolio Holder**

## 1 Introduction

- 1.1 This Asset Management Strategy replaces the previously adopted Commercial Property Investment Strategy (CPIS) (2017 – 2022) which outlined the Council's investment plans to build a sustainable income stream from commercial property assets. The original CPIS set out a robust and viable framework to create a balanced and well diversified portfolio with capital of up to £200m across England and Wales. A series of investments were subsequently made at a capital cost of circa £130 million, which generates a rental income to the Council of circa £9 million per annum.
- 1.2 The portfolio has been kept under regular review with a substantial review undertaken in 2019 and updated throughout the pandemic in 2020 and 2021. Due to considerable changes in the way funding can be used from the Government backed, Public Works Loan Board (PWLB), this proactive investment process has now ceased for all Authorities. The Council has therefore developed this new Asset Management Strategy (AMS) to set out how the existing portfolio will be actively managed. This new AMS has been produced in line with RICS (Royal Institute of Chartered Surveyors) Public Sector Asset management guidelines and CIPFA (Chartered Institute of Public Finance Accountancy) best practice, to establish an

Asset management policy that provides a consistent framework for how the Council will manage the investment property portfolio.

- 1.3 As this new strategy is launched, the current UK commercial property market has fundamentally changed, within a context of a rapid rise in the cost of debt and high inflation, together with the ongoing long-term structural shifts in demand precipitated by the pandemic. As costs continue to rise, the impact is felt by occupiers of commercial property and owners now faced with rising costs of holding and refurbishing properties. The Council aims to proactively engage with all occupiers of investment assets to understand their needs going forward.
- 1.4 The Council has been proactively managing the property investment asset portfolio to derive the best value from the portfolio for the benefit of wider Council service delivery. The Council define 'value' as protecting the income stream and reducing void costs wherever possible. This may involve active lease re-gearing to retain occupiers in difficult market conditions and ensuring where possible rental income is in line with current market valuations. The Council have continued to demonstrate this ambition by innovating the way we manage the portfolio to generate significant revenue to achieve both financial stability for the Council and deliver high quality public services. Active asset management has resulted in the portfolio maintaining a high 96% occupancy rate over recent years and 98% of rent collected for the pandemic period.
- 1.5 The strategy will be reviewed annually to ensure our investment assets fully support the Council's Medium Term Financial Strategy (MTFS) and corporate plans.

## **2 Mission Statement**

' To maximise revenue through effective management of the Investment Portfolio'

- 2.1 The role of the property investment portfolio is to generate sustainable rental income revenue which directly supports the delivery of the Council's Medium Term Financial Strategy (MTFS).

## **3 Policy Approach and Process**

- 3.1 In developing this new AMS and approach to the investment portfolio, this strategy includes certain actions and behaviours that promote accountability; target setting and transparency, which is encompassed within the revised governance measures to

ensure the investment portfolio delivers income and return for the Council, ultimately benefitting the districts constituents.

3.2 The Council recognises the pressures on different sectors of UK commercial property and by assessing the health of the current investment portfolio, the Council aim through this AMS to focus on:

- Driving efficiency through the management of our land and investment property assets.
- Managing the investment asset portfolio effectively using best practice, project and property management methodologies and adopting clear action plans at an individual asset level to meet our strategic goals.
- Maximising occupancy through customer retention and letting void units expeditiously, negotiating longer lease terms with occupiers where possible to decrease void risk and improve overall weighted income profile.
- Where appropriate, increase rental income in line with local market levels.
- Rebalance the portfolio to smooth lease events exposure over certain years in the medium term.

#### **4 MTFS and financing challenges**

4.1 This strategy aims to deliver a balance between projected income from the portfolio which is included within the MTFS against future capital expenditures across the Council, including those related to the portfolio itself. Financing of the investment activities is derived mainly from the Public Works Loan Board (PWLB) and governed by the Council's Corporate and MTFS strategies with oversight from the Councils' Audit and Scrutiny committee processes. Ongoing treasury management is therefore an important component. Due to recent changes in funding from PWLB, most notably "the Government and CIPFA are clear that borrowing to invest for yield is not permitted under the Prudential framework", the Council is evolving the strategy from an 'investment' perspective to an 'active management' of the existing portfolio. This has impacts on financial management as no further government borrowing will be required to support future purchases, but the existing income stream from the portfolio must be protected and where possible improved through active asset management.

4.2 Balancing a portfolio is the ultimate goal of any property investment management process. This strategy includes a regular review of asset valuations against the benefits of a potential disposal of a single or multiple assets in order to rebalance the

portfolio. These disposal activities are not straightforward given the strict rules of financing these activities from the PWLB. A disposal will be considered if the disposal of an investment property derives a positive financial benefit to Council activities with any sale receipts being recycled into frontline Council services or Regeneration activities, otherwise known as 'alternative re-investment' opportunities.

## **5 Portfolio Performance Measurement**

5.1 Assets are categorised dependent on their purpose and role within the wider Council asset portfolio; those being 'investment assets' or 'operational'. The purpose of this strategy paper is to focus purely on 'investment assets', which are located across the UK and are owned purely for income and capital return purposes. By categorising assets, the Council is able to focus on delivering a robust plan to effectively manage those 'investment' assets that solely provide an income for Council services.

5.2 The first stage of this process is to ensure the Council have an appropriate structure to measure portfolio performance. In the commercial property sector, performance is often measured as:

- 1) **Target return** – this is the total profit or loss from an asset or portfolio over a given period of time divided by the cost of the investment.
- 2) **Capital and Income return** – this is an expected return from an asset over a given period of time with return being either income or capital growth.
- 3) **Risk** – the expected risk from a portfolio of assets in comparison to a chosen benchmark of a similar portfolio of assets.

5.3 By aligning the Council investment portfolio performance with market tested performance metrics as above, the Council are able to regularly review the performance of the portfolio against a set series of targets and make informed decisions if the performance does not meet expectations. This review process is often referred to as 'benchmarking' and is a key part of ensuring performance of the portfolio is meeting the ambitious expectations of the Council. Comparison can be drawn on other portfolios or organisations that hold UK commercial property assets in a portfolio, as the Council are prohibited from trading into other asset classes.

5.4 This performance review entails an annual valuation process and regular reporting through internal governance on the following items:

- Rent collection including aged debtors.

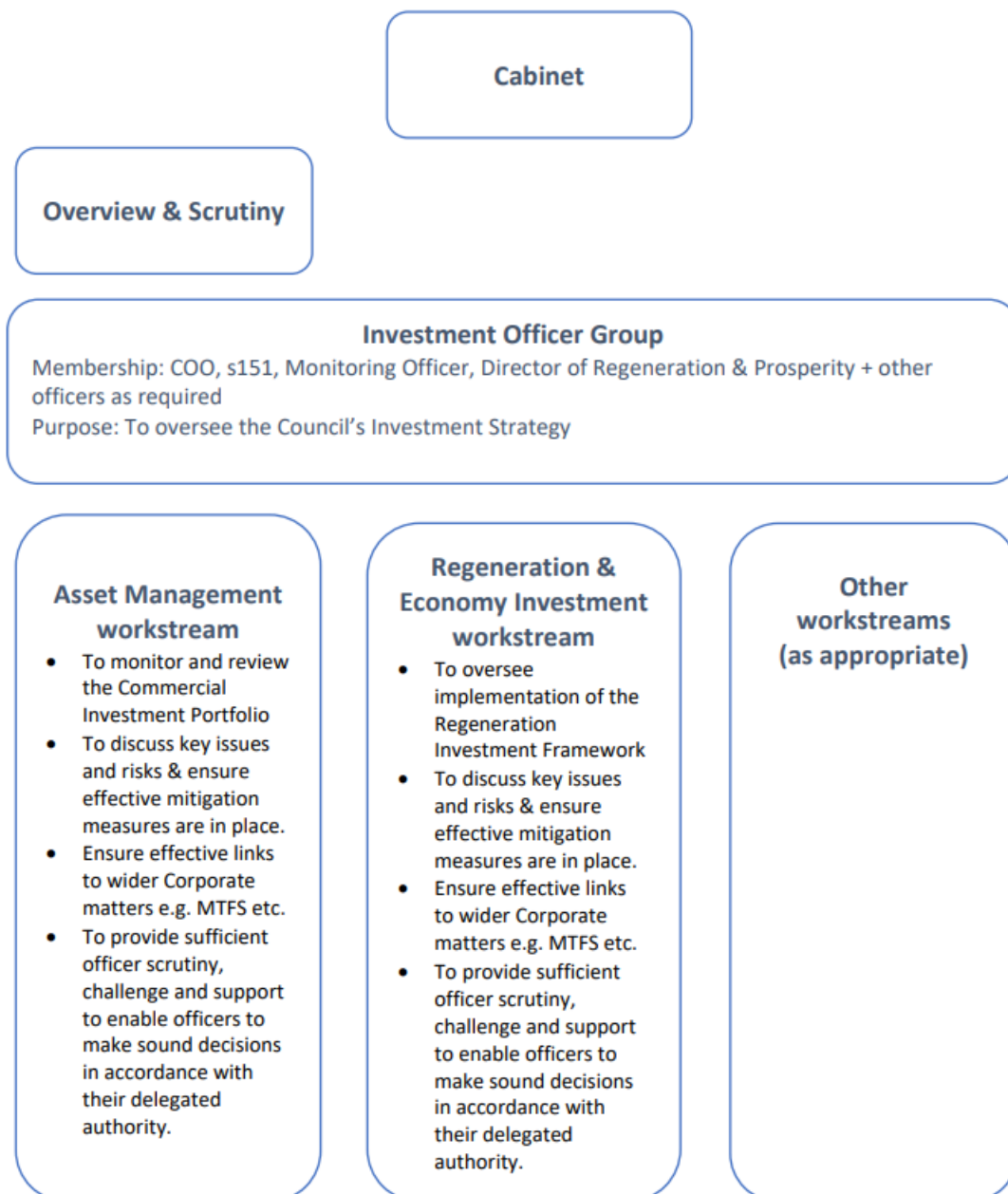
- Void properties with accurate accounting of void costs.
- Close engagement with Council finance teams to measure rental income vs cost vs debt repayment.

5.5 The performance data once collected can be used as a useful benchmark to set portfolio goals in the short, medium and long term and be compared with data of performance of similar commercial property portfolios.

5.6 Analysing performance at a portfolio level will allow the Council to produce and deliver individual asset plans which can focus on specific performance objectives from each asset. These individual assets plans will sit under this over-arching asset strategy and feed into the regular performance and review process.

## **6 Adopted New Governance Structure**

6.1 In December 2022, Cabinet approved new governance arrangement alongside development of this new Asset Management Strategy. The structure chart below shows the newly adopted governance arrangements to ensure an efficient and informative process in actively managing the investment property portfolio.



6.2 Investment property as a portfolio is held by Cllr Tony Costigan, who is responsible for oversight of the portfolio and regular reports to Cabinet, Overview and Scrutiny and Council.

6.3 A robust governance structure allows direction and transparency of the management of our property portfolio and further assurance that an investment is made in the right place and for the right reasons.

## **7 Portfolio Profile**

- 7.1 The investment property portfolio is valued by external chartered surveyors with the valuations updated annually in line with Council financial governance initiatives. Following a robust audit process, these valuation figures are then posted on the Council website. The total value of investment properties owned by the Council as at 31/3/2022 was £130,557,500 generating a total net (after deducting finance and holding costs) rental income of £3,826,000. The total gross income from the portfolio was in excess of £9,000,000. These figures are included within the Council's financial statements and, whilst this is not necessarily the exact amount that we would receive if we sold all of our investment assets, it demonstrates what a considerable resource our investment assets are, and why they need to be carefully managed.
- 7.2 The profile of the portfolio can be reported in numerous ways but comprises a mix of office, industrial, retail, supermarket use assets. A broad mix of uses is imperative to ensure a diversification of risk so that if values in a certain sector or use type are challenged, returns from other uses in the portfolio can balance any downside risk.
- 7.3 As part of the asset classification process, the Council can now organise the investment assets by value, income profile, tenant profile, lease expiry date, capex or general void exposure, internal resource capability or the local market outlook of where the specific asset is located. This strategy then informs decisions based on the chosen metric measured against risk depending on the individual asset.

## **8 Portfolio Appraisal**

- 8.1 Under this strategy, the Council is able to update internal stakeholders with a critical appraisal of the existing assets in the portfolio at a given point in time. The analysis focuses on:
- 8.2 **Expiry profile** - as at the end of 2022, the current weighted lease term to expiry is 5.1 years. Commercial property is cyclical and the Council will focus on extending this expiry profile to reduce risk wherever possible.
- 8.3 **Risk** - there is an element of risk across the portfolio and the Council proactively engage with all of the occupational tenants to ensure void risks are minimised wherever possible. If a property does become vacant, the Council will proactively assess the future options in a local context to ensure the asset is income producing as soon as possible.



**8.4 Tenant profile** - where possible, the Council aims to achieve a balanced profile of tenants from a range of industries. As EHDC is relatively rural by nature, inevitably investments have been made further afield as part of achieving diversity and manage the risk.

**8.5 Capex / general void exposure** - as part of the portfolio analysis, the Council can prioritise capital works programmes based on evidence from building condition surveys and advice received. Lease expiries are identified early and every effort made to secure the occupier on new market appropriate terms. However, if the occupier does vacate, the Council assesses the potential risk of capital expenditure in maintaining and improving the asset. It is critically important that all income producing assets are well maintained and if in the event of becoming vacant, improved to a standard that will attract new occupiers.

**8.6 Standards of Compliance** - a key objective of this Asset Management Strategy is to ensure that the Council's investment portfolio is fit for purpose and complies with all statutory regulations. Emphasis will be placed on understanding both Landlord and Tenant obligations and accuracy of recording of key dates and data. The team will ensure all assets are compliant with, for the following relevant regulations:

- Asbestos
- Electrical Safety
- Fire risk
- Gas safety
- Legionnaires

## **9 Asset challenge process**

9.1 The Council regularly assess each asset as part of this new asset management strategy. It is critical to assess the strategic purpose of the asset within the wider portfolio and to ensure the asset is continuing to meet the objectives set.

9.2 As part of this process, we assess:

- 1) **Strategic purpose** – What do we expect of the asset (income / capital gain return)?
- 2) **Opportunities and risks** – Do the risks of holding the asset outweigh its benefits?
- 3) **Performance appraisal** – What financial outcomes have been delivered vs management costs vs climate and environmental costs?

- 4) **Option appraisal** – what opportunities are available considering financial and funding constraints?
- 5) **Outcome** – Retained / replaced / re-modelled / disposed?

## **10 Asset management challenge**

10.1 The property team will be faced with a number of challenges over the period of this new AMS, currently and most notably:

### **1) The Market – Covid 19 & beyond**

The UK economy is facing a number of structural challenges from high inflation, government borrowing, soaring energy costs. The strength and weakness of the UK property market will impact upon the policies and processes needed by the Council for managing its asset portfolio.

### **2) Void risk**

The new strategy focusses on the active management of the existing portfolio given the rules around future borrowing from PWLB have changed significantly. The team will focus on reducing void, increasing lease terms, retaining occupiers and aligning rental income with current market rental levels where possible.

### **3) Capital Expenditure**

All assets need to be properly maintained to adhere with the appropriate legislation and maintain the Council's vision of holding best in class property. The property team will work hard to plan future maintenance programmes supported by robust financial business case appraisals. The Council must balance the need for income from the portfolio with the need to regularly maintain assets if / when they become vacant.

### **4) Data**

As was reported to Cabinet in the December 2022 update, the Council is currently procuring a digital and smart database of the Council's wider estate, and this will include its investment portfolio. The intention is that this system will be initially implemented by the middle of 2023.

## **11 ESG credentials**

11.1 The Climate Change Act 2008 (2050 Target Amendment) Order 2019 was passed which increased the UK's commitment to a 100% reduction in emissions by 2050

(when compared to 1990 levels). Further amendments have been made to UK Building Regulations (updates to the 2013 regulations); phasing out refrigerants and coolants for air conditioning systems by 2030; and improved Minimum Energy Efficiency Standards (MEES) where the minimum EPC rating of 'E' for a commercial property from 1st April 2023 and rising to a minimum of a 'B' from 2030.

11.2 The Council maintains a register of EPC assessments for every asset held in the portfolio and consistently ensure all properties in the portfolio are compliant with the appropriate legislative requirements of owning and managing UK commercial property.

11.3 In December 2022 the Council announced a '10 point plan' to support its net zero ambitions, led by the new environmentally focused Green Team. This builds on the Council's adopted Climate Change and Environment Strategy (2020-2025). These principles will also be applied to the investment property portfolio, where if environmental credentials of an asset fall short of the appropriate legislation or can be improved, the Council will work collaboratively with the occupier to deliver improvements to environmental efficiency of the asset where possible.

11.4 'ESG' stands for Environmental, Social and Governance, which refers to a set of standards that socially conscious organisations use to screen investments. Climate change and global socio-economic changes have highlighted a need for property investors to consider the impact that a building is having on the environment and the local area. This updated asset strategy is designed to give direction on the management of an existing portfolio and further detailed work will be carried out to look at how our investment portfolio can further support the net zero ambitions.

## **12 Summary**

12.1 This updated strategy has been developed to recognise the changing nature of the commercial property market and the need for the Council to proactively manage the existing portfolio.

12.2 Desired risk vs actual risk

It is imperative that the current risk profile of the portfolio is assessed and understood so that it can be compared with the desired risk profile of the previously adopted Commercial Property Investment Strategy. As the national economy currently battles with high inflation and recessionary risk, which could of course change through the life

of this strategy it is important that the Council continue to assess their desired risk criteria and marry that against the existing portfolio risk.

### 12.3 Lease profile

The weighted unexpired lease term of the portfolio is a key metric to understanding risk. Economic uncertainty has caused occupiers to reconsider their commercial property needs and the Council equally needs to understand where current market demand stands from occupiers in terms of rental level and lease length. The Council can then proactively manage the portfolio via this strategy to increase the weighted unexpired lease term wherever possible.

### 12.4 MTFS

The purpose of the investment portfolio is to provide income for the MTFS strategy. The Council will regularly assess the current return being achieved by the portfolio vs the desired return as cited in the MTFS. If there is a difference, the Council can then assess ways to improve the return performance through capital investment in certain assets and proactive engagement with occupiers.

### 12.5 Divestment opportunities

PWLB funding criteria is strict and in recent years, the parameters of funding have changed significantly from central Government. If an asset is underperforming or equally outperforming its peers, the Council could consider a disposal and reinvestment of the monies into regenerative projects. However, there may be financial implications on a disposal and this strategy aims to ensure officers from the property and finance sections of the Council work collaboratively to ensure all financial implications are fully understood prior to actioning any disposal.

12.6 Another key consideration is individual lot size of the portfolio vs the desired lot size profile of the previously adopted Commercial Property Investment Strategy. If there is an asset which comprises a large amount of the portfolio size in terms of value, then it is likely the Council will perform a challenge process on that asset to ensure it continues to meet the targets set for that asset.

### 12.7 Timeframe

It is anticipated this strategy will be adopted for a period of 5 years from adoption, to give the Council time to proactively manage the existing portfolio. Regular reporting and the annual valuation process will continue with the Council deciding upon a desired

annual return from the portfolio over this period. It is anticipated this strategy will then be reviewed and updated within the initial 5-year timeframe taking into account any changes with the portfolio.

### 13 Action Plan

#### 13.1 “Optimise rental income and value from the investment property portfolio whilst minimising void risk”

Objectives	Actions
Proactively manage and implement lease renewals.	Manage key dates with appropriate software. Ensure all key dates are not missed in implementing lease events.
Asset Management Plans	Suite of asset management plans clear exit strategies.
Secure new lettings.	Where an asset is vacant or facing void risk, actively negotiate new lease terms with existing or new occupiers to reduce void risk.
Complete categorisation of portfolio.	This is already complete as part of this new AMS and will ensure transparent reporting to key stakeholders.
Ensure standards of compliance are maintained.	The property team will ensure all assets are fully compliant and remind tenants of their obligations. Where an asset fails in compliance, the team will identify and action where appropriate.
Implement repair obligations on tenants.	If a tenant is vacating at lease expiry, the team will ensure the tenant fully complies with all of their liabilities under the lease.
Implement and operate a ‘best in class’ property management system.	The team working with internal stakeholders will continue the vital project of procuring and implementing a property management software database. The aim is to have this up and running by the middle of 2023 ready for data upload.
Ensure compliance with statutory environmental legislation.	Continually review assets to ensure their compliance with national environmental legislation as well as the Council 10 point plan.
Recycle assets.	If there is an opportunity for regeneration and investment in the District, the Council will assess the health of the portfolio and where possible identify assets for disposal

	subject to strict financial business case scrutiny and approval.
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